



### LEWIS LINDENBERG JOINS BBW&G !

BBW&G is extremely pleased to announce that Lewis Lindenberg has joined our firm.

Lewis was a senior partner at Borah, Goldstein, Altschuler & Schwartz, P.C. sharing the responsibility for overseeing and managing that firm's Supreme Court Litigation Department, as well as personally handling matters in the New York State Supreme Court, the Federal Courts, the Bankruptcy Court, and before various administrative agencies. Lewis' principle areas of focus involve commercial landlord tenant disputes, Supreme Court injunctive actions, declaratory actions, co-op/condo litigation, loft building issues and disputes between neighboring landowners.

Some of the clients Lewis has represented over the past two decades have included Williams Real Estate Co, Inc. (GVA Williams), Newmark & Company Real Estate, Inc., Joseph P. Day Realty, Corp., The Brown Companies, Olmstead Properties Inc and Townhouse Management.

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### Constructive Eviction: Requires "Substantial and Material Deprivation"

**T**he Appellate Division, First Department, in *Zevnik, Horton, Guibord, McGovern, Palmer & Fognani, LLP v. Sheraton Holding Corp.* recently issued a decision of interest regarding the requirements for invoking the doctrine of "constructive eviction."

At issue on the appeal was whether a commercial subtenant had been constructively evicted from the premises, because a cleaning crew that the subtenant had hired to prepare the premises for re-letting had been denied access. The Appellate Division held that a single incident, which occurred after the subtenant had already vacated the premises, "did not amount to the substantial and material deprivation necessary to establish a constructive eviction."

In perhaps the most interesting aspect of the case, the Appellate Divi-

sion held that the subtenant was obliged to replenish a letter of credit that it had previously given to the prime tenant, even though the subtenant was no longer in possession of the premises. The Appellate Division's holding was predicated on the fact that the subtenant's liability, for the payment of rent, continued until the end of the lease term. This appears to be the first time that the Appellate Division has held that a letter of credit must be replenished under such circumstances.

The prime tenant was represented by BBW&G and the Chicago law firm of Piper Rudick, LLP.

*This article was written by Jay Berg, whom along, with Joseph Burden and Magda Cruz, represented the prime tenant on this appeal.*

#### Special Points of Interest:

- Constructive eviction requirements defined by appellate court.
- Major victory for owners regarding "stub period" rent from tenant in bankruptcy.
- ACRI system permits ready access to numerous property records.

## BBW&G NEWS

**Errol Brett**, who heads BBW&G's Co-op/Condo Department, was featured in the *New York Times* article on the rules, rights and ramifications of the annual election of directors. Errol has also written about this event, in greater detail, in the *BBW&G Board Report* April 2003 edition; a copy of that issue (as well as many other issues of both *The Board Report* and *BBW&G Update*) can be found on our website, [bbwg.com](http://bbwg.com).

**Kara Rakowski** was quoted in the April issue of the *Apartment Law Insider* as to the present inapplicability of the recently enacted New York State Carbon Monoxide Detector Law to New York City properties.

The *New York Times* feature article on non-primary residence and regulated tenants quoted **Sherwin Belkin** regarding the legal basis for such proceedings, various methods of obtaining the requisite data in order to bring such litigation, and the economic benefits to owners that prevail in these cases.

*New York Landlord vs Tenant* featured a decision submitted by **Sherwin Belkin**, *Waterside Plaza, LLC v. Levine*, wherein the owner, represented by BBW&G, successfully prosecuted a "no pet" case. The Civil Court (Hon. Peter Wendt) had found that the owner's proof was credible and convincing, whereas the violating tenant's claim of waiver was not.

## UPDATE FROM THE BBW&G BANKRUPTCY DEPARTMENT

### Treatment of Rent When Tenant Is In Bankruptcy

**T**he bane of many a landlord's existence occurs when its tenant files for bankruptcy. The filing for protection from creditors, pursuant to the United States Bankruptcy Code, unleashes a plethora of issues affecting a landlord's rights to recover possession of the leasehold property as well as its ability to recover rental payments owed both prior and subsequent to such filing.

This article addresses a particularly vexing problem which has been left unsettled by existing legal precedent and

differing statutory interpretations. The issue: payment of rent during the "stub period" - which, in most instances is the date the tenant files its Bankruptcy petition with the Court -- and the end of that month.

In this case, BBW&G vigorously litigated the "stub period" issue, thus setting the tone for the entire bankruptcy proceeding that as a landlord our client would not permit the debtor to disclaim its statutory obligation to pay post-petition administrative rent.

Upon obtaining an order for relief, the Bankruptcy Code

imposes an automatic stay which prohibits all creditors from taking any action which would affect the debtor's interest in property, including any action to collect a debt owed by the debtor.

In order to collect on rent due and owing after a tenant's bankruptcy filing, the landlord is required to file a proof of claim detailing the amount owed, the nature of the claim, the basis of such debt, and the period for which it is owed. Various claims are assigned differing priorities with a corresponding

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likelihood of receiving payment. Funds owed by the debtor as of the commencement of the bankruptcy case are considered “pre-petition” [prior to filing for bankruptcy] claims. These pre-petition claims may only be recovered [unless the lease is assumed (i.e., reaffirmed) in accordance with the Bankruptcy Code], by filing a “proof of claim” and awaiting distribution either pursuant to a plan of reorganization or liquidation. A landlord’s claims for pre-petition rent are deemed to be “general unsecured claims,” which have the lowest priority, and, as such, are the least likely to be paid at the conclusion of the proceeding. However, rent which becomes due during the post-petition period is deemed to be an “ad-ministrative claim” —so called because it is incurred in the administration and/or preservation of the bankruptcy estate (the tenant’s property interests).

In assessing an administrative claim, a significant factor is the Bankruptcy Code’s consideration of the value of such goods or services as opposed to the amount specified in a contract or agreement. Therefore, even if allowed as an administrative claim, the amount of rent specified in the lease and the “fair value” may not be one and the same. In determining the administrative claim,

the court will not only look to comparable rents for similarly situated property, but will also look to the debtor’s actual use, partial use, or non-use of the subject premises. Additionally, administrative claims are generally paid out at the end of the Bankruptcy case, either pursuant to a plan of reorganization or upon liquidation and distribution of the estate.

The Legislature, in an apparent recognition of the special relationship between a debtor-tenant and a creditor-landlord (due to the landlord being the only creditor forced to provide ongoing credit to



the tenant in form of allowing continued occupation of its property), requires that the landlord receive ongoing rent and/or use and occupancy payments during the post-petition period on a timely basis. 21 U.S.C. §365(d)(3) states, in pertinent part, that “the trustee shall timely perform all the obligations of the debtor . . . arising from and after the order for relief under any unexpired lease of nonresidential real

property . . .” Therefore, not only does the classification of the claim affect the likelihood of payment, but, in many instances, it is the arbiter as to when, if ever, the rent is paid.

In the event the debtor-tenant defaults in its “post-petition” payments, the creditor-landlord may petition the Court for an order compelling the debtor to become current on its obligations or move to have the automatic stay vacated in order to allow the landlord to pursue its rights in a summary proceeding or other legal action to recover such sum.

While it is clear that Section 365(d)(3) requires a debtor-tenant to pay rent pursuant to its obligations under the lease, a problem arises where the lease calls for the payment of rent on the first of the month, but the debtor files after that date. In such case, the question arises as to whether the entire month is considered a pre-petition obligation or whether the rent for that month be prorated into pre-petition and post-petition obligations? Suffice it to say that there is a conflicting legal precedent among the various Federal Circuit Courts regarding the treatment of this “stub period” rent.

Further complicating matters is that the Second Circuit Court of Appeals (which is the highest Court, aside from the United States Supreme Court, with jurisdiction over the states of New York, Connecticut,

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cut, and Vermont) has not offered a definitive ruling on the matter, and the various Bankruptcy Courts and District Courts located in the Second Circuit have issued conflicting decisions.

The question of treatment of “stub period” rent rests on two distinct legal theories: (1) the “time of performance” approach, and (2) the “proration approach.”

Under the “time of performance approach,” the Court merely looks to the lease for a determination of the time at which the performance is to take place. Thus, where the lease states the rent is due on the first of the month, and the tenant files for Bankruptcy anytime from the second of the month onward, the entire month is considered to be pre-petition rent, and as such, is a general unsecured claim not subject to either an order to compel payment, or an order modifying the automatic stay. This approach, if followed by a court, is typically prejudicial to the landlord. However, in certain limited circumstances, there are advantages to landlords when this approach is used. For example, if the date of payment for the tenant’s portion of real estate taxes or utilities is post-petition but covers a pre-petition period, the landlord would be entitled to payment of the entire sum.

Nonetheless, where payment of the “stub period” rent is concerned, the proration

approach is greatly favored by landlords. Under the proration approach, the monthly rent is divided by the number of days in the month in which the tenant files its bankruptcy petition, and the rent due from the date of filing through the end of month is considered post-petition rent.

In April 2003, BBWG’s Stewart Smith, working with partner Daniel Altman and associate Joshua Losardo, argued this cutting edge “stub period” rent issue before Hon. Adlai

**“Stub period” rent issue  
argued before  
Hon. Adlai Hardin.**

Hardin of the United States Bankruptcy Court of the Southern District of New York. (*In re Regus Business Centre Corp., et al.*, Bankruptcy Case Nos. 03-20026 through 03-20029 [ASH]).

The debtor-tenant’s attorney argued that the “stub period” rent was pre-petition rent, and that recent legal authority mandated that the “time of performance” approach was the standard to be used in this jurisdiction. Debtor’s counsel, joined by the attorney for the Creditor’s Committee, proposed, as a fall back position, that the compromise approach enumerated in a Bankruptcy case decided in Delaware [*In re: HQ Global Holdings, Inc.*, 282 B.R. 169 (Bankr. D. Del. 2002)] be used. In HQ Holdings, the Court employed the time of performance approach but treated the

“stub period” rent as an administrative expense which was to be determined at a later date. The tenant’s counsel stated that it would agree to have the stub period rent treated as an administrative expense, to be paid pursuant to a plan of reorganization, at the close of the bankruptcy case.

BBW&G, appearing on behalf of our client, Boston Properties, Inc. [a creditor-landlord in this proceeding], argued that while there was conflicting legal precedent as to the treatment of “stub period” obligations, there was ample compelling authority which supported the proration approach. BBW&G also noted the landlord’s unique and vulnerable position of being the only creditor required to continue extending credit to the tenant after the tenant had filed for Bankruptcy and that the courts and the legislature have long recognized this special relationship. We also noted that this distinctive relationship warrants that landlords be given extraordinary consideration and protection. Arguing in favor of proration, BBW&G noted that the debtor alone has the ability to manipulate the date of filing, and as such, may strategically file on the second of the month, in a calculated move to have the entire month declared a pre-petition obligation. BBW&G asserted that it would create an undue hardship on the landlord in the event the Court adopted the “time of performance” approach and deemed the “stub period” rent



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as a pre-petition debt.

As to the debtor's "compromise" of deeming the stub period rent an administrative claim payable at the conclusion of the case, BBW&G demonstrated that such a "compromise" was inherently unjust. We asserted that the landlord would be forced to not only jump through hoops to demonstrate that the rent in the lease was the fair value for the use of the space, incurring additional expense and time, but that the landlord would be forced to assume the risk that the debtor would be administratively insolvent at the close of the case (i.e., there would be no funds remaining in which to satisfy the administrative claims).

In rendering its decision, the Court noted the absence of a definitive ruling by the Second Circuit on the treatment of "stub period" obligations; appeared troubled by the debtor's ability to manipulate the commencement of the "stub period"; and noted the landlords' plight in being forced to continue to deal with the debtor while other creditors maintain the ability to refrain from further dealings with the debtor or to require payment on post-petition obligations to be made on specified terms. However, the Court held that the express language of the statute mandated that the "time of performance" ap-

proach be used.

The Court went on to hold that the rent due for the "stub period" constituted an administrative claim and, contrary to the finding of *HQ Global, Inc.* and the debtor's "compromise," the Court ruled that such claim "should be treated in parity of reasoning, the same as the obligation under 365(d)(3) [the provision requiring a debtor to remain current on its post-petition rental obligations]." The Court reasoned that the lessor is "the only or one of the few post-petition creditors who has no choice. A professional has a choice not to get involved in the case. A seller of goods has a choice not to get involved in the case or to sell only on an immediate payment basis. A landlord does not."

The Court, in finding that the landlord should not have to wait until the end of the case before being paid, stated that the "landlord who is not free not to do business should not be at risk of administrative insolvency at the end of the case unless" it has sat on its rights. The Court in ordering immediate payment of the "stub period" rent ruled "that the reasoning underlying 365(d)(3) [requiring timely payment of post-petition rent] is equally applicable to the administrative claim for the stub period."

In seeking to reconcile the express language of the statute, the purpose of the statute, and the landlord's vulnerability to the bankrupt tenant's machinations, the Court declined to

choose between a strict "time of performance" and a "proration" approach. While the Judge felt constrained by his interpretation of the statute to adopt the "time of performance" approach, he clearly felt that "it makes great sense to argue and to adopt a ruling in favor of proration, and that . . . . the time of performance rule puts it in the hand of the debtor to manipulate its obligation with regard to the rent that's due during the month of filing . . ."

However, in order to avoid the inherent inequity of such approach, the Judge took a third course, which arose in the *HQ Holdings* matter, and expanded on it so that claims for "stub period" rent would be treated like a §365(d)(3) claim. The Judge used the powers vested in the Court pursuant to the claims provisions of 11 U.S.C. 503(b) [the provision related to administrative claims] to require the immediate payment of this post-petition administrative claim.

Judge Hardin's creative reconciliation of the various authorities and statutory interpretations on the "stub period" issue, seems to have fashioned a clever path which accomplishes what common sense and fairness dictate.

All in all, this decision is a great victory for landlords, especially in light of the recent tendencies for the bankruptcy courts of this district to take a literal and narrow interpretation of the applicable (Statutory)

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language. In fact it may prove to be a boon to landlords by allowing a landlord to argue that “stub period” rent is a post-petition administrative claim subject to immediate payment on the one hand, while on the other hand arguing that the “time of performance approach” is applicable to real estate tax reimbursable, build-out costs, and utility charges relating to pre-petition periods but which come due after the debtor’s bankruptcy filing. However, only time will tell the extent of the impact that this decision will have on tenant’s bankruptcy filings in the various Federal Districts of New York.

### **Survivorship of Mechanic’s Liens in Bankruptcy**

A client recently asked BBW&G whether mechanic’s liens placed on its property as a result of work the tenant caused to be performed on its leasehold, survived the tenant’s bankruptcy filing. The client reasoned that if the underlying obligation to pay the contractor was discharged in bankruptcy, then the lien on its property should be rendered unenforceable as well. While the client’s position is entirely reasonable, makes logical sense, and would be a fair result, its position is unsupported by the applicable statutory authority and judicial precedent.

The Courts have long held

that a valid lien perfected pursuant to state law prior to a bankruptcy filing survives a debtor’s discharge, even if the underlying debt is discharged during the bankruptcy proceeding. See, *Long v. Bullard*, 117 U.S. 617, 29 L.Ed. 1004, 6 S.Ct. 917 (1886) (bankruptcy discharge will not prevent enforcement of valid liens); *Louisville Joint Stock Land Bank v. Radford*, 295 U.S. 555, 79 L.Ed. 1593, 55 S.Ct. 854 (1935) (valid liens enforceable on both exempt and nonexempt property); *Johnson v. Home State Bank*, 501 U.S. 78, 84, 115 L.Ed.2d 66, 111 S.Ct. 2150 (1991) (“a bankruptcy discharge extinguishes only one mode of enforcing a claim--namely, an action against the debtor *in personam*-- while leaving intact another--namely, an action against the debtor *in rem*”).

Therefore, while personal liability for an obligation may be unenforceable, “[a] preexisting lien on property, however, remains enforceable against that property even after an individual’s personal liability has been discharged.” *Connor v. U.S.*, 27 F.3rd 365, 366 (9th Cir. 1994); see also, *Dewsnup v. Timm*, 116 L.Ed. 2d 903, 112 S.Ct. 773 (1992); *Dishong v. U.S.*, 188 B.R. 51 (Bankr. M.D.Fla, 1995).

As in most bankruptcy issues related to real estate, one is directed to state law for the assessment of property rights and obligations. Article 2, Section 3 of the New York State Lien Law specifically states that “a contractor, subcontractor,



laborer, materialman . . . who performs or furnishes materials for the improvement of real property with the consent or at the request of the owner thereof, or of his agent, contractor or subcontractor,” is entitled to the benefit of a mechanic’s lien.

Only work, equipment, and supplies which are deemed to be permanent improvements to realty are lienable. See, N.Y. Jur. 2d, Mechanic’s Liens, §27. The word ‘permanent,’ in the context of the Lien Law, has been interpreted as meaning actually “*becoming part of the realty . . . [the term] is not legal in origin and its meaning is not changed when employed [in the Lien Law]. . . [it means] services resulting in a lasting and continuing beneficial change in the character of the realty.*” See, *Mechanic’s Liens in New York*, Robert Bowmar, Section I.3, p. 10 (Lawyers Cooperative Publishing, 1992).

Where the Owner of property consents to work contracted to be performed by its lessee, the owner, even though it may not be personally liable for charges incurred, is subject

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to the placement of a mechanics lien on its property. However, where no such consent has been obtained, the lienor is only entitled to place a lien upon the interests of a lessee (the lessee's leasehold estate). See, *Mechanic's Liens in New York*, Robert Bowmar, Section 2.14, p.75 (Lawyers Cooperative Publishing, 1992); see also, 76 N.Y. Jur.2d, *Mechanic's Liens*, §45-46.

Therefore, "consent is the *sine qua non*, and if no consent is shown, there is no right to a lien." 76 N.Y. Jur.2d, *Mechanic's Liens*, §38. It has long been established that in order to have a valid mechanics lien placed on real property, the prospective lienor has the affirmative duty to investigate whether it is dealing with a lessee or actual owner of the property in question. The Court of Appeals has stated that an entity proposing to:

expend labor or material upon land under a contract with a person in possession, it is incumbent upon him to inquire and to assure himself of the fact that the person with whom he contemplates making the contract, or for whose benefit he is about to employ labor or materials, has in fact such an estate or interest in the land as will enable him to assert a statutory lien. If he fails

to do this, or is mistaken in his calculations and contracts with a person without title, the statute does not impress a lien upon the estate of the true owner unless he is in some way connected with the contract or given his consent . . ."

*Spurck v. McRoberts*, 139 N.Y. 193, 199, 34 N.E. 896 (1893).

In order to have a valid lien on real property for work, materials, and/or equipment provided to the actual owner's tenant, it must be shown that

**"Landlord is not personally liable for the debts of its lessee for work performed in the**

the owner has made an affirmative act, and not merely acquiesced to the performance of the "work." See, 76 N.Y. Jur., *Mechanics' Liens*, §40 ("Mere acquiescence and benefit are not alone enough to spell out an owner's consent to an improvement on his real property, sufficient to support a mechanic's lien therefor, without some affirmative, as distinguished from a neutral act of the owner"); see also, *Beaudet v. Smith*, 149 A.D.2d 772, 539 N.Y.S.2d 567 (3rd Dep't 1989), *lv. app. den*, 74 N.Y.2d 610, 546 N.Y.S.2d 554, 545 N.E.2d 869; *Harner v. Schechter*, 105 A.D.2d 932, 482 N.Y.S.2d 124 (3rd Dep't 1984); *Bedford Lake Park Corp. v. Twelve Linden Corp.*, 8 A.D.2d 818, 190 N.Y.S.2d 143

(2d Dep't 1959).

Whether or not consent has been given, a landlord is not personally liable for the debts of its lessee for work performed in the leasehold. The landlord's consent to the performance of the work gives rise to a mechanic's lien which may in turn be enforced against the landlord's property, and not merely against the leasehold interest. As such, the landlord would not be liable for a deficiency judgment in the event the value of the property is insufficient to satisfy the lien. Conversely, in the absence of the lien or in the event the lien is declared invalid, the landlord would face no exposure whatsoever.

Therefore, while a contractor may not impose personal liability on the landlord for material, work, equipment, and/or supplies furnished to its tenant without the landlord expressly agreeing to be so bound, it may enforce its mechanic's lien on the lessor's property, assuming proper consent for the work was obtained. The lessee's bankruptcy discharge of personal liability of the underlying debt is of no moment, unless, such discharge is the result of the payment in full of the underlying claim.

The question arises what a landlord may do to protect its property in the event its tenant contracts for "work" to be performed on its leasehold estate. It has been asked whether a landlord and con-

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## New York City's Register's Office Goes OnLine

**O**n January 6, 2003, the Register's office of the City of New York introduced its online document management system for real property records. Now copies of real property records, such as deeds and mortgages, can be retrieved online. The name of the new system is called the Automated City Register Information System, or ACRIS.

Though the ACRIS web site, you can search for property records, identify addresses or blocks and lots of parcels, create cover pages for recording documents and calculate real property transfer taxes due for property conveyances.

Tasks such as finding a block and lot number for a particular address are now made easy by using the "Find Addresses and Parcels" search feature. If you know the address, you can find the block and lot, and vice versa. In addition, if you know a parties name, you can search to see if that party has been involved in any recorded real estate transactions. Also, finding the owner of real property is easy by accessing the deeds for a particular property and identifying the most recent grantee.

In addition, you can search for UCC and federal liens filed against a particular property. Also, if you know

the reel and page of a recorded document, you can easily obtain a copy online.

The ACRIS home page has a tutorial that explains how the online document management system works. ACRIS is accessed by going to the Department of Finance's web site (<http://www.nyc.gov/html/dof>) and clicking the Property Records button and then the ACRIS menu button. ACRIS can be accessed directly by going to <http://www.nyc.gov/html/dof/html/acris.html>.

*This article was written by Robert Jacobs, who practices in BBW&G's Transactions and Land Use Departments.*

## COMING ATTRACTIONS!

The staff of the BBW&G Update will now take a much needed summer vacation, giving us (and our readers) a rest until September. However, once the dust has settled from the upcoming legislative session (during which rent regulation will surely be a focus of the debate), we will prepare a "Special Bulletin" so that you are brought current on all of the news that breaks out of Albany this summer.



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tractor or supplier may agree beforehand that the Landlord will consent to the performance of the work, provided the contractor and/or supplier agree not to file a lien against the property, but only as against the lessee's leasehold interest. The legislature and the courts have unequivocally held that such agreement would be void as against public policy.

Up until the legislature amended the Lien Law in 1977, such waivers were allowed. However, the present state of the law does not countenance any waiver of the right, to file and/or enforce a mechanic's lien. Section 34 of the Lien Law states in pertinent part.

Notwithstanding the provisions of any other law, and contract, agreement or understanding whereby the right to file or enforce any lien created under article two [Mechanic's Liens] is waived, shall be void as against public policy and wholly unenforceable. This section shall not

preclude a requirement for a written waiver of the right to file a mechanic's lien executed and delivered by a contractor, subcontractor, material supplier of laborer simultaneously with or after payment for the labor performed or the materials furnished has been made nor shall this section be applicable to a written agreement to subordinate, release or satisfy all or part of such a lien made after a notice of lien has been filed.

McKinney's Consolidated Laws of New York, Lien Law, Book 32, Article 2 Section 34.

Once an Owner consents to work constituting a permanent improvement to be performed in a leasehold, the fee interest, not merely the leasehold interest, becomes subject to the vagaries of the Lien Law. The lessor faces the possibility, in the event the contractor or supplier is not paid by the tenant, of foreclosure of such lien on its property. While only an *in rem* liability attaches, that is small comfort to lessors of real property.

However, all is not lost. A

"consenting" landlord may take steps to protect itself and its property in the face of "work" being performed on a leasehold. The landlord should ensure that a contractor or supplier performing a "permanent" improvement on the property is paid on a timely basis. The landlord should put in place certain protections such as requiring its tenant to obtain a surety and/or completion bond. The landlord should also have lease covenants in place prohibiting the performance of work, or limiting the extent and scope of such work, without express consent, mandating timely payment for such work, and making the breach of any such covenants a breach of the lease. The landlord should also obtain a personal guaranty of the performance of such covenants so as to avoid the problems and issues resulting from the filing of mechanics liens against a landlord's real property.

*These Bankruptcy Department Update articles were written by Stewart Smith and Daniel Altman. If you have questions about this case, or other bankruptcy related issues, please call Mr. Altman.*

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**Legal Update**  
**June 2003**