

AUDIT REPORT

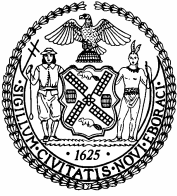


CITY OF NEW YORK
OFFICE OF THE COMPTROLLER
BUREAU OF FINANCIAL AUDIT
WILLIAM C. THOMPSON, JR., COMPTROLLER

Audit Report on the Compliance of New York Skyports, Inc., with Its Lease Agreement

FM08-094A

June 30, 2008



THE CITY OF NEW YORK
OFFICE OF THE COMPTROLLER
1 CENTRE STREET
NEW YORK, N.Y. 10007-2341

WILLIAM C. THOMPSON, JR.
COMPTROLLER

To the Citizens of the City of New York

Ladies and Gentlemen:

In accordance with the responsibilities of the Comptroller contained in Chapter 5, §93, of the New York City Charter, my office has audited the compliance of the New York Skyports, Inc., (Skyports) with its lease agreement with the City.

Skyports's lease with the City permits Skyports to use the property along the East River between East 18th Street and East 23rd Street in Manhattan for a marina, a seaplane base, parking, mooring, fueling, and other services. We audit private concerns under contract with the City, such as this, as a means of ensuring that they comply with the terms of their agreements, properly report revenue, and pay all fees due the City.

The results of our audit, which are presented in this report, have been discussed with officials from Skyports and the Economic Development Corporation, and their comments have been considered in preparing this report. Their complete written responses are attached to this report.

I trust that this report contains information that is of interest to you. If you have any questions concerning this report, please e-mail my audit bureau at audit@Comptroller.nyc.gov or telephone my office at 212-669-3747.

Very truly yours,

A handwritten signature in cursive script that reads 'William C. Thompson, Jr.'.

William C. Thompson, Jr.

WCT/fh

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Filed: June 30, 2008

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*The City of New York
Office of the Comptroller
Bureau of Financial Audit*

**Audit Report on the Compliance of
New York Skyports, Inc., with Its Lease Agreement**

FM08-094A

AUDIT REPORT IN BRIEF

Since 1959, the City of New York has leased the use of approximately two acres of land along the East River between East 18th Street and East 23rd Street in Manhattan. The property is to be used as a marina, a seaplane base, parking, mooring, fueling, and otherwise servicing motor vehicles, seaplanes, and watercraft; and for the sale of merchandise usually sold in connection with those services. On May 18, 1998, the lease was amended to assign all rights, title, and interest in the premises to New York Skyports, Inc. (Skyports). The amendment required Skyports to pay the City base rent, supplemental rent, and a one-time lump sum payment of \$666,666. During calendar year 2006 and 2007, Skyports paid the City a total of \$870,920 in base and supplemental rent. On April 12, 2008, Skyports's supplemental rent increased to \$275,000, increasing total annual rent to \$456,139.

On November 30, 1998, Skyports entered into a sublease with Gulf Oil Limited Partnership to use part of the premises as gas station without a convenience store. Subsequently, Gulf Oil Limited Partnership entered into a lease and franchise agreement with Kalish & Kerner Petroleum LLC (Kalish and Kerner) to operate the gas station.

Effective July 1, 2001, the Department of Small Business Services (DSBS) assumed the management of the property on the City's behalf and the Economic Development Corporation (EDC) administers the terms of the agreement with the lessee, Skyports, on behalf of DSBS.

This audit determined whether Skyports complied with certain terms of its lease with the City (i.e., rental payments, repair and maintenance of the facility, payment of revenue derived from the sale of goods, merchandise, and advertising on the premises, payment of utilities, and maintenance of insurance policies and a surety bond).

Audit Findings and Conclusions

Skyports violated the terms of several major provisions in its lease with the City and may owe the City nearly \$6.1 million. Its general disregard for maintaining the premises endangered public safety and may cost the City in excess of \$5.5 million of the \$6.1 million to rectify conditions. Skyports's lack of a maintenance program led to deterioration of the parking garage to the point that, according to a seven-day Notice to Cure filed by the Department of Small

Business Services against Skyports, “catastrophic failure was a present danger.” As a result, emergency temporary shoring was installed by EDC to prevent the collapse of the garage. In addition, Skyports violated the lease by not reporting 50 percent of all gross revenue derived from the sale of goods, merchandise, and advertising on the premises, and by not obtaining the City’s permission to allow Kalish and Kerner the right to make those sales. Moreover, Skyports did not pay water and sewer charges and did not increase its surety bond in accordance with increases in rent. Consequently, Skyports owes the City \$548,135—\$464,000 for emergency repairs performed by EDC, a minimum of \$46,614 for not paying 50 percent of the revenue derived from the sale of goods, merchandise, and advertising on the premises, and \$37,521 in water and sewer charges.

In addition, EDC did not fully exercise its responsibility to ensure that Skyports complied with the terms and conditions of the lease. EDC’s insufficient monitoring of the lease has contributed to the findings disclosed in this report.

Audit Recommendations

The audit recommends that EDC should consider terminating its lease with Skyports and continue to fully pursue legal action against Skyports to collect the \$6,056,653. However, if EDC decides not to terminate the lease, the audit makes 13 recommendations—8 to EDC and 5 to Skyports. Among those recommendations,

EDC should:

- Coordinate with Skyports to develop a written plan to complete the necessary repairs of the garage structure, as recommended by the engineers in the April 7, 2008 report, and any other needed structural improvements to the premises.
- Ensure timely follow-up on all recommendations cited in independent contractors’ and internal inspection reports and ensure that proper corrective action is taken.

Skyports should:

- Pay the \$548,135 due the City.
- Present EDC with a plan to make all necessary repairs to the premises as recommended by the engineers of the April 7, 2008 report and any other needed structural improvements to the premises. This plan should include project start dates, completion dates, and critical construction milestones (i.e., dredging, excavation, foundation, construction, etc.).
- Ensure that it obtains, on behalf of any sublessee, the City’s written consent authorizing the sale of any goods, merchandise, and advertising on the premises and ensure that it or its sublessee submits complete documentation to EDC supporting such sales.

INTRODUCTION

Background

On March 31, 1959, Gulf Oil Corporation (Gulf) entered into a lease (master lease) with the City of New York, through the Department of Marine and Aviation, for the use of approximately two acres of land along the East River between East 18th Street and East 23rd Street in Manhattan. Under the terms of the lease, Gulf was to construct and operate a parking garage built over the East River, outdoor parking on the adjacent upland area, a marina and sea plane base, a gas station, and a service garage. According to the lease, the property is to be used as a marina, a seaplane base, parking, mooring, fueling, lubricating, washing, repairing and otherwise servicing motor vehicles, seaplanes, and watercraft; and for the sale of merchandise usually sold in connection with those services. The initial term of the lease was 20 years, commencing April 12, 1962, and terminating April 11, 1982, at an annual base rental of \$143,640. The lease also provides for three consecutive renewal terms of 10 years with base rent escalating by \$12,500 each term.

On November 1, 1961, Gulf entered into a sublease with New York Skyports, Inc., (Skyports) to operate and manage the premises. In 1984, Chevron USA, Inc., (Chevron) merged with Gulf and became the successor to Gulf's interests in the lease and sublease. Through an amendment of the lease agreed to by the City, Skyports, and Chevron dated May 18, 1998, Chevron assigned all its rights, title, and interest in the premises to Skyports. The amendment required Skyports to pay to the City base rent, supplemental rent, and a one-time lump sum payment of \$666,666.¹ The amendment also authorized the City to occupy several parking spaces until April 11, 2000. Skyports was entitled to a reduction in supplemental rent of \$4 per space per day if the City continued to occupy those spaces after April 11, 2000.

On November 30, 1998, Skyports entered into a sublease with Gulf Oil Limited Partnership to use part of the premises as gas station without a convenience store. Subsequently, Gulf Oil Limited Partnership entered into a lease and franchise agreement with Kalish & Kerner Petroleum LLC (Kalish and Kerner) to operate the gas station.

Effective July 1, 2001, the Department of Small Business Services (DSBS), formerly the Department of Business Services, assumed the management and jurisdiction of the property on the City's behalf. The New York City Economic Development Corporation (EDC), on behalf of DSBS, agreed to administer the terms of the agreement with the lessee, Skyports. On April 12, 2002, Skyports exercised its option for a third and final 10-year renewal expiring on April 11, 2012.

During calendar year 2006 and 2007, Skyports paid the City a total of \$870,920 in base and supplemental rent. On April 12, 2008, Skyports's supplemental rent increased to \$275,000, increasing total annual rent to \$456,139, which remains in effect until the end of the lease. The lease also requires Skyports to maintain the property and its structures in good and sufficient repair and condition, pay the City 50 percent of all gross revenue derived from telephone booths,

¹ Supplemental rent began on April 11, 1999 at \$54,110 and periodically increased to \$275,000 beginning on April 12, 2008.

merchandise vending machines or concessions placed on the premises (i.e., sale of goods, merchandise, and advertising on the premises); maintain a comprehensive liability insurance policy; furnish a bond as security; and pay for all utilities.

Objectives

The audit's objective was to determine whether Skyports complied with certain terms of its lease with the City (i.e., rental payments, repair and maintenance of the facility, payment of revenue derived from the sale of goods, merchandise, and advertising on the premises, payment of utilities, and maintenance of insurance policies and a surety bond).

Scope and Methodology

The scope period of the audit was calendar years 2006 and 2007. To achieve our objectives, we reviewed and abstracted the lease between the City and Gulf Oil Corporation dated March 31, 1959, and the amendment of the lease and the consent to assignment of the City, the EDC, Skyports, Chevron dated May 18, 1998. In addition, we reviewed the Agreement of Sublease between Skyports and Gulf Oil, dated November 30, 1998, and the lease and franchise agreement between Gulf Oil and Kalish and Kerner, dated August 1, 2006.

We interviewed several EDC officials to understand their respective roles in monitoring compliance with the terms of the agreement. We documented our understanding of the operations through written narratives and flow charts. We reviewed the EDC's *Inspection Guidelines Manual* to gain an understanding of the waterfront inspection process. We also reviewed correspondence from EDC's files. In addition, we reviewed EDC field mechanic reports for the premises.

To determine whether Skyports maintained the premises in accordance with its lease, we conducted unannounced observations and an inspection of its parking garage, gas station, and marina. The unannounced observations were conducted on September 12, 2007, September 28, 2007, and January 16, 2008. On November 27, 2007, an inspection was conducted with a Comptroller's Office engineer. In addition, we obtained several inspection and letter reports from EDC and had our engineer review them to determine whether the conditions cited in the reports were repaired. Additionally, we attempted to verify the existence and scope of a maintenance program by requesting from Skyports invoices and contracts supporting expenditures made for the repair and maintenance of the facility.

To determine the accuracy of Skyports's rental payments and allowable reductions, we reviewed cancelled checks and deposit records on file with EDC and EDC's accounting records of these payments and compared them to the lease for our scope period. In addition, we attempted to reconcile those documents obtained from EDC to the records on file with Skyports.

We obtained evidence of Skyports's surety bond and determined whether the value of the bond was equal to the annual rent, as required by the lease. We contacted the surety company to independently ascertain the value of the bond amount and the currency of the bond. We also determined whether the bond was approved by the Comptroller's Office.

To determine whether Skyports kept the property and structures on the premises adequately insured, we obtained and reviewed copies of insurance policies and certificates, then ascertained whether those policies met the requirements of the lease provision. Further, we contacted Skyports's insurance brokers to independently verify the existence of insurance coverage and whether the coverage was valid.

To determine whether Skyports paid its utilities, we obtained and reviewed electric bills and confirmed the payments with the electric company. We also reviewed the water and sewer charges for Skyports maintained by the Department of Environmental Protection to ascertain whether Skyports paid all the charges.

Finally, we contacted EDC officials to determine whether Skyports paid the City 50 percent of all gross revenue derived from the sale of goods, merchandise, and advertising on the premises (i.e., ATM machine, cigarettes, beverages, snacks, and phone cards), and whether Skyports obtained City permission for such sales. Subsequently, we attempted to determine how much was owed the City by requesting the documentation necessary to perform a thorough review. However, Kalish and Kerner, Skyports's subtenant and operator of the gas station that conducted those operations, refused to provide certain critical documents (as disclosed under the Scope Limitation of this report).

Scope Limitations

To conduct our audit of the lease between Skyports and the City, we requested specific documentation to ascertain whether Skyports complied with certain terms of its lease. However, Skyports did not provide critical documents that would support its compliance with those terms. We made several attempts to obtain outstanding documentation; however, Skyports and its accountant (Fulvio & Associates) chose not to respond to some of those requests. Skyports did not provide the following documents:

- Invoices and cancelled checks supporting the expenditures made for the repair and maintenance of the premises. These documents were necessary to determine whether Skyports expended funds for the repair and maintenance of the facility.
- Base and additional rent payments and calculation and supporting documentation for the reductions taken from the supplemental occupancy rent due the City for operating years 2005 through 2007. These documents were necessary to reconcile the documents obtained from EDC with the records on file with Skyports to establish the appropriateness of the supplemental rent deduction taken for the parking spaces retained by the City.
- Copies of water and sewer bills and cancelled checks for water and sewer payments. These documents were necessary to verify that Skyports paid water and sewer bills.
- Certificate of occupancy/completion for the premises needed to determine whether the premises is certified for legal use and occupancy.

Furthermore, in regard to the revenue derived from the sale of goods, merchandise, and advertising on the premises, we requested documents from Skyports's subtenant Kalish and Kerner. Kalish and Kerner provided some of the documents, but refused to provide critical documents necessary to make an adequate determination of the additional fees due the City. Kalish and Kerner did not provide the following documents:

- Financial statements from 2001 to present, needed to determine the revenue derived from the sale of goods, merchandise, and advertising on the premises.
- Federal and State tax filing from 2001 to present, needed to reconcile tax filings with the financial statements.
- Sales journal, invoices, and vendor contact information for all sales of goods, merchandise, and advertising on the premises including, but not limited to, cigarettes, snacks, and beverages. These records are needed to trace the invoices to the sales journal, and the sales journal to the general ledger to verify the completeness of the information provided. The vendor contact information is needed to substantiate the information provided by third parties.
- A complete set of books and records including, but not limited to, chart of accounts, general ledger, cash receipts journal, cash disbursements journal, daily cash register tapes, and bank statements. A complete set of books and records is necessary to calculate the gross revenue derived from the sale of goods, merchandise, and advertising on the premises.

Consequently, the Comptroller's Office served subpoenas on Skyports and Kalish and Kerner demanding the documents that were not provided. The matter is currently being pursued.

Skyports Response: In his response, Skyports's attorney stated: "The Comptroller Office's unilaterally withdrew its Subpoena Duces Tecum to Skyports, after it had timely served its Responses and Objections to that Subpoena. In light of that withdrawal, there is no basis for the Report's criticism of Skyports for 'not provid[ing] critical documents.' (Id. at 5.)

"Because, as stated above, there is no contractual privity between Skyports and Kalish & Kerner, and no contractual relationship between the City and those entities, the Report erroneously faults Skyports for any alleged lack of cooperation on the part of Kalish & Kerner with the audit conducted by the Comptroller's Office. (See id. at 6.)"

Auditor Comment: On May 7, 2008, a second subpoena was served on Skyports at the address of the Secretary of State in Albany, New York. The second subpoena required Skyports to appear at the Office of the New York City Comptroller on May 30, 2008 and provide the requested documents. As of the date of this report Skyports has failed to appear or produce the documents requested.

This audit was conducted in accordance with generally accepted government auditing standards (GAGAS) and included tests of the records and other auditing procedures considered necessary. This audit was performed in accordance with the audit responsibilities of the City Comptroller as set forth in Chapter 5, §93, of the New York City Charter.

Discussion of Audit Results

The matters covered in this report were discussed with EDC and Skyports officials during and at the conclusion of this audit. A preliminary draft report was sent to these officials and discussed at an exit conference held on May 15, 2008. On May 20, 2008, we submitted a draft report to EDC and Skyports officials with a request for comments. On May 21, 2008, Skyports requested and received an extension to June 13, 2008. We received written responses from EDC and Skyports on May 28, 2008, and June 13, 2008, respectively.

In its response EDC stated that it agrees with the recommendation that it continue to pursue legal action to enforce the terms of the lease and cure all outstanding defaults.

With the exception of our finding pertaining to its surety bond, Skyports's attorney generally disagreed with the findings and would not address the report's recommendations until the pending litigation is resolved. The specific comments raised by EDC and Skyports and our rebuttals are contained in the relevant sections of this report.

The full texts of the responses received from EDC and Skyports are included as addenda to this report.

FINDINGS

Skyports violated the terms of several major provisions in its lease with the City and may owe the City nearly \$6.1 million. Its general disregard for maintaining the premises endangered public safety and may cost the City in excess of \$5.5 million of the \$6.1 million to rectify conditions. Specifically, Skyports's lack of a maintenance program led to deterioration of the parking garage to the point that, according to a seven-day Notice to Cure filed by the Department of Small Business Services against Skyports, "catastrophic failure was a present danger." As a result, emergency temporary shoring was installed by EDC to prevent the collapse of the garage. In addition, Skyports violated Article 34 of the lease by not reporting 50 percent of all gross revenue derived from the sale of goods, merchandise, and advertising on the premises, and by not obtaining the City's permission to allow Kalish and Kerner the right to make those sales. Moreover, Skyports did not pay water and sewer charges and did not increase its surety bond in accordance with increases in rent. Consequently, Skyports owes the City \$548,135—\$464,000 for emergency repairs performed by EDC, a minimum of \$46,614 for not paying 50 percent of the revenue derived from the sale of goods, merchandise, and advertising on the premises, and \$37,521 in water and sewer charges, as shown in Table I following.

Table I
Schedule of Amount Due the City

Description	Amount Due
Repair of Facility	\$5,508,500
Emergency Repairs	464,000
Sales of Goods, Merchandise, and Advertising on the Premises	46,614
Water and Sewer Charges	<u>37,521</u>
Total	\$6,056,635

In addition, EDC did not fully exercise its responsibility to ensure that Skyports complied with the terms and conditions of the lease. EDC's insufficient monitoring of the lease has contributed to the findings disclosed in this report, which are discussed in greater detail in the following sections of this report.

Inadequate Maintenance of the Premises

Skyports failed to adequately maintain the parking garage and marina as required by the lease. As a result, public safety was jeopardized, and the City had to expend \$464,000 to temporarily support a girder that was seriously damaged by corrosion. Article 14 of the lease states, "Lessee will at its own cost and expense at all times during the said term, keep and maintain the said property and every part thereof, and the structures thereon or to be erected thereon, in good and sufficient repair and condition."

Numerous surveys and inspections that were conducted from 2002 through 2008 by various engineering consultants identified serious condition deficiencies at the premises.² These deficiencies included exposed electrical wiring, missing fire-stopping, an unsafe gangway, faulty fireproof doors, deteriorated timber pile caps, cracked and spalled beams, unsafe pier connections, and elevator and stair bulkheads in poor condition. We should note that these conditions could have been addressed had the required maintenance been completed. However, Skyports did not take adequate steps to remedy these poor conditions.

When our auditors and engineers inspected the parking garage, they found that many of these deficient conditions continue to exist: degraded concrete piers with exposed, corroded reinforcing steel; water penetration in the superstructure; spalling, chipping, and cracked concrete; and roof drains and gutters clogged with debris and silt. (See photographs in Appendix.)

The lack of adequate maintenance eventually compelled the City in November 2007 to install temporary shoring to prevent “a possible failure of the structure along the expansion joint,” as stated in a December 21, 2007 letter from engineering consultant Thornton Tomasetti. The letter further stated that “the budget of this rehabilitation could range well over a million dollars. . . . Had a maintenance program been in place throughout the life of this structure, preventative routine maintenance could have prevented this structural distress for a fraction of the cost that will now be incurred to restore this structure to a permanently safe condition.” Subsequently, Thornton Tomasetti issued a condition survey on April 7, 2008, which stated the estimated costs to repair the garage to be \$5,508,500.

Skyports Response: In his response, Skyports’s attorney stated: “Skyports is currently in litigation with the City over the Second Notice to Cure. That action is encaptioned New York Skyports, Inc. v. The City of New York, index No. 106575/08 (Lowe, J.) (the ‘Yellowstone Action’), and seeks, among other relief, a *Yellowstone* injunction prohibiting the City from taking any action to terminate Skyports’ lease or to re-take possession of the Premises, pending judicial resolution of whether Skyports has violated any provisions of that lease. This is the second such action that Skyports has been forced to file against the City. In response to the first Notice to Cure, Skyports made most of the repairs that the City had requested and, after the City’s counsel refused to extend Skyports’ deadline for compliance therewith, commenced a prior action that sought relief similar to what Skyports has sought in the *Yellowstone* Action. The City subsequently withdrew the First Notice to Cure and successfully moved to dismiss that action, convincing Justice Lowe that the underlying matters and alleged lease violations were ‘moot.’

“Skyports disputes the City’s contention that it has an obligation to make structural repairs to the Premises and that its purported failure to maintain the Premises has resulted

² The inspection reports were as follows: January 31, 2008, by KM Associates; December 21, 2007 and April 7, 2008, by Thornton Tomasetti; March 26, 2007, by HPA Engineers; July 23, 2004, by EDC; September 10, 2006, by Ocean and Coastal Consultants; and February 2002, by DMJM+Harris, Inc., and Daniel Frankfurt.

in the structural defects that the City now alleges to exist. Indeed, this is one of the principal issues before the Court in the *Yellowstone* Action. Thus, until that action has been resolved, Skyports is not in a position to address the Report's recommendation that it submit to the EDC a repair plan and an annual maintenance plan for the Premises, inasmuch as Skyports disputes the City's construction of the scope of Skyports' maintenance and repair obligations under the lease.

“According to the Report, the City made seven inspections during the period from February of 2002 through April 7, 2008. Prior to November 7, 2007, those inspections never identified the deterioration or structural concerns now cited, and relied upon, in the Report. (See *id.* at 8 n.2.) Certainly, the City never gave any notice to Skyports or its manager that such allegedly structural concerns need immediate and emergency redress. The absence of such deterioration or structural concerns is further buttressed by the City's repeated representations, in March of this year, that any dispute as to whether Skyports had violated its lease obligations by failing to maintain the Premises in good and sufficient repair and conditions was ‘moot.’ Indeed, the Report itself concedes that Skyports made the requisite repairs to the Premises. (*Id.* at 11-12.)

“Paragraph one of the page eight of the Report presents an incomplete discussion of the condition of the Premises because it makes no reference to any of the following:

- Skyports did rectify the items identified therein, except for two structural items, which, as stated above, have been endemic to the building since 1962, when it was first constructed, and are the City's responsibility, not Skyports' contractual obligation.
- None of these items suggest the existence of a safety hazard or support the Report's allegation that ‘public safety was jeopardized.’ (*Id.* at 7.)

“Paragraph two of page eight of the Report relies on photographs that were taken of the Premises in September and November of 2007 and, therefore, do not support the claim that deficient conditions continue to exist on the Premises. The Comptroller's Office is less than candid to incorporate outdated photographs in a misleading attempt to suggest that those images reflect the current status of the Premises.”

Auditor Comment: Skyports presents several arguments in an attempt to discredit this finding. Skyports contends that it does not have to make structural repairs to the premises. Clearly, the lease assigns this responsibility to Skyports. Under Article 14 (“Repairs, Painting, Rebuilding”) Skyports is responsible to keep and maintain the premises in “good and sufficient repair and condition.” Although the lease makes no mention of structural repairs, the implication is that had Skyports actually kept the premises in “good and sufficient repair and condition” structural repairs would not be necessary.

Skyports also contends that the matters in the First Notice to Cure issued on November 7, 2007, which was limited to degraded steel supporting the parking garage, has been

resolved and states several times that the issue is “moot.” The First Notice to Cure was withdrawn on February 29, 2008, only to be replaced by a more comprehensive Second Notice to Cure on April 28, 2008. The Second Notice to Cure encompasses the entire parking garage and marina and still includes the critical condition cited in the First Notice to Cure. Obviously these matters have not been resolved as purported by Skyports.

Since, Skyports’s attorney did not provide documentation to support any action taken by Skyports to rectify conditions identified in this report and did not provide any documentation that would indicate it ever had a repair and maintenance program, we continue to believe that Skyports has failed to maintain the premises in accordance with the lease. Accordingly, we are satisfied that the Corporation Council, on behalf of the City, is pursuing litigation to cure all outstanding defaults.

Skyports Did Not Report Certain Revenue Generated at Premises

We were unable to determine how much revenue in total was derived from the sale of goods, merchandise, and advertising on the premises. Observations of the gas station revealed the subtenant, Kalish and Kerner was selling, among other items, beverages, candy, and cigarettes, and also had an ATM machine and several advertising panels on the premises. The master lease requires Skyports to remit to the City 50 percent of all gross revenue derived from the sale of goods, merchandise, and advertising on the premises. Further, Skyports did not obtain the City’s prior approval for those sales, as required by the lease. Article 34 states, “Should Lessee, after obtaining such written permission from the Commissioner of Marine and Aviation, place or install any telephone booths, merchandise vending machines or concessions thereon, then Lessee shall deliver to Lessor fifty per cent (50%) of all gross revenues derived by it from these operations. . . . Such fifty per cent (50%) of all sums so collected shall be the property of the Lessor.”

Kalish and Kerner receives revenue from four vending machines, an ATM, a convenience store, and advertisements placed at the gas station. As stated earlier in the Scope Limitation section, Kalish and Kerner refused to provide the necessary information for us to determine the amount of revenue derived from the operation of the convenience store or to verify the completeness of the information regarding the vending machines, ATM machine, and advertising panels.

Kalish and Kerner provided commission statements for the vending machines and the ATM, and a letter from its media representative stating the price, quantity, and display duration of panels on the premises. Kalish and Kerner’s attorney stated that the master lease does not require her client to provide records such as a general ledger, sales journal, cash receipts journal, tax returns, and invoices. Contrary to Kalish and Kerner’s position, Article 34 of the master lease states that “the books and records of Lessee with respect to such collections shall be open to inspection by Commissioner and his designees at all reasonable times for the purpose of determining any amounts due Lessor.” Moreover, Article Ten of the master lease states,

“Lessee shall also comply with and observe and this lease shall be subject to any and all valid laws, and to valid regulations and orders of any and all departments, bureaus, and boards of the city government in so far as they may so act in their governmental capacities in the exercise of general police power, as distinguished from the city’s capacity as a landlord or exercise of its power as a landlord.”

Based on the documentation provided, we believe that Kalish and Kerner may have underreported revenue derived from the sale of goods and merchandise, or advertising at the gas station. A letter from Kalish and Kerner’s media representative states that advertising panels were in service on the premises from only October 2005 through January 2007, and November 2007 through January 2008. However, during an unannounced observation in September 2007, auditors observed advertising panels on display.

Moreover, our review of the documentation found that Kalish and Kerner earned at least \$93,227 in revenue from the beverage sales, ATM commissions, and advertising fees. As a result, the City is owed a minimum of \$46,614. See Table II for details.

Table II
Schedule of Additional Fees Due
2003-2007

Description	Revenue Reported By Year	Total Revenue
Signage Revenue		
2005	\$2,520	
2006	10,080	
2007	<u>2,520</u>	
Total Signage Revenue		\$15,120
ATM Fees Received		
2003	\$5,586	
2004	7,314	
2005	6,290	
2006	6,950	
2007	<u>6,729</u>	
Total ATM Fees Received		\$32,869
Soda Machine Commission		
2004	\$6,928	
2005	11,640	
2006	13,408	
2007	<u>13,262</u>	
Total Revenue from Vending Machines		\$45,238
Total Gross Revenue		93,227
Applicable Percentage Fee		50%
<u>Total Revenue Due</u>		\$46,614

Without a complete set of books and records, the City cannot be assured that all sales relevant to this audit are being recorded and reported and that it is receiving its fair share of revenue.

Skyports Response: In his response, Skyports's attorney stated: "Skyports never approved, or consented to, the sub-sublease arrangement between Gulf and Kalish & Kerner. Rather, the obligation was on Gulf to monitor the actions of Kalish & Kerner and to revert 50% of any concession revenues to the City. Gulf sought and, on June 26, 2002, received the City's express written approval for this specific arrangement.

"Skyports withheld its consent to the sub-sublease arrangement expressly because it would not permit a convenience store on the Premises or the indirect sale of concession items through vending machines.

"Had the Comptroller's Office properly performed its due diligence audit, it would have learned and concluded that the City approved an arrangement for Kalish & Kerner, separate and apart from Skyports. Accordingly, the Report should have referenced the City's lapses respecting the operations of Kalish & Kerner -- which are totally unrelated to Skyports.

"Notwithstanding the foregoing, Skyports has asked Gulf to provide it with an accounting of any revenue earned by Kalish & Kerner from the sale of goods, merchandise, and advertising on the Premises and reminded Gulf of its obligation as a sublessee under the lease to abide by the terms of the Prime Lease.

"Notwithstanding the independent arrangement that the City approved, Skyports will cooperate with the City to determine the amount of unreported revenue that was earned on the Premises."

Auditor Comment: Although Skyports claims it did not approve Gulf's sublease with Kalish and Kerner, lack of approval does not relieve Skyports of its responsibility to ensure the property is being managed in accordance with the lease. Ultimately, Skyports, as the City's lessee, is responsible for all actions on the property. If Kalish and Kerner operate outside the terms and conditions of the lease, Skyports should require that Gulf ensure that its subtenant in compliance.

Nonetheless, we appreciate Skyports's effort in contacting Gulf to determine the total amount of unreported revenue earned by Kalish and Kerner. We believe that Skyports should act in good faith and satisfy the audit assessment, paying the City \$46,614. Once Skyports obtains Kalish and Kerner records from Gulf, it should undertake its own review to assess whether any additional fees are due the City.

Water and Sewer Use Not Paid

Skyports did not pay for water and sewer use since it was assigned the lease in 1998, as required by the lease. Skyports failed to inform the Department of Environmental Protection (DEP) that it was not being billed for one of its accounts.

After we reviewed Skyports's billing and payment history on the DEP Customer Information System, we found that the premises had three accounts, for which only two were consistently billed. One of these accounts—Boat Marina and Parking Ramp, No. 4000154405001—was being billed to the City; water and sewer bills were not being generated for this account. Once we informed DEP of this problem, DEP dispatched an inspector to the property, tested the meters, and adjusted the billing information. Subsequently, DEP billed the Skyports account (No. 4000154405001) \$37,521 for water and sewer use from November 27, 2003, to November 27, 2007.

Skyports Response: In his response, Skyports's attorney stated: "Skyports was unaware of the unusual circumstance that it had more than one water and sewer account with the Department of Environmental Protection (the 'DEP') and, as a result, was unaware of any arrearage for water and sewer charges. The genesis of this second account is and was unknown to Skyports. Indeed, the Report concedes that one of these accounts was billed to the City--which apparently received these invoices, but presumptively never paid the bills due thereon; nor did the City forward that information to Skyports. Under these circumstances, Skyports could not, and did not, fail to pay or to inform the DEP that it was not being billed. On the contrary, as the Comptroller's Office well knows and fails to acknowledge, Skyports was being billed by the DEP for water and sewer usage under the separate Account No. 50009-53963-001 and, as demonstrated by the documents that Skyports produced to the Comptroller's Office, Skyports was, and is now, current on its payments for this account.

"Indeed, the Comptroller's Office concedes in its Report that it instructed the DEP to dispatch an inspector and that inspector, on his own and without any disclosed support, apparently and merely 'adjusted the billing information.' (*Id.* at 10-11.) Thus, DEP simply attributed \$37,521 to Account No. 40001-54405-001 and unbeknownst to Skyports, billed it for an indeterminate amount of water and sewer usage for the period from November 27, 2003, to November 27, 2007. In this regard, the Report remains silent respecting the basis for the time period selected, the actual usage, or the unilateral decision to attribute it to Skyports.

"Skyports has requested copies of any account statements and other documentation supporting the Report's claim that \$37,521 is due and owing from Skyports to the DEP. Once Skyports receives the requested documentation and has an opportunity to review it, Skyports will consult with the City and the Comptroller's Office regarding Skyports' position on this claim."

Auditor Comment: We believe that any lessee, manager, or property owner should have a clear understanding of the terms, conditions, and responsibilities of their obligations.

Skyports's lease clearly states that the lessee is to pay for all water, gas, heat, electricity, and sewer charges. As lessee, Skyports is responsible for coordinating with DEP to ensure that a water and sewer account is established in the lessee's name, and to notify DEP of any billing inaccuracies.

Skyports's claim that the Comptroller's Office was well aware that Skyports was being billed by DEP for water and sewer use under Account No. 50009-53963-001 and that Skyport is now current on its payments for this account is somewhat misleading.

If Skyport had contacted DEP, it would have been made aware the City was being billed directly for Skyports's water and sewer use. As a result of our inquiry, DEP opened a new account (Account No. 50009-53963-001) in Skyports's name and back-billed it an estimated \$79,234 for unpaid water and sewer charges. However, DEP subsequently found a pre-existing account (Account No. 40001-544505-001) for the Skyport premises—this account was also in the name of the City. DEP updated the preexisting account 40001-544505-001, reversed the \$79,234 charge to \$0 for Account No. 50009-53963-001, and issued two new bills to Skyports—\$37,521 for Account No. 40001-544505-001 and \$0 due for Account No. 50009-53963-001.

In any case, once Skyports has the opportunity to review the appropriate documentation, it will realize that it owes the \$37,521 and should make restitution immediately.

Skyports Did Not Increase Its Surety Bond with the City

Pursuant to the provisions of the master lease and the 1998 amendment, Skyports is required, on an annual basis, to furnish a surety bond to the City in an amount equal to the amount of the annual rental in effect at the beginning of each term. Although Skyports did in fact obtain a bond in the amount of \$222,749 at the time that it was assigned the lease in 1998 and has continued to renew its bond, it failed to increase the amount of the bond in 2002, the beginning of the third and final term, to reflect the increased rental amount of \$406,140. Since Skyports failed to increase the value of the bond at the start of the third term (or at any subsequent time), the bond is currently in the amount of \$222,749 and thus, undervalued by \$183,391. Further, the bond was never submitted to the Comptroller for approval as required by the lease.

Surety bonds protect the City's interests and ensure that lessees comply with the terms and conditions of their leases. According to the lease, "This bond serves as security for the faithful performance of each and every term, condition, and covenant of this lease." Skyports failure to maintain the bond equal to annual rent in effect at the beginning of each term lessens its incentive to comply with the lease and places the City at additional financial risk.

Skyports Response: In his response, Skyports's attorney stated, "Skyports will arrange to have the surety bond amount increased as recommended by the Report."

Insufficient Oversight by EDC

EDC's insufficient oversight of the Skyports lease may have jeopardized public safety, placed the City at financial risk, and may have cost the City upwards of \$5.5 million or more to rectify conditions dangerous to the public. EDC's inability to sufficiently ensure the maintenance of the facility and to fully act on conditions brought to its attention may have contributed to deterioration of the parking garage. For example, EDC did not follow up an inspection performed on the parking garage by Ocean and Coastal Consultants Engineering P.C. in May 2006, which stated, "The expansion joint is rated in poor condition as in need of maintenance." In November 2007, EDC had temporary shoring installed along the expansion joint to prevent the collapse of the garage. Between May 2006 and November 2007, public safety may have been at risk due to EDC's inaction.

Although EDC filed a seven-day Notice to Cure on April 9, 2002, in an attempt to force Skyports to make recommended repairs based on an February 7, 2002 inspection report conducted by Daniel Frankfurt, P.C., several conditions identified in that inspection report remain unresolved. Between April 9, 2002, and December 27, 2004, EDC conducted several walk-throughs of the property and corresponded with Skyports several times to ensure that necessary repairs were made. Correspondence between the parties revealed that Skyports made some progress in implementing the report's recommendations; but there is no evidence to suggest that Skyports satisfactorily repaired all the conditions.

Additionally, EDC did not ensure that Skyports's insurance policies and surety bond—safeguards designed to protect the City's interest—were maintained to the fullest degree possible. In fact, EDC did not appraise the land every six months for the purpose of determining the replacement value of the structures to be covered by insurance, as is required by the lease. Further, Skyports's insurance policy places the current replacement value of the parking garage at \$7.8 million. According to documentation found in EDC files, the last appraisal of property was conducted in 1993. That appraisal, performed 15 years ago, valued the garage at \$7.1 million; the insurance policy may be undervalued by now. Moreover, EDC failed to ensure that Skyports maintained its surety bond to accord with rent increases. Surety bonds are another safeguard designed to minimize City risk. As previously stated, the current surety bond is undervalued by \$183,391.

Lastly, EDC did not ensure the City was receiving all the revenue it was entitled to from the operation of vending machines and a concession at the gas station. The responsibility to ensure that lessees comply with terms of their agreements resides with EDC. EDC should have been aware that Skyports's tenant was operating vending machines and a concession in violation of the lease. A cursory observation of the property would have revealed those activities.

RECOMMENDATIONS

Since Skyports violated the terms of several major provisions in its lease with the City, EDC should consider terminating its lease with Skyports and continue to pursue legal action against Skyports to collect the \$6,056,653.

EDC Response: “EDC agrees. EDC served Skyports with a 7 day notice to cure which expired May 14, 2008. Corporation Counsel on behalf of the City is pursuing litigation to enforce the terms of the Lease and to cure all outstanding defaults.”

If EDC decides not to terminate the lease, EDC should:

1. Coordinate with Skyports to develop a written plan to complete the necessary repairs of the garage structure, as recommended by the engineers in the April 7, 2008 report, and any other needed structural improvements to the premises. The plan should include project start dates, completion dates, and critical construction milestones.
2. Ensure that Skyports keeps and maintains the premises and the structure in good repair and condition henceforth by implementing a maintenance and repair program that is continuous and consistent by:
 - developing written, systematic procedures for monitoring property maintenance, and
 - ensuring that staff are properly trained and qualified to inspect the premises.
3. Ensure timely follow-up on all recommendations cited in independent contractors’ and internal inspection reports and ensure that proper corrective action is taken.
4. Implement a computerized property management system to track all activities on the premises, including but not limited to, inspections, surveys, repairs completed, repairs not made, and repairs in progress, along with dates and names of EDC staff and administrators in charge of each activity at the time.
5. Ensure that Skyports pays the \$548,135 in amounts due the City consisting of:
 - \$464,000 that the City expended to temporarily secure the garage structure;
 - \$46,614 from 50 percent of the sale of goods, merchandise, and advertising on the premises, and
 - \$37,521 in water and sewer charges.
6. Obtain those records listed in the Scope Limitation section and calculate any additional fees due that resulted from the sales of goods and merchandise, or advertising on the premises.

7. Conduct the required biannual appraisal of the premises for the purpose of determining the current replacement value of the structure for insurance coverage.
8. Ensure that Skyports complies with the recommendations made in this report.

Skyports should:

9. Pay the \$548,135 in amounts due the City consisting of:
 - \$464,000 the City expended to temporarily secure the garage structure;
 - \$46,614 from 50 percent of the sale of goods, merchandise, and advertising on the premises; and
 - \$37,521 in water and sewer charges
10. Present EDC with a plan to make all necessary repairs to the premises as recommended by the engineers of the April 7, 2008 report and any other needed structural improvements to the premises. This plan should include project start dates, completion dates, and critical construction milestones (i.e., dredging, excavation, foundation, construction, etc.).
11. Submit to EDC, for its approval, a maintenance program that will be carried out each year for the remainder of the lease.
12. Ensure that it obtains, on the behalf of any sublessee, the City's written consent authorizing the sale of any goods, merchandise, and advertising on the premises and ensure that it or its sublessee submits complete documentation to EDC supporting such sales.
13. Increase the security bond amount equal to the amount of the annual rental in effect at the beginning the final term.

As previously noted, Skyports's attorney would not address the report's recommendations until the pending litigation is resolved.

Conditions Observed at Skyports Parking Garage



Picture # 1: Degraded Concrete Pier with Exposed, Corroded Reinforcing Steel



Picture # 2: Degraded Concrete Pier with Exposed, Corroded Reinforcing Steel

Conditions Observed at Skyports Parking Garage



Picture 3: Cracked Concrete Support



Picture # 4: Chipped and Cracked Concrete, with Exposed, Corroded Reinforcing Steel

Conditions Observed at Skyports Parking Garage



Picture # 5: Chipping and Spalling of the Concrete Surface



Picture # 6: Two Inches of Sludge Buildup in Drain

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June 13, 2008

BY HAND DELIVERY

Mr. John Graham
Deputy Commissioner
Audits, Accountancy & Contracts
Office of the Comptroller of the City of New York
Executive Offices
One Centre Street
New York, New York 10007

Re: New York Skyports, Incorporated

Dear Mr. Graham:

This Firm represents New York Skyports, Incorporated ("Skyports") and on its behalf, I am writing in response to the Draft Audit Report on the Compliance of New York Skyports, Inc. with its Lease Agreement (the "Report"), a copy of which you sent to me on May 20, 2008, together with an invitation to submit written comments on the Report by June 4, 2008. Your colleague, Michael Morgese, subsequently extended that deadline until June 13, 2008.

As demonstrated more fully herein below, the Report is a subjective, unsupported, unverified, and intentionally one-sided presentation. Inexplicably, the Comptroller's Office, which has never before audited this almost 50-year-old landlord/tenant arrangement, has failed to investigate independently the underlying facts, ignored countervailing but controlling circumstances, misstated matters -- some of which have been previously resolved -- exaggerated the significance and implications of the current state of affairs, and relied exclusively on the landlord's contentions and allegations without resort to objectivity.

Most disappointing is the inalterable appearance that the otherwise objective and neutral Comptroller's Office has inexplicably joined the New York City Economic Development Corporation (the "EDC") in its concerted effort to terminate Skyports' lease well in advance of its remaining four-year term -- all without due monetary consideration and/or payment. Further, the City of New York (the "City"), as the landlord, seemingly for its own undisclosed business reasons, has enlisted the Comptroller's Office for the avowed purpose of harassing impermissibly its tenant, Skyports, in a classic tactic of employing the *in terrorem* effect of repeatedly serving 7-Day Notices to Cure, with the attendant economic force of engendering litigation, to pressure termination prematurely of the existing

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lease arrangement. Most reprehensible is that the City is not merely a landlord; rather, with its regulatory and police powers, it has sought, with the assistance of the EDC and the Comptroller's Office, to make Skyports' tenancy unprofitable and unworkable in the hopeful expectation that Skyports will abandon the leasehold. This draft Report, with its recommendation that the City, through "[the] EDC, should consider terminating its lease with Skyports and continue to pursue legal action against Skyports" (Report at 13), is simply another element of the over-arching scheme to disenfranchise Skyports' leasehold rights.

In accordance with your invitation, Skyports hereby submits the following comments on the Report.

General Comments

1. The Comptroller's Office made no independent, objective review and merely assumed the correctness of the April 7, 2008 report on the Premises prepared by Thornton Tomasetti, Inc. ("Thornton Tomasetti"), which was hired by the EDC, an entity that, over the past ten years, has repeatedly sought the eviction of Skyports. Put simply, the Comptroller's Office's fact-finding efforts were so limited as to invite error and the appearance of subjectivity.
2. As more fully discussed herein, the issues discussed in the Report are open to debate, and subject to litigation and resolution by a court of law. The Comptroller's Office's failure to acknowledge and reference this material further fact reflects its subjectivity and bias.
3. On March 3, 2008, and again on March 14, 2008, the City declared that many, if not most, of the alleged maintenance deficiencies in Skyports' compliance with its lease that are allegedly identified in the Report, specifically those contained in a November 7, 2007 Notice to Cure (the "First Notice to Cure") that the City had served on Skyports, were "moot." The Comptroller's Report fails to acknowledge or address this fact; it certainly fails to explain how these same deficiencies were mysteriously resurrected.
4. The Report improperly relies on a subsequent Notice to Cure, dated April 29, 2008 (the "Second Notice to Cure"), that the City served on Skyports, the validity of which is the subject of litigation that is currently pending between Skyports and the City. (See, e.g., Report at 7.)
5. The obligation to make structural repairs to the Premises, as distinguished from general maintenance thereon, rests with the City, as landlord -- not Skyports. The Comptroller's Report fails to address the relevant provisions of the Lease Agreements regarding these matters and the applicable case law related thereto.
6. Kalish & Kerner Petroleum LLC ("Kalish & Kerner") is not Skyports' sub-tenant. Instead, Kalish & Kerner operates the gas station located on the Premises pursuant to the July 2, 2002 Lease and Franchise Agreement with Gulf Oil Limited Partnership ("Gulf") -- not Skyports -- an agreement to which the City expressly consented in writing on July 26, 2002. Indeed, there is no contractual privity whatsoever between Skyports and Kalish & Kerner. (See discussion

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infra at 6.) The Comptroller's Report fails to understand the independent relationship between Gulf, Kalish & Kerner, and the City.

Specific Comments

1. With respect to the section titled "Scope Limitations" (Report at 5-6), Skyports responds as follows:

- The Comptroller Office's unilaterally withdrew its Subpoena Duces Tecum to Skyports, after it had timely served its Responses and Objections to that Subpoena. In light of that withdrawal, there is no basis for the Report's criticism of Skyports for "not provid[ing] critical documents." (*Id.* at 5.)
- Because, as stated above, there is no contractual privity between Skyports and Kalish & Kerner, and no contractual relationship between the City and those entities, the Report erroneously faults Skyports for any alleged lack of cooperation on the part of Kalish & Kerner with the audit conducted by the Comptroller's Office. (See *id.* at 6.)

2. With respect to the first paragraph of the section titled "Findings" (Report at 7), Skyports responds as follows:

- There is no basis for the conclusion that "catastrophic failure was a present danger" and required emergency work totaling \$464,000. (*Id.* (citing First Notice to Cure).) The report of Thornton Tomasetti, on which the Comptroller's Office has exclusively relied, does not state that, as of November 7, 2007, the garage located on the Premises was in danger of collapse or created a general public safety hazard. In any event, on March 3, 2008, and again on March 14, 2008, the City represented that any dispute between it and Skyports regarding the alleged lease violations identified in the First Notice to Cure was "moot." Accordingly, the Comptroller's Report fails to state that these matters had been completely resolved.

4. With respect to the section titled "Discussion of Audit Results" (Report at 6), Skyports responds as follows:

- Skyports disputes the Report's characterization that "[a] preliminary draft report was ... discussed at an exit conference held on May 15, 2008." (*Id.*) At that conference, which invited a full panoply of City officials and representatives but lasted fewer than thirty minutes, Mr. Morgese of the Comptroller's Office merely reiterated on a page-by-page basis what the preliminary draft report stated. There was no "discussion" whatsoever -- it was a *fait accompli*.

5. With respect to the section titled "Inadequate Maintenance of the Premises" and the corresponding recommendations that "Skyports should ... [p]ay ... \$464,000 [that] the City

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expended to temporarily secure the garage structure” and “[p]resent EDC with a plan to make all necessary repairs to the premises” and “[s]ubmit to EDC for its approval, a maintenance program that will be carried out each year for the remainder of the lease” (Report at 7-8, 14), Skyports responds as follows:

- Skyports is currently in litigation with the City over the Second Notice to Cure. That action is encaptioned New York Skyports, Inc. v. The City of New York, Index No. 106575/08 (Lowe, J.) (the “*Yellowstone* Action”), and seeks, among other relief, a *Yellowstone* injunction prohibiting the City from taking any action to terminate Skyports’ lease or to re-take possession of the Premises, pending judicial resolution of whether Skyports has violated any provisions of that lease. This is the second such action that Skyports has been forced to file against the City. In response to the First Notice to Cure, Skyports made most of the repairs that the City had requested and, after the City’s counsel refused to extend Skyports’ deadline for compliance therewith, commenced a prior action that sought relief similar to what Skyports has sought in the *Yellowstone* Action. The City subsequently withdrew the First Notice to Cure and successfully moved to dismiss that action, convincing Justice Lowe that the underlying matters and alleged lease violations were “moot.”
- The discovery process has only recently begun in the *Yellowstone* Action, and Skyports expects to receive documents in the very near future concerning the engineer’s reports to the City that pertain to the alleged emergency repairs made to the Premises and the current condition of the garage located thereon. Once Skyports receives the requested documentation and has an opportunity to review it, Skyports will inform the City and the Comptroller’s Office further regarding Skyports’ position on this issue.
- Skyports disputes the City’s contention that it has an obligation to make structural repairs to the Premises and that its purported failure to maintain the Premises has resulted in the structural defects that the City now alleges to exist. Indeed, this is one of the principal issues before the Court in the *Yellowstone* Action. Thus, until that action has been resolved, Skyports is not in a position to address the Report’s recommendation that it submit to the EDC a repair plan and an annual maintenance plan for the Premises, inasmuch as Skyports disputes the City’s construction of the scope of Skyports’ maintenance and repair obligations under the lease.
- According to the Report, the City made seven inspections during the period from February of 2002 through April 7, 2008. Prior to November 7, 2007, those inspections never identified the deterioration or structural concerns now cited, and relied upon, in the Report. (See *id.* at 8 n.2.) Certainly, the City never gave any notice to Skyports or its manager that such allegedly structural concerns need immediate and emergency redress. The absence of such deterioration or

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structural concerns is further buttressed by the City's repeated representations, in March of this year, that any dispute as to whether Skyports had violated its lease obligations by failing to maintain the Premises in good and sufficient repair and condition was "moot." Indeed, the Report itself concedes that Skyports made the requisite repairs to the Premises. (Id. at 11-12.)

- Paragraph one of page eight of the Report presents an incomplete discussion of the condition of the Premises because it makes no reference to any of the following:
 - Skyports did rectify the items identified therein, except for two structural items, which, as stated above, have been endemic to the building since 1962, when it was first constructed, and are the City's responsibility, not Skyports' contractual obligation.
 - None of these items suggest the existence of a safety hazard or support the Report's allegation that "public safety was jeopardized." (Id. at 7.)
- Paragraph two of page eight of the Report relies on photographs that were taken of the Premises in September and November of 2007 and, therefore, do not support the claim that deficient conditions continue to exist on the Premises. The Comptroller's Office is less than candid to incorporate outdated photographs in a misleading attempt to suggest that those images reflect the current status of the Premises.

6. With respect to the section titled "Water and Sewer Use Not Paid" and the corresponding recommendation that "Skyports should ... [p]ay ... the City ... \$37,521 in water and sewer charges" (Report at 10-11, 14), Skyports responds as follows:

- Skyports was unaware of the unusual circumstance that it had more than one water and sewer account with the Department of Environmental Protection (the "DEP") and, as a result, was unaware of any arrearage for water and sewer charges. The genesis of this second account is and was unknown to Skyports. Indeed, the Report concedes that one of these accounts was billed to the City -- which apparently received these invoices, but presumptively never paid the bills due thereon; nor did the City forward that information to Skyports. Under these circumstances, Skyports could not, and did not, fail to pay or to inform the DEP that it was not being billed. On the contrary, as the Comptroller's Office well knows and fails to acknowledge, Skyports was being billed by the DEP for water and sewer usage under the separate Account No. 50009-53963-001 and, as demonstrated by the documents that Skyports produced to the Comptroller's Office, Skyports was, and is now, current on its payments for this account.
- Indeed, the Comptroller's Office concedes in its Report that it instructed the DEP to dispatch an inspector and that inspector, on his own and without any

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Page 6

disclosed support, apparently and merely "adjusted the billing information." (*Id.* at 10-11.) Thus, DEP simply attributed \$37,521 to Account No. 40001-54405-001 and unbeknownst to Skyports, billed it for an indeterminate amount of water and sewer usage for the period from November 27, 2003, to November 27, 2007. In this regard, the Report remains silent respecting the basis for the time period selected, the actual usage, or the unilateral decision to attribute it to Skyports.

- Skyports has requested copies of any account statements and other documentation supporting the Report's claim that \$37,521 is due and owing from Skyports to the DEP. Once Skyports receives the requested documentation and has an opportunity to review it, Skyports will consult with the City and the Comptroller's Office regarding Skyports' position on this claim.

7. With respect to the section titled "Skyports Did Not Report Certain Revenue Generated at Premises," and the corresponding recommendations that "Skyports should ... [p]ay ... the City ... \$46,614 from 50 percent of the sale of goods, merchandise and advertising on the premises" and "ensure that it obtains, on behalf of any sublessee, the City's written consent" to such sales (Report at 8-10, 14), Skyports responds as follows:

- Skyports never approved, or consented to, the sub-sublease arrangement between Gulf and Kalish & Kerner. Rather, the obligation was on Gulf to monitor the actions of Kalish & Kerner and to revert 50% of any concession revenues to the City. Gulf sought and, on June 26, 2002, received the City's express written approval for this specific arrangement.
- Skyports withheld its consent to the sub-sublease arrangement expressly because it would not permit a convenience store on the Premises or the indirect sale of concession items through vending machines.
- Kalish & Kerner has operated concessions on the gas station portion of the Premises without Skyports' consent. Skyports was unaware of the extent to which unreported revenue was earned on the Premises and received no such revenue from either Gulf or Kalish & Kerner.
- Had the Comptroller's Office properly performed its due diligence audit, it would have learned and concluded that the City approved an arrangement for Kalish & Kerner, separate and apart from Skyports. Accordingly, the Report should have referenced the City's lapses respecting the operations of Kalish & Kerner -- which are totally unrelated to Skyports.
- Notwithstanding the foregoing, Skyports has asked Gulf to provide it with an accounting of any revenue earned by Kalish & Kerner from the sale of goods, merchandise, and advertising on the Premises and reminded Gulf of its

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obligation as a sublessee under the lease to abide by the terms of the Prime Lease.

- Notwithstanding the independent arrangement that the City approved, Skyports will cooperate with the City to determine the amount of unreported revenue that was earned on the Premises.

8. With respect to the section titled "Skyports Did Not Increase Its Surety Bond With The City," and the corresponding recommendation that "Skyports should ... [i]ncrease the security bond equal to the amount of annual rent in effect at the beginning of the final term" (Report at 11, 14), Skyports responds as follows:

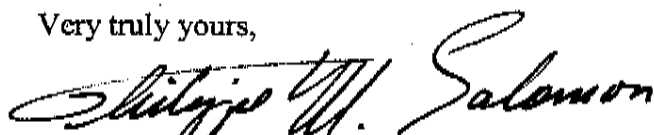
- Skyports will arrange to have the surety bond amount increased as recommended by the Report.
- It should be noted, however, and the Report should have referenced, that in the over 10 years since Skyports assumed the direct tenancy of the Premises, it has *never* failed to satisfy timely its lease payments to the City.

9. As explained in my May 14, 2008 letter to Mr. Morgese, it is Skyports' position that, by virtue of the Temporary Restraining Order entered by Justice Lowe in the *Yellowstone* Action on May 13, 2008, the City and the EDC are currently enjoined from adopting the recommendations made on page 13 of the Report.

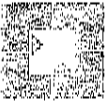
* * *

Skyports would be pleased to resolve expeditiously all of these matters with the City. If you have any questions, or would like to confer, please do not hesitate to contact me directly.

Very truly yours,


Philippe M. Salomon

cc: Mr. Michael Morgese (By Hand & Email)



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May 28, 2008

John Graham, Deputy Comptroller
Audits, Accountancy & Contracts
The City of New York
Office of the Comptroller
1 Centre Street
New York, New York 10007-2341

Re: Response to Audit Report on the Compliance of New York Skyports,
Inc., with its Lease Agreement
FM08-094A

Dear Mr. Graham:

Below is our response to the above referenced draft audit report:

Recommendation: Since Skyports violated the terms of several major provisions in its lease with the City, EDC should consider terminating its lease with Skyports and continue to pursue legal action against Skyports to collect the \$6,056,653.

EDC's Response: EDC agrees. EDC served Skyports with a 7 day notice to cure which expired May 14, 2008. Corporation Counsel on behalf of the City is pursuing litigation to enforce the terms of the Lease and to cure all outstanding defaults.

Thank you for the opportunity to respond to the recommendations in the audit report.

Very truly yours,

A handwritten signature in black ink that reads "Chris Malin".

Christopher Malin
Controller

cc: Seth Pinsky
Jason Wright
Lee Benedict
Hope Mallari