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Ten Lease Provisions That Require Attention In Today's Market

When negotiating commercial leases, attorneys typically focus their attention on achieving the business objectives and protecting the legal rights and remedies of their clients. Often, however, without much thought, attorneys tack on a litany of boilerplate provisions. These boilerplate provisions, which are typically relegated to the end of the lease, are frequently overlooked while the lawyers dwell on the weightier issues. Nevertheless, boilerplate provisions address important legal underpinnings, and if improperly drafted, may have significant legal and financial consequences. A heightened degree of care or "respect" towards crafting lease boilerplate provisions may help lease parties avoid unwanted surprises.

1. Force Majeure

> Sample Provision: "If Landlord or Tenant shall be delayed or hindered in, or prevented from the performance of, any act required hereunder by reason of strikes, lockouts, labor troubles, inability to procure materials, failure of power, restrictive governmental laws or regulations, riots, insurrection, war, environmental remediation work, whether ordered by any governmental body or voluntarily initiated, or other reason of a like nature not the fault of Landlord or Tenant, respectively, the period for the performance of any such act shall be extended for a period equivalent to the period of such delay."

Occurrences defined as constituting force majeure events will excuse lease parties for non-performance, or delay performance, of their obligations under the lease. The party with the most performance obligations will want an expansive definition of force majeure events. In many cases, the determination of whether an event of default has occurred may turn on whether or not the cause for non-performance is within the definition of a force majeure event as set forth in the lease. Since the force majeure provision is effective to excuse a party from liability for non-performance, lease parties often seek to expand the applicability of the provision.

2. Limiting Liability/Exculpatory Provisions

> Sample Provision: "Landlord's liability under this Lease shall be limited to its interests in the Demised Premises, and neither Landlord nor any member or partner in Landlord nor any member, partner in any such member or partner nor any other person having any direct or indirect interest in Landlord, shall have

any personal liability with respect to any of the provisions of this Lease."

Landlords typically require that their liability for claims under the lease be limited by the inclusion of exculpatory provisions. While most tenants will accept such a limitation, many will not permit the landlord to limit its liability in the event of intentional misconduct by adding the following language to the end of the provision:

> Except, as to the Landlord, in the event of (i) misapplication or misappropriation of insurance proceeds or any award paid in the event of a Taking, (ii) misapplication or misappropriation of any amounts paid to Landlord in escrow, in trust, or otherwise paid to Landlord to be used by Landlord for a specific purpose as set forth in this Lease, or (iii) any fraudulent conduct.

In recent cases, tenants have utilized the tort theory of "implied covenant of good faith and fair dealing" to attempt to sidestep exculpation clauses. To avoid such a result, the lease should state that the exculpation clause applies not only to claims under the express terms of the lease but also "to claims of any kind whatsoever arising from the relationship between the parties or any rights and obligations they may have relating to the property, the lease, or anything related to either." Note that exculpability provisions may be contained in various lease sections. Exculpability clauses sometimes appear in estoppel provisions in the context of tenant's agreement to attorn to successor landlords. In such contexts, counsel for the landlord should provide that (a) landlord's liability shall terminate upon a transfer of its ownership interest in the property, (b) successor landlords should not be liable for claims tenant may have had against a former owner, (c) tenants are required to assert claims against the landlord within ninety (90) days after tenant first becomes aware of the facts supporting the claim and (d) tenant indemnify landlord from and against all harm arising from tenant's use and occupancy, all environmental liability and tenant's installations, and require that such indemnification obligation survive the termination of the lease. Conversely, if tenant has sufficient bargaining power, counsel for the tenant may seek to (a) limit the tenant's liability and the liability of the tenant's partners or members to their interest in the lease and (b) allow for release of departing or deceased partners.

3. Notices

> Sample Provision: "All notices to be given hereunder by either party shall be written and sent by personal delivery, by nationally recognized overnight courier service, by registered or certified mail, return receipt requested, postage prepaid, or by an express mail delivery service, addressed to the

party intended to be notified at the address set forth above. Either party may, at any time, or from time to time, notify the other in writing of a substitute address for that above set forth, and thereafter notices shall be directed to such substitute address. Notice given as aforesaid shall be sufficient service thereof and shall be deemed given as of the date received, or, the case of mailing or express mail delivery, shall be deemed given forty-eight (48) hours after deposit with the United States Postal Service. A duplicate copy of all notices from Tenant shall be sent to any mortgagee as provided for in Section _____."

A vague or unclear notice provision may prevent the lease parties from efficiently enforcing critical rights and remedies under the lease. Notice provisions should specifically identify the acceptable methods of delivery, and clearly specify <u>when</u> notices will be deemed to be given.

If allowing hand delivery as an acceptable means of providing notice, the parties should consider whether or not that method is likely to be effective under the particular circumstances presented, taking account of the size of the entities involved and other practical considerations. In addition, the hand delivery method must require an acknowledging signature, receipt or other documentation to evidence the actual delivery. The parties should also consider whether the more convenient methods of facsimile and e-mail will be allowed, which will depend in part on the preferences of the parties and the term of the lease. Note, however that since facsimile numbers and e-mail addresses will likely change over time, the notice provision must provide for the contact information to be updated as needed.

4. Integration Provisions

Sample Provision: "There are no representations, covenants, warranties, promises, agreements, conditions or undertakings, oral or written, between Landlord and Tenant other than herein set forth. Except as herein otherwise provided, no subsequent alteration, amendment, change or addition to this Lease shall be binding upon Landlord or Tenant unless in writing and signed by them."

In general, integration provisions are interpreted by the common law plain meaning rule. When a contract contains an integration clause, extrinsic evidence may not be admitted to prove different or additional terms in the contract, although such evidence may be admitted to interpret ambiguous terms of an integrated contract. Are the exhibits to a lease included as part of the integrated lease provisions? Typically, the parties

will provide that the exhibits are incorporated into the integrated document even when the exhibits are attached or finalized after full execution of the lease. While it is not unusual for the exhibits to be included as part of integrated lease provisions, the parties may overlook the impact of terms contained in the exhibits. The parties acknowledge that none of the prior oral and written agreements between them (and none of the representations on which either of them has relied) relating to the subject matter of this Lease shall have any force or effect whatever, except as and to the extent that such agreements and representations have been incorporated in this Lease.

5. Surrender

> Sample Provision: "At the expiration or earlier termination of the Term, Tenant shall surrender the Demised Premises to Landlord in the same condition as it is required to be maintained by Tenant pursuant to this Lease, reasonable wear and tear and damage caused by casualty, condemnation or the negligence or willful misconduct of Landlord, its employees, agents or contractors excepted."

Lease surrender provisions define the condition in which tenant is required to return to landlord the leased premises. Lease parties frequently dispute and litigate over the conditions required by surrender provisions. If the lease is silent, the standard at surrender is generally that the lessee is under a duty at common law to return the premises in substantially the same condition as when they were received, reasonable wear and tear excepted. It is important to note that when surrender provisions are litigated, a court will likely interpret the surrender provision in the context of the lease as a whole, especially in conjunction with the maintenance provisions contained in the lease. Depending on the scope of the tenant's maintenance obligations during the term of the lease, the tenant may be liable for repairs or replacements at surrender that are not apparent from a reading of the surrender provision alone.

6. Waiver Provisions

> Sample Provision: "No waiver by Landlord or Tenant of any breach of any term, covenant or condition hereof shall be deemed a waiver of any additional or subsequent breach of the same or any other term, covenant or condition. The acceptance of rent by Landlord shall not be deemed a waiver of any earlier breach by Tenant of any term, covenant or condition hereof, regardless of Landlord's knowledge of such breach when such rent is accepted. No covenant, term or condition of this Lease shall be deemed waived by Landlord or

Tenant unless waived in writing."

Waiver provisions in leases address acts or omissions that have the potential to function as a renouncement of rights and remedies otherwise available under the lease. As one New York court explained, "A waiver is the voluntary abandonment or relinquishment of a known right. It is essentially a matter of intent which must be proved." By including waiver provisions in a lease, the parties expressly agree that specific acts and omissions that could constitute a waiver will not be deemed a waiver. Another basic function of waiver provisions is to "give a contracting party some assurance that its failure to require the other party's strict adherence to a contract term... will not result in a complete and unintended loss of its contract rights if it later decides that strict performance is desirable." Basic waiver provisions usually provide that (a) failure to exercise a remedy is not a waiver, (b) no course of dealing constitutes a waiver, (c) a waiver on one occasion is effective only for that occasion and (d) a waiver is not effective against any other person. The parties may also provide that payments or performance made while a dispute is ongoing, shall not be deemed a waiver of any rights.

7. Compliance with Laws

Sample Provision: "Landlord and Tenant agree to comply with applicable laws, with their respective responsibilities to be allocated as follows:

(a) Tenant will be responsible for compliance with all applicable laws, statutes, ordinances and governmental rules, regulations or requirements now in force or that may hereafter be in force with respect to the operation of Tenant's business or the Premises, including, without limitation, any accommodations or alterations that need to be made with the Premises to accommodate disabled employees and customers of Tenant pursuant to requirements under the Americans With Disabilities Act [Public Law 101-336 (July 26, 1990) and the (Applicable State Statute) (collectively, the "Disability Statutes"). Any alterations made to the Premises in order to comply with any such statutes must be made solely at Tenant's expense and such alterations must also comply with the requirements of Section _____ of the Lease.

(b) Except for the obligation of Tenant under clause (a) above, Landlord shall be responsible for compliance with all applicable laws, statutes, ordinances and governmental rules,

regulations or requirements now in force or which may hereafter be in force that affect the Building, including without limitation, the Disability Statutes and local building or fire code requirements applicable to the Building. If such installation constitutes a capital improvement item over $_____ under GAAP, consistently applied, the cost of such installation over $_____ shall be accomplished at Landlord's sole cost and expense and may be charged to Tenant as a part of the Landlord's Common Area Costs of the Building."

Compliance with laws provisions can shift liability to one party for any work and/or costs associated with making the leased premises compliant with government ordered alterations or repairs. In addition, these provisions typically make a tenant's criminal or tortious use of the property an event of default. In general, except for circumstances of unequal bargaining power, in a commercial lease, shifting of liability for the risk and expense of government ordered alterations and repairs is likely to be enforced.

8. Estoppel Certificates/Status Statements

Sample Provision: "As often as reasonably requested, but not more often than two (2) times in any twelve (12) month period, Tenant shall, upon not less than thirty (30) days prior written request by Landlord, execute, acknowledge and deliver to Landlord a written statement certifying the condition of this Lease or the Premises, including, but not limited to, that the Lease is unmodified and in full force and effect (or, if there have been modifications, that the same is in full force and effect as modified and stating the modifications), the dates to which Rent and other charges have been paid, that Tenant has received no notice of an Event of Default by Tenant which remains uncured and Tenant has no off-sets or defenses against Landlord under this Lease, whether or not to the best of Tenant's knowledge Landlord is in default hereunder (and if so, specifying the nature of the default), together with such other information as may be reasonably requested by Landlord (or any mortgagee, existing or prospective, and/or prospective purchaser) it being intended that any such statement delivered pursuant to this Section may be relied upon by a prospective purchaser of Landlord's interest or by a mortgagee of Landlord's interest or assignee of any mortgage on Landlord's

interest in the Premises and/or Building. Tenant's failure to deliver any such statement as required by this Section within thirty (30) days of Landlord's prior written request shall constitute a default hereunder."

Over the term of a lease, estoppel certificates will be required if the landlord seeks to sell or refinance the property. Similarly, large commercial tenants may also require estoppels in the event of a transfer or refinance. The party that seeks the estoppel will want assurances that the other party will promptly execute estoppel certificates, whereas the other party will want to ensure that the form of certificate and turnaround period are not onerous. Since there is potential for significant monetary damages in the event a party is unable to complete a contemplated transfer or financing, the importance of a detailed estoppels provision is paramount. Another consideration when drafting estoppel provisions is to avoid the potential use of an estoppel certificate by one of the parties beyond the intended purpose.

9. Holdover

Sample Provision: "If Tenant remains in possession of the Demised Premises beyond the expiration or earlier termination of the Term, such holding over in itself shall not constitute a renewal or extension of this Lease, but the Parties agree that the value per month of Tenant's use and occupancy of the Demised Premises shall be equal to one hundred twenty five percent (125%) of the then current monthly Fixed Rent in effect at such expiration or termination."

When a tenant fails to vacate the leased premises at the end of the lease term, if landlord continues to accept rental payments, the common law presumption is that the parties have agreed to extend the lease on a month-to-month basis, subject to the original terms of the underlying lease. In general, lease holdover provisions can clarify that tenant's failure to vacate the leased premises is not an extension of the original lease but rather a special, separate agreement. Lease holdover provisions can also delineate distinctions from the otherwise applicable common law. Since leases provide tenants with certain rights and remedies, an extension of the lease would be an extension of those protections to tenant. Regarding the rental rate during a holdover tenancy, it is important to note that some jurisdictions may regard a double or triple holdover rental rate as an unenforceable penalty. In addition, a tenant may ultimately be held liable for the holdover rate even if the landlord initially accepts a lesser amount. Holdover provisions may be impacted by other lease provisions that address termination of the lease term. Accordingly, the tenant expected that the subtenant's rental payments would cover twelve (12) months of the

early termination payment amount.

10. Audit Rights

Sample Provision: "Tenant shall have such right of audit and inspection no more than one (1) time per calendar year during the Lease Term. Tenant shall deliver to Landlord a copy of the results of such review within fifteen (15) days thereafter. Tenant agrees that any information (including, without limitation, costs, expenses, income and any other matters pertaining to Landlord and/or the Project) obtained through any inspection, review or audit pursuant to this Section shall be considered confidential, and Tenant agrees not to disclose such information to others, except to Tenant's agents and advisors (who shall also maintain such information as confidential) and except in litigation between the parties and/or if required under penalty of any governmental agency or pursuant to a subpoena or judicial process, and after notice to Landlord and an opportunity for Landlord to be heard by an appropriate court on the matter. Provided Landlord's accounting for real estate taxes or Landlord's Common Area Costs is consistent with the terms of this Lease, Landlord's good faith judgment regarding the proper interpretation of this Lease and the proper accounting for real estate taxes or Landlord's Common Area Costs shall be binding on Tenant in connection with any such audit, review or inspection. If Landlord and Tenant determine following any audit or review pursuant to this Section that Landlord has overcharged Tenant its share of Common Area Costs, then such amount shall be applied against Common Area Costs next coming due under the Lease (except that following the expiration of the Term, any such excess shall be promptly refunded to Tenant, except to the extent of any default by Tenant beyond applicable cure periods). Notwithstanding the foregoing, (a) if the results of the audit reveal that Landlord overstated real estate taxes or Landlord's Common Area Costs by ten percent (10%) or more, Landlord shall reimburse Tenant for Tenant's actual out of pocket costs and expenses of the audit (not to exceed $_____); (b) if the results of the audit reveal that Landlord overstated real estate taxes or Landlord's Common Area Costs by three percent (3%) or less, Tenant shall reimburse Landlord for Landlord's

actual out- of- pocket costs and expenses of the audit (not to exceed $_____); and (c) if the results of the audit reveal that Landlord overstated real estate taxes or Landlord's Common Area Costs by more than three percent (3%) but less than ten percent (10%), then Landlord and Tenant shall each be responsible for their own out- of- pocket costs and expenses of the audit and neither party shall have any right to seek reimbursement from the other party for such costs and expenses. Any compromise, settlement, or adjustment reached between Landlord and Tenant relative to the results of the review or audit shall be held in strict confidence by the Tenant and its officers, agents, lenders and employees. No subtenant or assignee shall have any right to conduct any such audit, inspection or a review."

Leases typically contain payment provisions pursuant to which one of the parties is required to calculate the amount payable by or to the other party. Examples of such provisions include the calculation of operating expenses by the landlord and the determination of percentage rent payable by the tenant. In such instances, the party responsible for calculating the amount payable often has a measure of discretion in making such calculations, usually in connection with determining which items are permissibly included and to what extent. Detailed provisions regarding the exclusions from operating expenses and from the definition of "Gross Sales" for purposes of calculating percentage rent are critical in a well drafted lease. Nevertheless, the party relying upon a calculation made by the other lease party, should have a mechanism for verifying the accuracy of the calculation. Audit right provisions typically provide this mechanism. In lease audit right provisions, the devil is in the details, or rather the lack thereof. A well drafted audit right provision should, at a minimum, specify the audit timing, procedures, required documentation and the persons or entities qualified to perform the audit. In addition, audit right provisions should also contain some "teeth," i.e., a meaningful penalty if the amount reported is not accurate. Typically, if the audit reveals that the submitted calculation varies from the actual amount by a specified percentage, then not only is the other party entitled to recover the difference, but usually the costs of the audit and other penalties may be imposed upon the party that submitted the inaccurate calculation. Audit provisions should also include a method for dispute resolution. An audit provision should specify the type of documentation that the auditing party may request to verify the accuracy of the reported amounts. A detailed audit provision that specifies the nature of the required back-up materials can avoid disputes about whether the auditor can review primary documentation of expenses such as receipts and invoices, or whether the auditor must instead rely upon secondary sources, such as the landlord's financial statements. Additionally, disputes over what documentation should be reviewed during an audit may be driven by the specificity of other lease provisions. Since operating expenses are

typically based on proportionate square footage of a tenant's leased premises in relation to the total square footage of the building, verification of square footage measurements is a frequent subject of audit rights. Many leases include a statement that the size of the leased premises is approximated, and that the parties agree to use the approximated figure for the purposes of calculating certain payments due under the lease, e.g., " 'any statement of size' in the lease or used to calculate rent 'is an approximation which the Parties agree is reasonable and any payments based thereon are not subject to revision whether or not the actual size is more or less.'" Nevertheless, such language may not protect a commercial landlord from claims of fraud or misrepresentation if square footage measurements are materially inaccurate. Accordingly, to the extent feasible, leases should include the precise square footage figures or provide for a procedure for measurement. If an audit right includes square footage verifications, the lease drafter should define and limit the remedies for inaccurate measurements. Typically, if an audit reveals that a party's submitted calculation varies from the actual amount by a specified percentage, then not only is the other party entitled to recover the difference, but usually the costs of the audit and other penalties may be imposed upon the party that submitted the inaccurate calculation. An example of such a percentage threshold is an overcharge of 5% or more by a landlord for operating expenses. If the audit reveals such an overcharge of 5% or more, then tenant should receive the full amount of the overcharge, the landlord should pay for the cost of the audit, and landlord may incur some additional penalty. An example of an appropriate landlord penalty might be an agreed upon offset or credit amount against future payments or a lump sum payment to tenant. To limit exposure for such claims, lease parties may provide for a cap or limit of liability for such miscalculations. One way or another, a good audit provision must provide some form of finality. When the lease parties do not agree on the proper calculation of a sum due under the lease, an audit right may provide a dispute resolution procedure. Such a provision should also indicate that the outcome of the dispute resolution procedure will be the "sole and exclusive remedy" of the parties. Alternatively, some leases provide that a landlord's invoice is a "final determination" of additional rent due unless tenant disputes same within 30 days after such figures are furnished. Other leases simply preclude disputes by specifying that a tabulation by a designated person will be deemed a binding "final determination."

Landlord audits of tenants' percentage rent calculations are a frequent subject of litigation. Case law reveals the nuanced disputes arising from percentage rent disputes, including (1) the correctness of excluding sales to "wholesalers" from gross sales calculations, and (2) interpretation of the phrase "due and payable" when calculating accrual of interest.

There are numerous other provisions which have come into play as a result of the economic slowdown. In particular, "use" provisions addressing continuous use and restrictions are at the top of several client's lists as both parties vie to make the center more viable. In difficult

economic times almost every provision is scrutinized so particular care must be paid to those provisions which are commonly overlooked.

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