Who's Afraid of the Big Bad Lease?

Ten Terms to Watch for in Commercial Leases

By Kate Henry

Navigating a commercial lease can be like wading through shark-infested waters – the language may look familiar and favorable, but lurking in the next sentence could be a clause that jeopardizes your client's interests. While all leases are different in format and scope, the following ten terms generally appear in the majority, and are worth getting to know before you jump in to a negotiation on behalf of a client.

1. Damages

The two most common types of damages are Liquidated Damages ("LDs") and Consequential Damages ("CDs"), and as the word itself implies, they serve as a remedy for one party when the other breaches in some way. LDs are usually stated as a per diem amount, payable for each day of a default. If you are unsuccessful in striking them from a lease, a good option is to limit the timeframe by inserting a start and end date, and/or limit the overall amount your client could be liable for by capping the total damages. CDs are a little trickier; in most states they are "implied" – meaning you will not see anything to the tune of "Tenant shall be liable for Consequential Damages if…." In my practice, we call CDs the "Aphonic Assassin." The problem with CDs is they are extremely hard to calculate – how exactly does one determine the value of reputation or good name? Accordingly, the amounts awarded can vary greatly, which may pose too big a risk for a smaller client. The only way to ensure your client will not be liable for CDs is to strike any express provision conferring liability, or to insert a waiver. Most commonly accepted are mutual CD waivers such as "Neither party shall be liable for consequential damages, including, but not limited to, loss of profits, loss of good will, loss of business opportunity, additional financing costs or loss of use of any equipment or property."

2. Additional Insured Parties

Remember when you first got your driver's license and your parents begged you to buckle up, drive slowly, keep off the highway, and avoid parallel parking at all costs? Part of the reason for that is you were likely an Additional Insured on their car insurance policy – meaning if you had an accident or claim, **their** insurance rates go up. Same goes for Additional Insureds on a company Commercial General Liability ("CGL") policy: if a landlord requires to be named as an Additional Insured by a tenant, that landlord is entitled to all of the same benefits as the tenant is under their policy, and any claims paid because of the landlord chip away at the aggregate and could have a lasting impact on the tenant's insurance rates. One way around this is to procure a separate policy in the name of the landlord, where they would be a "Named Insured" and separate from the tenant's CGL. Another strategy, although less likely to pass muster with larger landlords, is to add the caveat that the tenant-provided insurance is secondary to the landlord's own insurance.

3. Force Majeure

This fancy French phrase really just means an unexpected, disruptive event, usually in the form a gift from Mother Nature such as a hurricane. While it may seem reasonable to

excuse performance for forces of nature, it is important to take into account the location of the property, duration of the term, and effect of the Force Majeure (FM) clause on the parties. For example, if you represent a tenant who plans to rent space in a large warehouse in southern Florida, and the landlord wants to enter into a twenty-year lease, it would be important to word the FM clause in a way that protects the tenant via rent abatement or termination/suspension rights in the event of a hurricane, since a hurricane would likely hit southern Florida at least once during that twenty-year term. Often, FM clauses can be drafted to include non-weather-related occurrences specific to your client's needs: for example, if your client is a unionized company prone to labor disputes, think about including strikes, labor disputes and lockouts as FM events so your client might avoid liability should one occur.

4. Indemnity

Everyone likes a little assurance that they will not be forced to bear a burden that is not theirs. A fair Indemnity provision will have a tenant protecting the landlord against liability from the tenant's negligent acts and omissions and willful misconduct, and vice-versa. The two key things to look out for in an Indemnity clause are a defense obligation and liability for the actions of other parties. When the word "defend" appears in the Indemnity, you have an express defense obligation on your hands – meaning if the conditions of the provision were met (e.g. the tenant was negligent), that tenant have to retain and pay for an attorney for the landlord – in addition to paying for their own legal fees. Some crafty drafters will even require the indemnified party be the one to select the attorney – meaning they could choose a senior partner at a top firm and your client would be stuck paying the bill. Reworking the defense obligation of an indemnity clause, as well as striking or limiting any other language regarding repayment of legal fees, could save your client an enormous amount of money. The second key thing to look for is liability for the actions of other parties. Making a client liable for their own actions as a tenant is fair; having a tenant liable for the landlord's actions, and often any affiliate, representative, invitee, licensee, etc. of the landlord, is risky. Since there is little a tenant can do to control the actions of the landlord or any other third parties, a good strategy is to negotiate a fair indemnity where each party is liable for only its own acts and omissions.

5. Termination for Convenience

Most commercial leases contain several termination clauses, with the most common being Termination for Default – meaning if one of the parties defaults on an obligation under the lease, the non-defaulting party has the right to cancel the agreement altogether. Termination for Convenience is an extremely powerful lease term because it literally allows a party to terminate the lease for any reason whatsoever, or no reason at all. Consider this: if your client, a family-owned restaurant, spent $500,000 building out the space they leased from a corporate strip mall landlord, and then the landlord decided two months later it wanted to exercise its right to terminate for convenience, your client's financial future could be devastated. Two important remedies to include if you see a Termination for Convenience clause are Notice and Net Book Value Protection. Without an express Notice provision, your client is only afforded the statutorily required notice period of that state – which can be only a few days in certain jurisdictions. While 30

days notice is standard in commercial leasing, a common tactic is to negotiate for 60, 90, even 120 days, depending on factors such as the term of the lease, the extent of tenant improvements prior to opening for business and refurbishment requirements throughout the term. A Net Book Value Protection clause will allow a tenant to reclaim some of the capital invested in the space should the landlord terminate for convenience. Most commercial landlords will agree to some form of reimbursement based on straight-line amortization of tenant improvements, and you can also bargain for title to fixtures. While this does not compensate for the value of the business itself, these negotiated for changes can offer a tenant some protection again termination by the landlord for convenience.

6. Cross-Default

Imagine your client is the owner of a budding chain of perfume shops, and entered into a contract with a major corporate landlord to put a shop in a mall in each of the fifty states. If your client's leases contain a Cross-Default clause, then a default at the perfume shop in Alaska would mean all forty-nine other leases were then in default. This leasing term is clearly pro-landlord! To protect your client's interest, strike the Cross-Default language or negotiate a fair cure period to allow your client to remedy the default in the one lease before all the others are pulled in the undertow.

7. Asbestos

While not a concern in newer buildings, asbestos is still a looming problem in older construction. The issue with Asbestos clauses in commercial leasing is two fold: first, who is responsible for abatement, encapsulation or removal if Asbestos is found onsite, and second, what happens to the space during that work. Some leases will try to place responsibility on the tenant if the Asbestos is not discovered during the tenant's building inspection prior to turnover of the space. In representing a tenant, always negotiate the lease to ensure the owner of the building, the landlord or the building management company is responsible for abating, encapsulating and removing any Asbestos, regardless of who discovered it or when it was discovered. Additionally, add a clause either granting rent abatement or use of a similar space during the Asbestos work, to ensure your client doesn't suffer financially.

8. Alternative Dispute Resolution

More and more commercial landlords are choosing to resolve disputes out of the courtroom, generally via Arbitration or Mediation. While an Alternative Dispute Resolution (ADR) clause can wind up saving your client quite a bit of time and money compared to litigation, it is important to ensure the language meets your client's needs. Be sure that the neutral who will serve as arbitrator or mediator is selected through a process that is fair to both parties, and include a condition that the neutral can not be in any way related, affiliated with or politically connected to either party, to ensure complete neutrality. Require the use of established ADR processes, such as adhering to the rules of the American Arbitration Association or the International Institute for Conflict Prevention and Resolution. Depending on the nature of your client's business and their particular goals, you may want to agree to only non-binding arbitration, leaving your client free to pursue other remedies available at equity and law. Additionally, be sure to determine the location of the arbitration when negotiating the ADR clause – if the

landlord's corporate office is in Texas, but your client is renting space in Boston, it might be in your client's best interest to have the arbitration in Massachusetts.

9. Assignment

The "re-gifting" clauses of the commercial leasing world, Assignments are commonplace in today's ever-changing market, much to the chagrin of landlords. Frequently, an assignment clause will be laden with conditions that must be met before an assignment can be effective, the most common being advance written permission of the landlord. While this is certainly reasonable, be sure you thoroughly understand your client's business structure before negotiating an assignment clause. For instance, if you represent a small subsidiary of a Fortune 500 company that has a dozen other companies under its corporate umbrella, you might try to negotiate that an assignment to another subsidiary requires only notice, not advance landlord approval. Similarly, if you represent a father who is contemplating handing his business off to his son in a few years, the Assignment clause should allow for this change without the son having to go through too many hoops.

10. Holdover

What happens when a lease runs out and neither landlord nor tenant has secured an extension, amendment or entered into a new lease? If there is a Holdover clause in the lease, it likely contains astronomical penalties for the tenant once the lease expires, often requiring rental payments in excess of 200% of the originally agreed to amount. While most state laws address this issue by creating a monthly tenancy, the language in the lease will also apply, meaning your client may be paying quite the premium to remain in the space. A good strategy is to buffer the Holdover clause by tolling any penalties during re-negotiation of the lease terms or negotiating an amendment. Another idea is to have the lease go month-to-month upon expiration, with a Termination for Convenience clause exercisable by either party during that monthly tenancy, and have the Holdover clause only apply if the lease is terminated, not simply because it expired.

While there are many more commercial leasing terms out there, the above ten represent a good sampling of the most important clauses that could affect your client's financial security in his or her business. Not meant to be an exhaustive review of these issues, but rather a general overview of the problems a tenant might face, this foray into commercial leasing is a good way to get your feet wet. The more leases you negotiate, the more familiar with the subtle nuances of these terms you will become, and the more adept you will be at drafting language that is not only in your client's best interest, but also likely to be acceptable to the other party as well. After all, in Commercial Leasing, both parties essentially want the same thing: get the tenant in the space. Keep in mind this common goal, focus on fairness, and you will be in for smooth sailing!

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