

NEGOTIATING THE COMMERCIAL LEASE

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NEGOTIATING THE COMMERCIAL LEASE

A. NEGOTIATING TERMS AND NEGOTIATION PROCESS

The negotiation and preparation of a lease begins with the core business elements, such as the rent, location and size of the premises, term of lease, and any improvements to be constructed in the space by the landlord or the tenant. These kinds of issues are frequently delineated in a letter of intent or term sheet.

One of the most important factors in the negotiation of a lease is the choice of form. While the lease provisions themselves will ultimately be the focus of the parties' discussions, no matter how detailed and thorough the negotiations, the starting point significantly influences the final product. For example, a shopping center owner normally provides a form lease on which the negotiations are based, and by doing so, dictates the parameters of the negotiation and negotiates from a position of strength. The owner generally maintains the right to draft any agreed upon changes to the form, and in doing so, carefully controls the concessions that may be made to the tenant. Nevertheless, if a retailer, such as a large national anchor store, has significant bargaining power, that retailer may exercise such power by insisting that *its* lease form be used, thereby controlling the boilerplate terms of the lease.

The first rule to follow when drafting a lease is to be careful to include the entire agreement of the parties. In light of the parole evidence rule, as well as the "integration clause" included in virtually every lease, promises, representations, understandings and pledges not found in the lease are, in most cases, not binding upon the parties. Consequently, both parties should include any statements, promises, understandings,

representations and agreements considered to be part of the deal in the written document itself.

The other important rule to follow in the preparation and negotiation process is that the lease should be drafted in a way that is clear and understandable. Failure to do so may result in potential disputes over the meaning of the terms, and if there are any ambiguous terms, the provisions in question generally will be construed against the drafter. The parties must keep in mind that, in order for the document to be properly enforceable and practically effective, it must clearly spell out the parties' intent. While the parties involved in the negotiation of the lease may "know what they mean" with the language of the document, they must ask themselves whether their respective successors in interest and an impartial judge will "know what they mean" when they look at the words on the paper years down the road.

Thorough planning prior to and during the negotiation and drafting of a lease can prevent many problems that would otherwise arise during the life of a lease and help the parties to address those problems that will arise during the term. In the lease preparation and negotiation process, the parties must keep in mind their respective legal duties and responsibilities as landlord and tenant, and they should also anticipate possible economic, legal and operational problems that may arise during the lease term. For example, in the context of a retail lease between a shopping center owner and a large department store anchor tenant, the failure to include a clearly stated continuous operation covenant with respect to the tenant may result in a situation in which the anchor tenant of a shopping center has no duty to continuously use and operate in the premises, despite the shopping center owner's intentions to impose such a duty. In the absence of such a duty, an anchor tenant could close its doors, and the entire shopping center, which is, at least in part, dependent upon the foot traffic generated by such an anchor, may lose customers. That loss of customers means a loss of sales for tenants (which could put them out of business), a loss of

percentage rent proceeds for the landlord, and ultimately, a reduction in the value of the shopping center property.

B. BASIC LEASE TERMS

A lease should contain certain essential elements. Particular circumstances may require specific drafting. Generally, the most important elements are:

- (1) The parties;
- (2) The premises;
- (3) Base rent and other rental charges;
- (4) Term;
- (5) Authorized use by tenant;
- (6) Construction responsibilities with respect to improvements or alterations to the premises;
- (7) Tenant's assignment and subleasing rights;
- (8) Responsibilities with respect to the condition and maintenance of the premises;
- (9) Parties' rights and remedies in the event of a default;
- (10) Parties' respective rights and obligations in the event of damage, destruction or condemnation of portions of the premises; and
- (11) Any rights of third parties.

C. ISSUES SPECIFIC TO COMMERCIAL LEASES

With the exception of the basic requirements required by subtitle 1 of the Real Property Article, commercial leases are generally fully negotiated because all terms are subject to negotiation. Therefore, the drafting of a commercial lease requires an understanding on the part of the drafter of the significance of each clause as it relates to

the parties' legal relationship, as well as the relevant legal, tax and economic consequences.

1. Common Lease Provisions

(a) The Parties

The major issue in this section of the commercial lease is defining and identifying the parties to the transaction. This seems to be a simple matter, but is complicated by the fact that both the landlord and the tenant may want to choose among several business entity options before they enter into the lease. It is further complicated by the fact that the parties may need lease language that permits them to modify the entity form or to merge into, sell or assign their respective interests to third parties.

Commercial landlords should scrutinize the tenant entity that will be executing the lease agreement. In making this decision to whom to lease, the landlord should take into account the entity, entities or individuals that the landlord wishes to bind to the lease. For example, if the tenant is a start-up business, with little in the way of assets and income, the landlord may require that the principal of the business, and even his or her spouse, sign as the "tenant" or guarantor on the lease in order to provide the landlord with some security for the performance of the tenant's lease obligations.

(b) The Premises

It is necessary in every lease to provide an exact description of the premises being let. The premises must be described in a manner that permits parties to the transaction to know exactly what property is conveyed by the lease. Otherwise, the lease may be in danger of being held unenforceable by the courts or, at a minimum, creating confusion between the parties. Therefore, the complete description of the premises and its precise

parameters is often referenced at the beginning of the lease and also attached as an exhibit. Note also that the premises clause should include a reference to any applicable appurtenances, such as rights to utilize common areas in common with other tenants, driveway easements, and other rights needed for the full use and enjoyment of the property.

(c) **Usable/Rentable Areas**

In lease negotiations, rent usually involves a dollar cost per square foot, which is converted into actual annual and monthly rent figure payable under the lease. A common method to calculate annual rent is to multiply the square footage by the cost per square foot. In addition, the tenant can also be charged rent for its share of the common areas, referred to in various terms, such as load factor, gross-up core factor or conversion factor. This mark up of the usable area is often used as a method to allocate those common area costs among the various tenants. In other words, the area actually occupied by the tenant, the usable area, is converted to a figure representing the area for which the tenant is charged rent after the load factor is applied, and is then known as the rentable or leasable area. The calculation to determine the “rentable” and “usable” areas is found in the American National Standard Method for Measuring Floor Area in Office Buildings, Building Owner’s and Manager’s Association International (the “BOMA Standard”)¹ and other standardized methods of measurement utilized by architects and real estate professionals.

¹ To purchase a copy of the standards, see The Building Owners and Managers Association (BOMA) International, <http://www.boma.org>. There are other standards, such as those promulgated by some Boards of Realtors.

(d) Calculating Tenant's Costs Pro Rata Share

Costs incurred by landlords in connection with the ownership and operation of multi-tenant commercial property, such as real estate taxes, operating costs, and insurance, are advanced by the landlord and often passed on to tenants as additional rental items based upon the tenant's pro rata share of the building or property to which such costs apply. This is usually done by determining the tenant's "pro rata share" of such costs — a calculation that involves the comparison of the rentable or leasable area of the premises to the total rentable or leasable area of the subject building or property.

There are two basic methods of allocating such costs among multiple tenants at a property. The first is most commonly used in the office leasing market, in which base rental rates payable by the tenant are expressed as "full service" figures (meaning that the base rent being paid by the tenant encompasses the landlord's current carrying costs for the property, such as taxes, insurance, maintenance, and operating costs). In such "full service" leases, a base year or base amount is established, whereby the landlord bears the costs during the base year or for the base amount, and as costs increase over the base, those increased costs are passed onto the tenant in subsequent years of the lease term. The second method is commonly used in the retail market, in which base rents are often expressed on a "triple net" basis (meaning that the base rent is exclusive of and does not take into account, the landlord's carrying costs for the property, such as taxes, insurance, and maintenance and operating costs). Under such an arrangement, the tenant's rental obligations, from day one, include a base rent, as well as the tenant's pro rata share of real estate taxes, insurance, and operating and maintenance costs (often referred to as a common area maintenance charges or "CAM").

(e) Option to Expand

A clause providing for an expansion of the lease to include greater space is not found in every lease, but it is often requested by office and retail tenants who anticipate growth in their business and a corresponding need for additional space. There are two common alternatives that are preferable from the landlord's perspective to a tenant's absolute right to expand, namely, the "right of first offer" and the "right of first refusal." In the former case, the landlord must offer specific additional space that becomes available to the tenant before offering the space to third parties. In the latter case, the landlord may negotiate the terms of a lease for the subject expansion space with a third party, but the landlord must disclose those terms to the tenant and offer the tenant the space on these terms before the deal may be consummated with the third party.

(f) Base Rent and Other Rental Charges – Base Rent, Plus

In most commercial leases, the term "rent" usually encompasses several categories of payments that the tenant makes on a regular basis to the landlord. The most basic component of the tenant's rental obligations is generally referred to as "basic rent," "fixed rent" or "minimum rent." In a commercial setting, this component is generally calculated based on an annualized per square foot structure and is payable on a monthly basis in equal installments. The leasable square footage of the premises is utilized to calculate this component. Additional rental items also include those related to charges incurred by the landlord and subsequently passed through to the tenants, such as real estate taxes, operating expenses and insurance costs. In retail leases, tenants are often obligated to pay landlords, as additional rent, a small percentage of the tenants' sales when such sales reach a certain threshold. Such additional rent is referred to as

percentage rent and is addressed in greater detail below. All of these additional rental items other than basic or minimum rent are frequently collectively referred to in the lease as “additional rent” (and classifying all such payments as “rent” is important from the landlord’s perspective in that it allows the landlord to exercise its full range of legal remedies in the event of non-payment by the tenant).²

(g) Landlord Costs Passed Through to Tenants

As outlined above, in most commercial leases, it is common for the tenants, collectively, to bear some, if not all, of the costs incurred by the landlord in connection with the operation of the property, whether it is office, retail or industrial. There are a number of ways in which these costs can be apportioned between the landlord and its tenants. Generally, office building landlords will absorb the cost of the real estate taxes and the operating and insurance expenses incurred in a base year (most often, the calendar year in which the lease term commences), and the tenant will be responsible for its particular pro rata share of any increase in costs incurred over that amount. Conversely, retail tenants usually are responsible for their pro rata share of all common area real estate taxes, operating expenses, and insurance expenses.

The pro rata share is utilized to apportion the tenants’ collective share of the real estate taxes and operating and insurance expenses among the tenants. Each tenant’s individual “pro rata share” is most often determined by the proportion of the entire leasable space at the property that each individual tenant occupies. This method of allocating responsibility for these costs among individual tenants emphasizes the need for

² *Univ. Plaza Shopping Ctr., Inc. v. Garcia*, 279 Md. 61, 367 A.2d 957 (1977); see also *Shum v. Gaudreau*, 317 Md. 49, 562 A.2d 707, 715 (1989) (holding that under *Garcia*, a commercial lease defining rent to include “repairs and renovations to the leased premises” was not so broad as to include the drilling of a new well, “at a different location from and of a different capacity than the old one”).

each tenant's premises to be accurately and precisely measured. Precision is also needed in defining the terms "operating expense" and "common area expenses" so that both parties clearly understand which costs may be passed along to the tenants, and which costs must be absorbed exclusively by the landlord.³

(h) Percentage Rent

Percentage rent is utilized by retail landlords as a method of capturing a portion of the retail success of their properties. The parties generally agree upon an annual sales threshold and a split of any additional sales over that threshold.

(1) Gross Sales: Percentage rent is always structured as a percentage of the tenant's gross sales, frequently above a certain threshold. To avoid future disputes over the amount of percentage rent owed, great care must be taken in defining the term gross sales. Tenants will seek certain exclusions to the definition of gross sales, particularly items that are related to that portion of income that is a pass-through or that is not profit-producing such as returned merchandise, casualty loss recoveries, bulk sales and sales or other taxes.

(2) Calculation of Percentage Rent: The percentage of sales payable by a tenant to a landlord is always a negotiated business point in a lease which includes percentage rent. The agreed upon percentage is frequently applied against sales over a certain threshold sales amount. In many cases that sales threshold, referred to as the "natural breakpoint," is derived by dividing the annual minimum rent paid by the tenant to the landlord by the percentage of sales agreed upon in negotiations.

³ See *Gebhardt & Smith LLP v. Md. Port Admin.*, 188 Md. App. 532, 982 A.2d 876 (2009) (holding that repair of hurricane flood damage fell within the definition of "operating expense" under the lease terms and that the plaintiff was responsible for a portion of the repair costs).

(3) Recent Developments: Many retail landlords are moving away from negotiating for percentage rent and are instead asking for higher base rents. This minimizes the landlord's risk (and upside) and produces more predictable cash flows. In addition, the elimination of percentage rent also does away with the need for monitoring the tenants' sales by the landlord and additional recording and accounting obligations on the part of the tenants.

(i) **Term**

The length of a particular lease term is simply a matter of negotiation between the parties. However, agreement regarding the term also involves the resolution of more particular issues regarding the precise commencement and expiration of the term. For example, retail tenants will not want their business interrupted during the important winter holiday shopping season and will, therefore, oppose having either the commencement or termination date fall within the months of at least November and December. Similarly, to the extent that the tenant is undertaking improvements or alterations in the premises at the outset of the term, tenants will not want the term (or their rental obligations) to commence until the work is completed and the premises can be used for its intended purpose. Conversely, landlords will want to limit the "free rent" or "construction" period during which the premises are generally occupied by the tenant without rental income.

In addition to the foregoing, from the landlord's perspective, one of the most important concerns is whether the landlord will be able to provide the tenant with possession of the premises by the agreed upon commencement date. This date must be set so that the previous occupant of the premises will have vacated and all construction

required in the premises will be completed by the commencement date. Landlords are aware that the previous tenant may hold over after the expiration of its lease and that the new tenant's construction may not be completed on schedule. Therefore, landlords will want to set up the commencement date as a "floating date," which is dependent upon when the premises can actually be delivered. Landlords will also seek protection in the lease from exposure to liability in the event that they are unable to provide the new tenant with possession by the commencement date. Conversely, tenants will desire protective language in the lease regarding the possibility that the landlord will not have the space available by the targeted commencement date.

Aside from the commencement and expiration dates, the parties may agree to several other provisions that will affect the term of the lease. For instance, the tenant may be given an option to renew or extend the term of the lease for a specified period of years. Although clearly desirable from the tenant's standpoint, the landlord will have several concerns with such a provision. Some of these concerns can be addressed in the lease (1) by providing that the tenant may not exercise its option if it is in default under the lease; (2) by providing for adjustments in rent during the renewal term; and (3) by requiring the tenant to give advance notice to the landlord that it is exercising its option.

The tenant may also be given the right to terminate the lease before the end of the stated lease term. Landlords are extremely reluctant to grant such rights, however. They feel that if a tenant agrees to a set term, the tenant should be obligated for the entire term of years and should not be allowed to escape from its lease before the term has expired. Therefore, except in weak rental markets, if landlords grant a right to early termination at

all, they will usually demand a significant termination payment in the event that the right is exercised.

(j) Authorized Use by Tenant

In most commercial leasing transactions, the lease itself places limits on how the tenant may use the premises. These limitations may be drafted in a broad or general fashion, such as “general office use,” or defined specifically, such as “retail flower shop.” Such limitations can create obstacles for tenants who wish to modify the use of their premises or to transfer their interest in their premises to a transferee who may engage in a different business (and thus seek to use the premises in a manner different from that defined in the lease with respect to the original tenant). In addition, in the case of some retail leases, affirmative obligations regarding the operation of the tenant’s business may also be imposed for the landlord’s benefit.

(k) Restrictions on Use

The use restrictions placed on office space tenants can be, to an extent, uniform. These restrictions are far less onerous to deal with from the tenant’s point of view than the limitations found in most retail leases. Retail leases tend to place more use restrictions on tenants because landlords at shopping centers have a vested interest in the makeup of the tenant mix at a particular property. Thus, many retail leases contain detailed covenants and rules, which ensure that the type of business conducted from the tenant’s premises is firmly within the landlord’s control. As a result, during the lease negotiations, the use restriction clause can become a contentious issue. Landlords will negotiate for highly specific use clauses, such as: “For retail sale of women’s careerwear at upper price lines and for no other purpose.” Tenants, on the other hand, desire broadly worded

clauses such as: "The parties intend that the premises be used for the retail sale of women's clothing. Tenant covenants that it shall not use the premises at any time for nonretail purposes except as may be ancillary to the use of the premises as a retail store." In the latter case, courts will most likely interpret such a clause as being permissive rather than restrictive.

(l) Exclusive Use

By granting the tenant the exclusive right to engage in a certain line of business or the sale of specific products, the landlord's right to lease the remainder of its property is restricted. These exclusive use clauses prevent the landlord from leasing space in the property (or, depending on the lease language, neighboring properties under the landlord's control) to tenants who may compete with the tenant's retail operations. Such provisions are often used by landlords as an incentive to attract desirable tenants. When a landlord agrees to such covenants, however, the landlord must be certain to maintain control of all uses within the shopping center. Otherwise, the landlord may face the prospect of litigation if a tenant over whom it has little control decides to sell merchandise that is within another tenant's exclusive covenant.

(m) Zoning Laws

The tenant should confirm that the contemplated use of the premises is allowed under applicable zoning laws. For instance, if the use clause provides for a commercial use in an area that is zoned only for residential uses, the tenant may not claim that the

lease is void for illegality if the illegal use can be made legal by obtaining a special exception to the zoning laws.⁴

(n) Continuous Operation

Because of the negative impression that vacant, dark retail space gives to potential customers, retail landlords often insist upon covenants in leases that require tenants to remain open and regularly operate their businesses. In addition, because landlords often plan the development of retail properties based upon a certain tenant mix, landlords often depend upon large or well-known “anchor tenants” to draw business to the shopping center. The cessation or interruption of operations by an anchor tenant can have a major impact on the number of patrons to the shopping center. Because landlords are acutely aware of the economic reality of tenants’ interdependence, landlords often impose a continuous operations clause in the lease with, at the least, the anchor tenant to try to ensure that the anchor tenant maintains an active and operational business. Absent an express provision, some courts have held that the tenant is under no obligation to occupy or continuously operate its business in the premises.⁵

(o) Construction

Often the parties enter into a lease before the premises has been made suitable for the tenant’s use. As a result, the lease must clearly delineate the parties’ responsibilities leading up to the time that the space is ready for occupancy by the tenant. Under these circumstances, the lease must apportion responsibility for the work that is necessary to

⁴ See *Custer Envtl. v. 9305 Old Georgetown Rd. P’ship*, 345 Md. 284, 691 A.2d 1336 (1997).

⁵ Although Maryland courts have upheld express continuous operation provisions, they have not addressed whether there may be an implied covenant of continuous operation. However, it may be instructive to look to District of Columbia case law for guidance. In *Cong. Amusement Corp. v. Weltman*, 55 A.2d 95 (D.C. App. 1947), the District of Columbia Court of Appeals held that, without express language, a use restriction provision in a lease does not imply a duty of continuing use or any use at all.

render the demised premises ready for the tenant's occupancy. In addition, a schedule is usually established, and the respective parties may be granted the right to approve the work done by the other. The respective parties' rights to alter or improve the premises or the surrounding areas during the lease term should also be specifically addressed in the lease in order to avoid future disputes. There are various approaches to apportioning the parties' respective construction responsibilities. These approaches are referred to by using terms like "turnkey," "shell plus allowance - landlord builds," "shell plus allowance - tenant builds," and "build to suit."

In a turnkey situation, the landlord is responsible for performing all of the improvements necessary to allow the tenant to operate in the premises. Upon completion of such work, the premises are delivered to the tenant, and the term commences. The landlord is solely responsible for all costs associated with the improvements or alterations to the premises.

In a shell plus allowance situation, the parties agree upon a definition of the basic improvements necessary to construct the "shell" of the premises. The cost of any improvements necessary to bring the premises up to the required "shell" condition are borne exclusively by the landlord. The parties then agree upon the improvements to be constructed in the premises in addition to the shell in order to ready the premises for the tenant's use (often referred to as "tenant's improvements"). The parties also agree upon the extent of the landlord's financial responsibility for these tenant improvements, with the understanding that any additional costs will be borne by the tenant. That portion of the tenant improvement costs that the landlord agrees to pay is usually referred to as the "improvement allowance."

In a shell plus allowance situation where the tenant is responsible for building the tenant improvements, the landlord usually delivers the premises to the tenant in “as is” condition (or after having made the necessary changes to render the premises to the agreed upon “shell” condition). Such an arrangement is most common in retail leases.

Regardless of which party is performing work in the premises, the parties should identify the issues and then establish deadlines and notice provisions for each. The following checklist generally addresses the issues to be covered in developing a construction schedule:

- Drawing preliminary plans;
- Approval of preliminary plans by other party;
- Preparation of working drawings (final plans);
- Approval;
- Resolving a dispute concerning terminating the lease, submitting to an independent party, or setting a time limitation for action;
- Putting plans out to bid;
- Evaluating bids;
- Revising plans if necessary to reduce costs;
- Obtaining building permits;
- Commencing construction;
- Notice to tenant thirty days in advance of completion; and
- Substantial completion (that level of completion sufficient to permit the tenant to occupy the premises for its intended purpose).

(p) Assignment and Sublet

An important and heavily negotiated lease provision is the assignment and sublease clause. Tenants are aware that unexpected circumstances may arise in the future, and this clause represents an important and often the only means by which a tenant can extricate itself from a lease. In addition, several years into its lease term, the tenant may discover that its lease has become a valuable asset for which other businesses are willing to pay. On the other hand, landlords take great care in choosing their tenants, and landlords want the ability to prevent these tenants from assigning or subletting their leases to persons or businesses that will be unable to meet the lease obligations or would otherwise be objectionable to the landlords. Consequently, landlords will at least negotiate to retain reasonable review and approval rights with respect to proposed subtenants or assignees of the tenants' leasehold interests.

Absent an assignment and sublease clause that provides to the contrary, the tenant has the full right to assign its interest or sublet all or a portion of the premises. Thus, while the tenant will want as much freedom as possible to transfer its leasehold interest, the landlord will want a lease provision that prohibits the tenant from assigning or subletting the lease absent landlord consent. In drafting such a provision, the standard of review to be applied to the landlord's granting its consent or withholding the same should be defined. Frequently, the landlord and tenant will agree on a clause that provides that consent "may not be unreasonably withheld." Absent a provision which specifies the landlord's criteria under these circumstances, the landlord cannot withhold consent based on its own economic grounds. Moreover, the landlord generally can only withhold consent based on objective criteria, such as lack of creditworthiness of the subtenant or

assignee. Finally, if the landlord wants to reserve the right to unreasonably withhold its consent to a proposed assignment or sublease, such reservation of rights must be clearly and unequivocally stated in the lease, using terms such as “consent may be withheld in the sole and absolute subjective discretion of the lessor.”⁶ However, even where a clear and unequivocal reservation of a right to unreasonably withhold consent to assignment is included in the lease, an effective assignment may occur if the landlord regularly accepts rent from the assignee.⁷

(q) Conditions and Maintenance of Premises

The lease must clearly define the responsibilities of the parties with respect to the maintenance of the premises and any improvements and systems therein, as well as the securing and paying for essential utilities and other services. In most retail leases, the landlord retains the obligation to maintain the structural portions of the property, as well as the common areas outside of the premises, while the tenant takes on the obligation to maintain the interior portions of the premises. In most retail leases, landlords assume the responsibility for providing utilities and services necessary to preserve the character of the premises and allow the tenant to operate, as well as providing basic maintenance of standard fixtures, systems and components which are located in the premises. While landlords assume these responsibilities, the costs of providing such services are often passed through as part of the operating expense additional rent mentioned above.

⁶ See *Julian v. Christopher*, 320 Md. 1, 575 A.2d 735 (1990) (applying to leases entered into after June 1990).

⁷ See *La Belle Epoque, LLC v. Old Europe Antique Manor, LLC*, 406 Md. 194, 958 A.2d 269 (2008) (where the court held that a genuine issue of material fact existed as to whether an assignment occurred because a reasonable trier of fact could find that the landlord waived the requirement that it give written consent to an assignment by accepting rent payments, even where the contract specifically provided that accepting rent payments would not act as a waiver).

Conversely, retail tenants often are directly responsible for performing a significant portion of the maintenance work with respect to the premises, as well as securing the necessary utility and other services to allow them to operate their businesses.

(r) Interior/Exterior

Because of the general division of maintenance responsibilities between landlords and tenants based upon whether certain items are located inside or outside of the premises, items that are part of the exterior or interior of the premises should be defined in the lease. For example, there are some items that at first blush would appear to be outside of the premises but are considered to be interior to the premises due to custom and practice and, therefore, are the responsibility of the tenant. An example of an exterior item that is deemed interior for leasing purposes is the glass storefront of a retail store.

(s) Structural/Nonstructural

Similarly, the parties' respective maintenance obligations are often divided on a structural or nonstructural basis. Therefore, the terms "structural" and "nonstructural" should be clearly defined in the lease to avoid possible confusion and conflict. Absent a definition, courts have defined both terms inconsistently based on different factors. For instance, some courts have decided that a matter was structural based on whether a "substantial" amount of money is involved. Other courts have concluded that an improvement is structural if it is an intrinsically important element of the building. Still other courts have decided that an issue is structural based on whether the improvement is a structural member of the building in question.

(t) Repair/Replacement

Another distinction that should be drawn in the context of the parties' maintenance obligations is the difference between a repair and a replacement. This issue arises most often in the retail and industrial space leases, in which the tenant is responsible for ongoing maintenance and repair obligations, while the landlord is responsible for capital repairs and replacements. For example, a retailer seeks to enter into a lease, and during the negotiations the retailer agrees to maintain the HVAC (heating, ventilating and air-conditioning system) if the shopping center installs a high-quality system and obtains a good warranty from the manufacturer and the installer. However, the retailer should be concerned about the possibility of the failure of the HVAC system, in which case the retailer may be liable for replacing the system if replacement is the appropriate step to take under the circumstances. The retailer should therefore negotiate for a provision that would lessen the impact of an unqualified maintenance obligation.

(u) Default

The default provisions are critical because they generally control the rights of the parties in the event that either fails to live up to its obligations. In the event of a tenant default, most commercial leases provide the landlord with a number of remedies in addition to those provided by law.

(v) Written Notice

Generally, the landlord wants to streamline the default process by not self-imposing too many requirements before the tenant is deemed to be in default and the landlord is free to exercise its remedies. For instance, a lease provision requiring the

landlord to provide written notice before the tenant is considered in default should be avoided from the landlord's point of view as this often results in additional delays from the landlord's perspective before it can exercise its remedies. The landlord can contend that the lease itself is written notice to the tenant that rent is due on a specific date. The tenant, on the other hand, will always seek language in the lease that requires prior written notice with an opportunity to cure before the landlord may exercise its remedies. Such a provision will allow the tenant to avoid forfeiture of its leasehold rights based upon an inadvertent mistake.

While landlords are often reluctant to provide anything beyond a minimal written notice with respect to a monetary default, written notice may be more justifiable from the landlord's perspective in the context of a non-monetary default. For example, the landlord may want to notify the tenant that the tenant is underinsured or that the tenant is not conducting business properly in accordance with the lease requirements. Time frames required with respect to this type of notice should be specific and as short as is reasonably possible from the landlord's perspective. If the time frame is open-ended, requiring only that the tenant make "reasonable efforts" to resolve the default, the landlord can be left with an unresolved problem for a long time. If the provision states a specific time period, the landlord can take action after the appropriate notice is given and the tenant has not cured the default in a timely manner.

(w) Remedies

In the commercial context the remedies may be negotiated by the parties within a fairly broad spectrum. In most commercial leases, landlords will have the basic remedies of termination of the lease and termination of the tenant's right to possession of the

premises, as well as additional remedies, such as the right to accelerate rent or cure the tenant's default at the tenant's expense.

(x) Tenant's Bankruptcy

The issue of the tenant's bankruptcy is of great concern to most landlords. Nevertheless, no lease provision addressing the possibility of the tenant's bankruptcy can provide the landlord with any greater rights than those contained in the federal bankruptcy code. Accordingly, upon a bankruptcy filing by or against a tenant, the tenant/debtor is immediately protected from further action by the landlord under the automatic stay provisions of the bankruptcy code. The automatic stay prohibits the landlord from recovering possession or from pursuing any other attempt to recover damages from the tenant outside of the bankruptcy court without first filing a motion for relief from the stay with the bankruptcy court.⁸ Lease provisions terminating the lease upon a tenant's bankruptcy ("ipso facto" clauses) are therefore unenforceable.⁹

In addition, 11 U.S.C. (the "Code") Section 365(a) authorizes the trustee to assume or reject any unexpired lease, subject to the court's approval. If the trustee assumes the lease, the trustee must cure, or provide adequate assurance of a prompt cure, of any non-monetary defaults that have occurred under the lease (other than the bankruptcy itself), pay rent from the date of the bankruptcy to the date the lease is assumed and provide adequate assurance of future performance.¹⁰ The trustee may assign a lease (unless the debtor is an affected air carrier that is the lessee of an aircraft terminal or aircraft gate) even if there is a lease provision to the contrary, and the landlord objects

⁸ See 11 U.S.C. § 362(a).

⁹ 11 U.S.C. § 365(e).

¹⁰ 11 U.S.C. § 365(b)(1).

to such assignment.¹¹ Unless the court grants an extension, the trustee has 120 days after the order for relief within which to assume or reject a commercial lease.¹² If the trustee takes no action within this 120-day period, the lease is considered rejected. Until an unexpired lease is assumed or rejected, the tenant must timely perform all of its obligations under the lease.¹³ The court may grant an extension of the 120-day period for 90 days upon motion of the debtor and “for cause,” provided that the debtor makes its motion prior to the expiration of the 120-day period.¹⁴

(y) Damage, Destruction, Condemnation

In negotiating damage and destruction clauses in the lease, the parties must address three critical issues surrounding the question of liability for damages and injury: (a) insurance, (b) rental abatement and (c) termination rights.

(z) Insurance

Most commonly, a damage and destruction provision requires the landlord to obtain fire and extended coverage insurance for the building and all of its improvements and requires the tenant to obtain fire and extended coverage insurance for the tenant’s furniture, equipment and other contents of the premises. Should the premises be destroyed, the landlord will want to limit its reconstruction obligations of the premises to the amount of insurance proceeds actually received by the landlord.

¹¹ 11 U.S.C. § 365(f)(1).

¹² 11 U.S.C. § 365(d).

¹³ 11 U.S.C. § 365(d)(3). Section 365(b)(4), however, provides that if a default has occurred under a lease, the landlord is not required to furnish services or supplies incidental to the lease unless the landlord is compensated pursuant to the lease terms. For this reason, a lease should segregate any incidental services and supplies and label them accordingly.

¹⁴ 11 U.S.C. § 365(d)(4).

(aa) Rental Abatement

In the event of a casualty, the tenant will want to have its rent abated, whereas the landlord will want the tenant to purchase business interruption insurance to cover such rental obligations. Moreover, the landlord likely will not permit rent abatement if the tenant intentionally causes the casualty or if the premises can still be used and occupied without substantial inconvenience to the tenant.

(bb) Termination Rights

Where the intrinsic value of a lease is more than the rents received under the current lease, the landlord will look at the destruction of the premises as an opportunity to terminate the lease. Thus, in the event of a substantial casualty, the landlord will want to negotiate a right to terminate the lease so that it can increase the rent or obtain a superior tenant. Conversely, the tenant may consider the lease to be an asset and may want to hold on to the lease and have the premises rebuilt by the landlord. However, the tenant will often seek a termination right if the landlord has not completed its rebuilding obligations within a defined time period following the date of the casualty.

(cc) Rights of Third Parties

The rights of the parties with respect to the leasehold and any improvements often come into question not only in direct disputes between the landlord and tenant, but also in the context of disputes between one of the parties to the lease and a third party. Such third parties with some type of potential interest in the lease include mortgagees, trustees, other creditors, prospective purchasers of the property and brokers representing the parties to the lease transaction. Because such disputes do arise, the lease should include provisions that anticipate such potential claims and attempt to diffuse them by carefully defining the

parties' rights in the real estate and the fixtures of the leasehold with respect to various prospective claimants in a number of different contexts.

(dd) Brokerage Provisions

In most commercial leases, at least one of the parties is represented by a third-party broker, who becomes entitled to a commission in consideration of its efforts in bringing the parties together. The amount of the commission and details regarding its payment are generally set forth in a separate agreement between the broker and the parties responsible for paying the commission—most often the landlord. However, because of the possibility that undisclosed third parties could seek a commission in connection with the lease transaction, most landlords demand that the tenant affirmatively represent in the lease that no such undisclosed parties exist, and further that the tenant will indemnify the landlord against any claim which may be made by any such undisclosed parties. The provision is frequently written as a mutual indemnification.

2. Miscellaneous Lease Provisions

- (a) Integration**
- (b) Severability**
- (c) Subordination**
- (d) Rules and Regulations**
- (e) Guaranty**