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Tenant Protection

Suggestions Offer Remedies for Harsh Provisions

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LEASE DRAFTING

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During the last five years, the pendulum of commercial leasing has begun to swing. At common law, the doctrine of "caveat emptor" governed commercial leasing. By the 1970's, New York courts, relying on equitable principles, began to carve out exceptions to caveat emptor.[1] Equity gained greater currency and judicial decisions softened commercial lease provisions that potentially endangered or evicted tenants.[2] Recently, New York courts at all levels have moved away from finding equitable solutions to prevent harsh results or evictions and have applied the terms of negotiated lease provisions. Past judicial activism by judges protecting tenants' rights has now evolved into a consistent enforcement and implementation of commercial leases.[3] In many cases, no matter how draconian the lease provision, New York courts have been enforcing the contents of commercial leases.[4]

Too many tenants' businesses have suffered severe financial consequences or lost leases as a result of poorly drafted provisions. Although temporary tenant victories providing endless delays as a result of technical mistakes and jurisdictional defect defenses are still alive and well, a recent case has caused tenant attorneys to think twice before using and relying on such tactics. In this case, the court found a holdover commercial tenant liable to the third-party incoming tenant for damages for failing to vacate after its term expired.[5]

Therefore, it is imperative that tenants negotiate better leases in order to protect their interests. The suggestions in this article provide proposed remedies for a few of the harshest lease provisions. Although market conditions always play a factor in providing negotiating leverage to a landlord or tenant, some of these proposals should survive scrutiny in any real estate market.

Mitigation by Landlord

Since the Court of Appeals decided the seminal case of *Holy Properties v. Kenneth Cole*[6] in 1995, landlords have not been required to mitigate damages when a commercial tenant defaults on its lease and surrenders or is removed from the premises. As the tenant of record remains liable for all rents due during the remainder of its term of the lease, a landlord has no incentive to even attempt to re-rent or alleviate a defaulting tenant of its duty to pay rent. Landlords are not obligated to mitigate prospective losses in the event of default on rent payments.[7] This has produced exceedingly harsh results.

Hence, every lease should contain a clause which provides that, upon a default in the lease that results in the surrender or eviction from the premises, the landlord agrees to mitigate its losses and to use reasonable efforts to re-lease the demised premises. If it can be negotiated, such a clause should include a requirement by the landlord to advertise weekly and to employ a qualified real estate broker to find a new tenant to lease the premises. This clause should also include a duty by the landlord to attempt to rent the premises for at least the same rent to reduce any remaining tenant liability.

When one contemplates the potential amounts that could be owed without a mitigation of damages clause, it is clear that negotiating such a simple clause may provide a tenant a life preserver in an ocean of financial devastation.

A Prevailing Party Clause

Most commercial leases include a provision that a tenant must pay a landlord's legal expenses and attorney fees in connection with any default in the lease.[8]

Although state law mandates that such an attorney fees clause in residential leases is deemed to be reciprocal, this statute does not apply to commercial leases.[9] Despite many failing arguments to the contrary, attorney fees provisions providing payment to the landlord in connection with a legal proceeding will not provide the same rights to a tenant unless specifically stated in the lease.[10]

Hence, a prevailing party clause should be negotiated into the commercial lease agreement. The provision should read that the losing party to any legal action shall pay the prevailing party's legal fees and expenses. Such a clause should prevent, or at least lessen, the number of frivolous and harassing lawsuits initiated by both parties. As neither party will be able to commence legal action without the threat of having to fund the victorious party's legal bill, parity should prevail and thereby preclude attempts to exploit any inequitable leveraging positions.

Right of Expansion Clause

An expansion clause is the right or option to lease a specific additional space in the demised premises for a defined term in the future. Such an option becomes significant when a company has outgrown its space and wishes to avoid having to move to a new location and save the cost and inconvenient time delays that relocation necessitates.[11] Financially, it saves the tenant from being forced to lease additional space if its financial situation does not dictate growth when the option becomes available.

The expansion clause allows a tenant the flexibility of either (a) taking an entirely new and larger space in the building without any financial consequences for vacating

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its present space, or (b) permits the tenant to simply expand its tenancy by taking additional floor space or additional square feet. The expansion option also benefits the landlord by allowing it the flexibility to deliver different floors or rental space to the tenant at different times. The expansion clause also requires communication between the landlord and tenant at certain fixed times which might not otherwise occur without a lease provision dictating such contact.

As the landlord knows when existing leases expire, it will be able to determine vacancy dates before the execution of the initial lease. As such, the negotiated expansion clause should address different possibilities for potential expansion. The expansion clause should be expressly negotiated to include (a) a detailed description of specific potential expansion spaces, (b) the yearly rent due or an agreement to use the fair market rent, and (c) any increases in taxes and/or operating expenses. In addition, a provision requiring the landlord to use reasonable efforts to recover possession from a holdover tenant in the chosen expansion space should be included. Tenants should also attempt to negotiate a Right of First Refusal to protect their long term interests in the premises.[12]

The Option to Renew

The option to renew has been in practice for hundreds of years.[13] It is not the option itself, however, that led to its discussion in this article but the methodology of negotiating such a right on behalf of the tenant and the tremendous benefits provided to a tenant. The option permits a tenant to sign on for another five or ten years at a negotiated rent. The renewal rent negotiated at the time of the initial lease is often only three to five percent above the rent for the last year of the original lease period. Since the tenant is not required to exercise the option, it can vacate the space without any liability after the initial lease term. Furthermore, after investing heavily to turn raw space into an office or store, a tenant will be more comfortable signing a lease with a shorter term with the knowledge that, at its option it can remain for one or more renewal periods. In fact, a shorter term with option periods may be beneficial for a smaller company without the ability to forecast financial success. Finally, if the market calls for a lower rent than the renewal option specifies, negotiation may result in a decreased rent when it is time to renew.

The option to renew is beneficial to the landlord as a result of the incentives supplied and its importance as a negotiating tool. By making the option contingent on the tenant's good standing with its lease obligations during the current term, the tenant shall have an important incentive to be on its best behavior, and to comply with all its lease obligations to avoid losing the right to renew. Granting the option can also give the landlord an important negotiating tool that may overcome any stalemate that has impeded the lease negotiations.

Ownership and Use

The Worldwide Web has provided a cost efficient way to provide additional protection for a tenant for the most basic foundations of the tenancy. First, when receiving a draft of a landlord's lease, the ownership interests of the entity or person listed in the agreement should be investigated. Property ownership and tax information should be checked by visiting the proper Web site.[14] Second, investigate whether the tenant's anticipated use for the premises is permitted by law by searching the relevant government Web site. For example, in New York City, the legal use for the premises and the certificate of occupancy can be viewed by searching the Department of Buildings Web site.[15] In New York City, any premises constructed after 1938 or where significant renovations resulted requires a certificate of occupancy.[16]

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The certificate of occupancy will report the legal uses for the premises, and, if a tenant's proposed business is not listed, a competent expediter or architect should be able to determine whether legalization is possible. To legalize a new use for the premises, the architect or expediter must have all building violations corrected, and then proceed with an application for an amendment to the certificate of occupancy approving the new use.

Every tenant should attempt to garner for its intended utilization of its business the catch-all phrase "any lawful use" in its lease. However, obtaining a favorable use clause will not guarantee that the business will be able to function as such.

If any doubt lingers, a provision should be negotiated giving the tenant the ability to cancel the lease upon a determination that the planned use of the premises cannot be legalized or that it cannot be made so within a reasonable time after submitting a proper application. During this waiting period, the lease should require that no rent become due. To facilitate the process, a provision requiring the landlord to complete any necessary forms to legalize the use or proposed alterations should be drafted. If the lease is cancelled the landlord should be required to return all monies forwarded to the landlord as well as to reimburse any expenses incurred by the tenant in attempting to legalize the premises.

A tenant should also retain the ability to cancel the lease if the tenant is unable to take possession on the move-in date or soon thereafter. A representation should be added whereby the landlord agrees to make a good faith effort to complete, and legalize the premises, as well as to evict a holdover tenant. In an alternative to canceling the lease, the tenant should be granted a rent abatement for each day that the landlord fails to deliver possession. Upon the delayed commencement of the lease, the expiration dates of the lease should be extended, and the commencement date should be contingent on the issuance of the various approvals and permits necessary to complete construction.

Signage and Alterations

A disproportionate amount of commercial leasing litigation derives from disputes over signs and alterations.[17] In an attempt to decrease the amount of litigation involving such items, attorneys should learn a tenant's business needs and carefully adopt them to the lease. In addition, the following suggestions may prevent litigation and provide a tenant with greater freedom in its space. Before the lease signing, negotiate the advance or pre-approval of any alteration changes and signage requests as well as any foreseeable alteration changes during the term of the lease. Specific plans, measurements, drawings and pictures should be provided and attached to the lease agreement. If possible, obtain the right to make non-structural alterations without the landlord's approval, including any alterations that are insignificant or do not require building permits. Also, draft a representation by the landlord to remove any existing violations against the premises, so that any permit applications needed to perform work will not be rejected. For all other alterations necessitating permission, ensure that such authorization will not be unreasonably withheld.

Repairs and Self Help

Regarding repair responsibility, tenants should attempt to make the landlord liable for all structural repairs to the demised space and to the building, as well as nonstructural repairs occasioned by the landlord's negligence.

One of the most useful tenant-friendly clauses is the tenant's self-help provision. Such a provision permits a tenant to complete any repairs that the landlord neglects to complete within an allotted time period after notification

from tenant. Under this clause, a tenant shall seek reimbursement by obtaining a rent credit for the cost of the repair or by obtaining reimbursement from the landlord. Besides vitiating the tenant's dilemma of whether it can withhold rent until the repairs are done, it will provide a mechanism that should assist in keeping the premises free of necessary repairs. The self-help clause will also resolve the "independent covenant" dilemma, where any rental amounts due to the landlord are deemed independent of the landlord's obligation to do repairs.[18] Any lease provision specifying that each provision in the lease is independent of every other provision should be modified to include the tenant self help provision.

Conclusion

Dozens of other provisions exist that would be helpful to a tenant; however, this article has recommended a few of not only the most essential, but those that have a decent chance of being negotiated into the lease.

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1. See Frey, The *Yellowstone* Injunction, or "How to Vex Your Landlord Without Really Trying", 58 Brook. L. Rev. 155, 161-162 (stating that, "in 1972, *57 E. Realty Corp.*, a decision from the New York County Appellate Term, marked a shift in this genre of landlord-tenant cases...By basing its decision on attitudinal jurisprudence....the lower court opened the door to an era of extreme pro-tenant doctrine"). See also Curtis J. Berger, Hard Leases Make Bad Law, 74 Colum. L. Rev. 791 (1974) (under subsection entitled, "Doctrines Openly Hostile to the Landlord and the Lease").

2. See *First Nat'l Stores, Inc. v. Yellowstone Shopping Center, Inc.*, 21 N.Y.2d 630, 290 N.Y.S.2d 721 (1968). See also *40 Assocs., Inc. v. Katz*, 112 Misc.2d 215, 446 N.Y.S.2d 844 (Civ. Ct. 1981) (stating that there is a warranty of fitness implied in all commercial tenancies); *220 W. 42 Assocs. v. Cohen*, 60 Misc.2d 983, 302 N.Y.S.2d 494 (1st Dept. 1969) (stating that "the call for caution is reinforced by the well-settled rule that courts do not favor forfeiture of leases. Forfeitures are abhorrent to the law and will not be declared if there is any other reasonable theory upon which a case can be settled"); *Madison Avenue Specialties Inc. v. Seville Enterprises, Inc.*, 40 A.D.2d 784, 337 N.Y.S.2d 590 (1st Dept. 1972) (court decided that even if there was a breach of the lease, "there may be equitable considerations which would forbid forfeiture as the remedy"); *57 E. 54 Realty Corp. v. Gay Nineties Realty Corp.*, 71 Misc. 2d 353, 335 N.Y.S.2d 872 (1st Dept. 1972) (court held that tenant's delay in rent payments was not such a material breach as to allow the landlord to forfeit the lease and further stated that "landlords and tenants do not generally meet on equal footing. Land and space are limited and in short supply. Tenants, more often than otherwise, must take inequitable lease provisions as offered, or not get much needed space at all. To strictly enforce provisions of leases in such circumstances is to run counter to all modern thinking").

3. See *Excel Graphics Technologies, Inc. v. CFG/AGSCB 75 Ninth Avenue, LLC.*, 1 A.D.3d 65, 767 N.Y.S.2d 99 (1st Dept. 2003) (in strictly enforcing a lease provision requiring tenants to obtain written consent of landlord before subletting premises, the court refused to allow landlord's actions to constitute a waiver, stating that a "written agreement that is complete, clear and unambiguous on its face must be enforced according to the plain meaning of its terms. Courts are obliged to interpret so as to give meaning to all of its terms"); *Renali Realty Group 3, LLC, v. Robbins MBW Corp.*, 259 A.D.2d 682, 686 N.Y.S.2d 855 (2d Dept. 1999) (holding that a landlord's acceptance of rent does not waive its right to enforce lease provisions where the lease contains a clear and unambiguous "no-waiver" clause); *James Pinto Photography, Ltd. v. Sheppard*, 2006 NY Slip Op 26284 (NYC Civ. Ct. 2006) (in deciding the status of the tenants tenancy, the court noted that "where a lease clearly specifies the time and manner in which a notice of renewal is to be given, and that notice is not given before the expiration of the lease, equitable considerations cannot serve to revive and renew a tenancy); *Vermont Teddy Bear Co. v. 538 Madison Realty Co.*, 1 N.Y.3d 470, 775 N.Y.S.2d 765 (2004) (basing their decision on "longstanding contract interpretation principles" the Court of Appeals held that since there was no specific lease provision requiring the landlord to notify the tenant when the premises were sufficiently repaired to resume occupancy, the tenant's obligation to pay rent was only suspended for the period until the premises were restored, regardless of whether the landlord ever notified the tenant of the restoration).

4. See, e.g., *Four Cees Jewelry Inc. v. 1537 Realty LLC.*, 2005 NY Slip Op 52272U (NY Sup. Ct. 2005) (upholding a lease provision authorizing the landlord to use self-help to discontinue the tenant's electrical service in the event of nonpayment of electric bills); *1029 Sixth LLC, v. Rinz Corp.*, 9 A.D.d 142, 777 N.Y.S.2d 122 (1st Dept. 2004) (court strictly enforced settlement provision requiring tenants to leave the premises in "broom clean" condition and thereby relieved landlord of his obligation to make payments between $25,000 and $55,000, including a lump sum, a partial rent waiver and a partial return of the security deposit to the tenants after tenants left garbage bags and refuse on the premises).

5. See *Kronish Lieb Weiner & Helman, LLP v. Tahari, Ltd.*, 2006 NY Slip Op 50264U (NY Sup. Ct. 2006).

6. 87 N.Y.2d 130, 637 N.Y.S.2d 964 (1995).

7. See Standard Form of Office Lease, The Real Estate Board of New York, Inc. 7/04, ¶18. See also *Marketplace v. Smith*, 181 Misc. 2d 440, 694 N.Y.S.2d (N.Y. J. Ct. 1999); *Syndicate Building Corp. v. Lorber*, 128 A.D.2d 381, 512 N.Y.S2d 674 (1st Dept. 1987).

8. See Standard Form of Office Lease, The Real Estate Board of New York, Inc. 7/04, ¶19. ("If Owner...makes any expenditures or incurs any obligations for the payment of money, including but not limited to reasonable attorneys' fees, in instituting, prosecuting or defending any action or proceeding, and prevails in any such action or proceeding, then Tenant will reimburse owner for such sums so paid, or obligations incurred, with interest and costs).

9. N.Y. Real Prop. Law §234 (1969).

10. See *Huron Associates, LLC v. 210 East 86th Street Corp.*, 18 A.D.2d 231, 232, 794 N.Y.S.2d 360, 361 (1st Dept. 2005). See also *Camatron Sewing Machine, Inc. v. F.M. Ring Assoc, Inc.*, 179 A.D.2d 165, 582 N.Y.S.2d 396 (1st Dept. 1992) (stating that "absent some contractual or statutory right thereto, attorneys fees and litigation costs are not ordinarily recoverable as an element of damages").

11. In many instances, moving expenses can reach $14.75 per square foot, or up to $133,500.00 for 8000 square feet of space, with a minimum cost of approximately $10.25 per square foot. Information on representative relocation expenses was provided by Douglas Grabiner, Managing Director of Newmark Knight Frank.

12. Adam Leitman Bailey & John M. Desiderio, Right of First Refusal, In Pursuit of an Effective, Litigation-Proof Proviso; at http://www.alblawfirm.com/news/images/20060520_nylj.pdf.

13. See *Crosby v. Moses*, 92 N.Y. 634 (1883); *Elston v. Shilling*, 42 N.Y. 79 (1870); *Bogan v. Moses*, 22 Misc. 94, 48 N.Y.S. 546 (Sup. Ct., App. Term, 1897); *Wallace v. Arkell*, 28 Misc. 502, 59 N.Y.S.597 (Sup. Ct., App. Term, 1899).

14. In NYC, tax information can be found at The Department of Finance Web site: http://www.nyc.gov/html/dof/html/home/home.shtml. To check for property ownership, the ACRIS system, can be found at http://a836-acris.nyc.gov/Scripts/Coverpage.dll/index.

15. http://www.nyc.gov/html/dob/html/bis/bis.shtml.

16. N.Y. Admin. Code §27-217.

17. See e.g., *Marshall v. Ahamed*, 2004 NY Slip Op 51549U (N.Y App. Div. 2004); *Harrar Realty Corp. v. Michlin & Hill, Inc.*, 86 A.D.2d 182, 449 N.Y.S.2d 213 (1st Dept. 1982); *Williams v. Ron-Jay Enterprises, Inc.*, 65 A.D.2d 213, 411 N.Y.S.2d 86 (4th Dept. 1978).

18. See *Green 440 Ninth LLC v. Reade*, 2005 NY Slip Op 25508 (NY App. Div. 2005) ("Tenant's withholding of rent while in possession of the premises was a violation of a fundamental covenant of the lease, regardless of any breach by landlord..."). See also *Westchester County Indus. Dev. Agency v. Morris Indus. Builders*, 278 A.D.2d 232, 717 N.Y.S.2d 279 (2d Dept. 2000).

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