

Using a License Agreement Instead of a Lease

By Adam Leitman Bailey and John Desiderio

A number of years ago, I sat down with one of the New York's real estate legends and his company's general counsel. He was bothered by New York's eviction process — the loss of rental income, the wasted legal fees, and the incredible amount of time between a tenant's default and an actual eviction.

For a number of his buildings, he was unveiling a new type of office space for smaller tenants needing smaller spaces. Under his design, a tenant would have a designated office and share a copy machine, fax machine, kitchen, and conference rooms. The furniture, carpeting, phones, computer, and coffee would be supplied by the landlord. The spaces would be pre-constructed. The renter would only need to bring a pencil to be able to work. The general counsel asked about using a license agreement where it could change the locks or, in this case, turn off the key cards upon a renter's default. Our firm's mission was to draft an enforceable license agreement providing for self-help without having to resort to litigation. This article discusses the license agreement — its limitations and its powers. It also dissects and explains when and how to use a license agreement, and the ability to effectuate self-help properly.

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THE LICENSE AGREEMENT

Landlord attorneys have either overlooked or been too cautious to suggest the use of license agreements to their clients. However, license agreements permit commercial property owners to eliminate the landlord-tenant relationship entirely and thus avoid those burdens often experienced in the legal framework of traditional landlord-tenant proceedings.

The legal relationship between the property owner-landlord and a tenant established by a lease is entirely distinct from the legal relationship established by a license between the property owner-licensor and a licensee.

As explained in *Friedman On Leases*, the distinction between a lease and a license is that:

A lease is a conveyance of exclusive possession of specific property...usually in consideration of the payment of rent, which vests an estate in the grantee, [while] a license, on the other hand, merely makes permissible acts on the land of another that would otherwise lack permission. A license is said to be revocable at the will of the licensor, [and] creates no estate.

Chief among the owner-licensor's rights in a license relationship is the right to revoke the license "at will" and to use "self-help" to remove a defaulting licensee from the licensed premises without having to endure months or years of lengthy and frustrating litigation to regain possession of valuable real estate.

Self-help is not unavailable to landlords in New York who reserve the right to use it in their lease agreements.

However, courts are generally hostile to a landlord's use of self-help and will not approve its use if there is an ambiguity in the lease terms or if there is any factual question concerning whether or not the lease has expired. Moreover, under New York's Real Property Actions and Proceeding Law ("RPAPL") §853, if a tenant is ejected from real property by force or other unlawful means, the tenant may recover treble damages from the landlord and may also be restored to possession if ejected before the end of the lease term. Only when a court concludes that restoring the tenant to possession would be "futile," because the landlord will prevail in a summary proceeding to eject the tenant, is the court unlikely to order restoration of the premises to the tenant.

In contrast, under a bona fide license agreement, the tenant-licensee owns no estate in the premises and has no right to possession. Common law principles apply, and the owner-licensor has the absolute right to use peaceable self-help — at any time — to remove a licensee from the licensed premises for any reason or no reason.

Nevertheless, the use of a license agreement, instead of a lease, will not entirely eliminate all possibility of litigation between the owner-licensor and the tenant-licensee. The question of whether or not the "self-help" used was peaceable (and therefore lawful) or forcible (and therefore unlawful) is always a possible subject of litigation. However, where a valid license agreement exists, the owner-licensor will not be required to re-admit the ousted licensee to the premises, even if the self-help used is found to have been

forcible and not peaceable. In New York, the licensee's sole remedy will lie in the treble damages provide by RPAPL §853 for forcible ejectment. In the interim, before any judgment by a court, the owner-licensor is free to re-license use of the premises to another licensee.

In these circumstances, depending on the nature of the damages provable by the former licensee, the owner-licensor may view what is only a possible, but not certain, treble damage judgment as a far less onerous cost of doing business than the total of all the expenses normally associated with landlord-tenant litigation. In addition, instead of losing income during the litigation over self-help, the owner will actually be realizing income from the payments received from the new licensee of the premises.

Of course, the owner-licensor should take every precaution to ensure that the self-help it employs is always accomplished in a "peaceable" manner and without any real possibility of it later being found to have been done "forcibly." There are, in fact, several well-known "peaceable" self-help techniques that have been employed, by landlords and licensors alike, which have passed muster with the courts, and that should always be used to minimize any risk of a court finding of "forcible" ejectment.

LICENSING FACTORS

To obtain the benefit of a license agreement, the property owner must ensure that its agreement with the prospective user of the premises is indeed a license and not a lease. This is not necessarily an easy task to accomplish. Merely calling the agreement a "license" will not make it so. Whether an agreement is held to be a license and not a lease will depend on the presence or absence in the agreement of the three essential characteristics of a real estate license: 1) a clause allowing the licensor to revoke "at will"; 2) the retention by the licensor of absolute control over the premises; and 3) the licensor's supplying to the licensee all of the essential services required for the licensee's permitted use of the premises.

Courts have found licenses to be leas-

es where any one or more of these characteristics is either missing from the agreement altogether or not sufficiently vested in the powers retained by the licensor. However, the less control given the licensee, the more likely the agreement is to be a license because a license offers no autonomy, but merely allows a party "to render services within an enterprise conducted on premises owned or operated by another, who has supervisory power over the method of rendition of the services." Nevertheless, it has been held that the licensor's retention of control over prices charged by the licensee, times of operation within the licensed space, and even the choice of the licensee's employees, is no guarantee that the agreement will be held to be a license and not a lease, as such controls may be deemed "no more than would reasonably be demanded by a careful owner as against a lessee for [any] business."

Therefore, careful drafting of appropriate license agreements will be required, and, for this purpose, there must be close cooperation between attorneys and their clients who wish to implement a license regime. Communication to the client of the risks, as well as the benefits, of utilizing a license regime will be essential. In addition, attorneys will need to give close attention to the objectives of the client and determine how much initial cost the client is willing to accept in order to provide the kind of "full service" agreement that will pass a court's "license" test.

Owners will also have to make judgments about the commercial feasibility of obtaining licensees who are willing to accept license agreements with "at will" revocation clauses. Whether potential tenant-licensees are willing to sign such agreements may depend upon the type of premises that the owner is making available for licensed use, *e.g.*, whether the licensed space is a warehouse, an office suite for multiple users, or simple storage space. To attract licensees concerned about making a substantial investment in space subject to a revocable license, owners may create new

financing incentives or build into the agreement a mechanism to compensate a non-defaulting licensee for the remaining unamortized value of its investment at such time as the licensor invokes the "at will" clause of the agreement.

At present, real estate license agreements appear to be utilized primarily by owners of properties licensed to short-term users: office space, laundry rooms, certain types of storage spaces, and kiosks in shopping malls. It is clear that there is a market for such agreements. Whether there is a market for real estate license agreements for other types of occupancy may not be so apparent, but, given the need of landlords to be relieved of the onerous burdens and frustrations of traditional landlord-tenant litigation, such an agreement may be useful for the right business plan.

Tenant attorneys whose clients are in default of a bona fide license agreement will no longer be able to guarantee delaying a judgment of eviction for up to six months. If their licensee clients do not cure their default, the clients will be subject to peaceable self-help eviction from the licensed premises swiftly and without further ado. No longer will property owners eagerly waive income and past due monies owed in order to guarantee regaining possession of the premises on a date certain. The negotiating leverage will shift in favor of the owner-licensor who will be able either to require full payment from the defaulting licensee, if it wishes to avoid eviction, or to require peaceable possession of the premises with the full backing of the law. For frustrated landlords with the right set of facts and real estate using the latest computerized entrance systems, this is a revolution that is long overdue.

