

COMMERCIAL LEASING

THIRD EDITION

VOLUME ONE

EDITOR-IN-CHIEF
JOSHUA STEIN, ESQ.



NEW YORK STATE BAR ASSOCIATION

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DEDICATION OF THE THIRD EDITION: MELVYN MITZNER

We dedicate the third edition of the New York State Bar Association's Commercial Leasing treatise to the memory of Melvyn Mitzner, former chair of the NYSBA Real Property Law Section and a friend, advisor, and great resource to many members of the New York commercial real estate bar.

Mel was the dean of the title insurance industry and New York commercial real estate law, the person to call with difficult questions and judgment calls. He had special knowledge and expertise that he shared freely with the industry—not just to people who ordered title insurance from Commonwealth Land Title Insurance Company, but also real estate lawyers young and old throughout the region, as well as underwriting counsel at Mel's title company and its competitors.

He wrote and spoke extensively, sharing his knowledge and helping all of us do our jobs better. And he was a good guy, with a great sense of humor, patience, and respect for everyone with whom he dealt.

He graduated from City College and Brooklyn Law School, and in the course of his career served as an adjunct professor at St. Johns University Law School, New York University's Real Estate Institute, and Manhattanville College.

After decades in the title insurance industry, Mel became senior counsel at the White Plains law firm of Keane & Beane P.C. in the last few years of his life. He died in 2010 in a car crash.

In Mel's memory the New York Bar Foundation, the NYSBA Real Property Law Section, and Mel's widow, Rosalyn, created the Real Property Law Section Melvyn Mitzner Scholarship, which is awarded to a second- or third-year law student in New York State every year.

He was survived by Rosalyn, two children (one of them, Jeff Mitzner, is a senior executive at First American Title Insurance Company), and five grandchildren.

Mel is missed. We honor his memory by dedicating the Third Edition of NYSBA's Commercial Leasing treatise in honor of Melvyn Mitzner.

ACKNOWLEDGMENTS

This book is officially a project of the Commercial Leasing Committee of the New York State Bar Association Real Property Law Section. Less officially, it grew out of two of the Committee's programs: first, a series of speakers on commercial leasing and related issues while I co-chaired the Committee; and, second, two "silent lease issues checklists" that a subcommittee of the Commercial Leasing Committee put together starting in about 1998.

This book was first suggested by S.H. Spencer Compton of First American Title Insurance Company, co-chair since the beginning of the subcommittee on "silent lease issues checklists" and the motor for getting those projects done. Spencer initially suggested republishing those checklists in book form, along with other commercial leasing resources that the Commercial Leasing Committee had developed through its other activities.

I expanded Spencer's idea to include chapters from a number of commercial leasing practitioners who had spoken on a range of leasing topics at Commercial Leasing Committee meetings, as well as a number of commercial leasing practitioners who had not. These practitioners provided the most important pieces of this work, and their efforts are very much appreciated.

Particular thanks goes to Andrew L. Herz of Patterson Belknap Webb & Tyler LLP. As an earlier downstate co-chair of the Commercial Leasing Committee, Andy initiated the "model nondisturbance agreement and report" that I chaired and edited in 1993, and which is included in this work. (That model nondisturbance agreement and report has become disturbingly old. Although the law in the area does not change much, the agreement and report deserve another look. Anyone who would like to get involved in that project should please contact the author.)

Over 20 years ago, Andy encouraged my active involvement in the Commercial Leasing Committee, without which this book would not exist. That involvement led to my becoming co-chair of the Committee and eventually Chair of the Section for the year ending in May 2006.

In addition to being entitled to recognition under each of the preceding three paragraphs, Andy also reviewed and commented on a number of the pieces that I contributed to this work.

My friend Mark Senn of Senn Visciano Rosenstein P.C., Denver, Colorado, many years ago undertook a project to collect each state's major statutes on commercial leasing in a single reference source and recruited me as the "reporter" for New York.

Mark and his publisher, Wolters Kluwer Legal & Regulatory U.S., graciously allowed me to publish a modified version of the New York statutory collection in this book. I regularly update the New York collection for Mark's book, and again publish an updated edition of that work here. Commercial leasing practitioners who negotiate leases in multiple states should look for Mark's national leasing guide, a tremendous help for those transactions. (See lrus.wolterskluwer.com.)

As another contribution to this work, Mark strenuously warned me against undertaking any publishing project that involved having multiple authors contribute multiple chapters. I ignored Mark's advice. The only reason I could do so and yet bring this book to completion was the persistence, professionalism, and follow-through of the New York State Bar Association's editorial department.

Alex Dickson, Kirsten Downer, Reyna Eisenstark, Marisa Kane, and Naomi Pitts of the NYSBA editorial department did a great job tracking all the pieces of this book and bugging everyone (including me) who needed to be bugged.

This book was very much a team project. Every member of the team contributed, and that contribution is very much appreciated.

I also thank my clients, who have been sending me terrific leasing and other work for many years, both before and after I founded Joshua Stein PLLC in 2010. And no matter how many transactions I've negotiated before, I always learn something new—and usually make a new friend across the table—from each negotiation. So I also thank all my esteemed adversaries for everything they've taught me.

My colleagues at Joshua Stein PLLC helped with this book more than they necessarily know. Deborah Goldman (now co-chair of the Section's Commercial Leasing Committee), Alexa Klein, James Patalano, and Lauren Silk, all members of my legal staff, have regularly helped me update many of the templates in this book and write articles that became chapters. My managing editor, Karen Lively, oversaw all these projects as well as dozens of other publications projects. And Waldemar Robles helped

keep the office running and the computers working, without which we would have had a lot of trouble doing any of this.

Finally, I thank my daughters, Helaina and Julia, for their support and for being such terrific daughters.

Joshua Stein
Editor

PREFACE

Commercial leasing transactions are all about practicalities: the link between legal principles and issues on the one hand and the real world of real estate on the other. This book seeks to give the reader (or the “*user*”) a set of practical tools that he or she can use in day-to-day lease negotiations.

Although the tools offered here are grounded in the law of commercial leasing, they emphasize the give-and-take of negotiations and the need to meet the practical needs of landlords and tenants.

This book does not cover exhaustively every possible topic in commercial leasing law. It is not a treatise in the sense that it drills deeply into every possible legal topic within its purview. It is a set of targeted guides that seek to help lease negotiators do their job. And it focuses on the practical topics that matter most.

Because of the nature of this book, some of the chapters overlap. Almost every chapter overlaps, at least partly, with our “silent lease issues” checklists. Each author approaches his or her topic from a particular point of view. Even though the discussion may overlap, the varying viewpoints add value.

Most of the discussion in this book would apply in any state, except perhaps Louisiana. To a very limited degree, the discussion is specific to New York and considers issues unique to New York law. In most cases, those discussions are readily identifiable. Also, of course, the statutory supplement at the end of this work is entirely specific to New York State and City, although cannot possibly include every possible municipal code provision that might apply in some circumstance.

We hope to follow this third edition with subsequent editions. Any reader who has comments, reactions, responses, or corrections to anything in this book should communicate with the editor or with the author of the affected chapter. The editor can be reached at Joshua@joshuastein.com.

Future editions will be expanded to cover additional topics. Nominations, including self-nominations, for new authors and chapter topics for future editions will be much appreciated and should be directed to the editor.

ABOUT THE EDITOR

JOSHUA STEIN, ESQ.

Joshua Stein closes large mortgage loans for major lenders and borrowers, negotiates major ground leases and commercial leases for both landlords and tenants, assists real estate investors in acquiring substantial properties from coast to coast, and handles hotel-related transactions, including mixed-use development transactions with hotel components.

A member of the American College of Real Estate Lawyers, Mr. Stein has chaired the Practising Law Institute's annual two-day seminar on commercial real estate finance since 1997. He chaired the New York State Bar Association Real Property Law Section for the year ending May 31, 2006.

Mr. Stein has published five books and more than 250 articles on commercial real estate law and practice, and is a national leader as a speaker and writer in these areas. He has written more than 1,000 model documents, outlines, and checklists for commercial real estate transactions, many published by Bloomberg and others. His name appears regularly in published lists of the leading real estate lawyers in the world.

After more than two decades as a partner with a global law firm, he established Joshua Stein PLLC in August 2010.

Mr. Stein graduated from Columbia Law School (1981), where he was a managing editor of the law review, and earned his undergraduate degree at University of California, Berkeley (1977, Phi Beta Kappa). He is admitted in California and New York. Before law school, he worked in book publishing, journalism, and computers.

He can be reached through his website, www.joshuastein.com, which he created in 1997 to provide more information about his practice and experience, as well as reprints of many of his articles.

ABOUT THE AUTHORS

ADAM LEITMAN BAILEY, ESQ.

Actively at the helm of Adam Leitman Bailey PC, the law firm he built from scratch, Adam Leitman Bailey practices residential and commercial real estate law. Among New York's most successful and prominent real estate attorneys, Mr. Bailey is one of two attorneys in New York that has been ranked in Chambers & Partners, honored with a Martindale-Hubbell "AV" Preeminent rating, a Best Lawyer ranking for himself and his law firm, and selected as one of New York's Top 100 attorneys by Super Lawyers, which included only five real estate law firms' attorneys. The internationally esteemed Chambers & Partners has repeatedly selected Mr. Bailey as one of New York's Leading Real Estate lawyers, making him one of only three New York attorneys from firms with fewer than 30 attorneys to receive the honor. The *Commercial Observer* named him as one of New York's Most Powerful Real Estate Attorneys.

Mr. Bailey's advocacy has prevailed in numerous important trials and cases before various courts and trial venues, including Housing, Civil, and New York State Supreme and Federal Courts, as well as various New York Appellate tribunals. Most recently, Mr. Bailey secured the largest settlement in New York City history for a property casualty lawsuit.

CHRISTOPHER J. CENTORE, ESQ.

Christopher J. Centore is a partner with the firm of Barclay Damon, LLP, where he is the chair of the Real Estate practice area. He is also a member of the firm's Energy and Financial Institutions and Lending practice areas. Mr. Centore focuses his practice on real estate and finance transactions, including commercial leasing transactions. Mr. Centore's prior experience includes representing municipalities in real property tax certiorari proceedings, and his real estate project experience frequently involves property tax exemptions and incentives. In the commercial leasing context, Mr. Centore routinely represents both landlords and tenants in retail, shopping center, office, warehouse and industrial leases. He is a member of the Real Property Law Section of the New York State Bar Association and the Onondaga County Bar Association.

S.H. SPENCER COMPTON, ESQ.

S.H. Spencer Compton is Vice President and Special Counsel at First American Title Insurance Company in New York City. Prior to joining First American, he was a Practicing Real Estate Attorney, with an empha-

sis on commercial leasing and financing transactions, for 11 years in New York City.

Mr. Compton is the Budget Officer of the New York State Bar Association Real Property Law Section. He has lectured and published articles about commercial real estate law and practice as well as title insurance, UCC insurance, and 1031 exchanges.

Mr. Compton earned his undergraduate degree in 1972 from New York University and his law degree in 1989 from Brooklyn Law School, where he graduated *cum laude*. Prior to law school, he was a screenwriter and film producer.

KEVIN J. CONNOLLY

Kevin J. Connolly is a licensed insurance consultant who concentrates on managing the risks of commercial construction projects. In addition to conventional property-casualty insurance. Mr. Connolly advises regarding completion risks, legal compliance (including the New York Construction Contracts Act), and mechanics' liens, including the notorious trust fund provisions of the New York Lien Law.

JOHN M. DESIDERIO, ESQ.

John M. Desiderio, partner and chair of Adam Leitman Bailey, P.C.'s Real Estate Litigation Practice Group, has been a practicing attorney in New York City for over 40 years. His practice focuses on cooperative/condominium representation, real estate litigation, title litigation, mortgage foreclosures, and antitrust and trade regulation.

Mr. Desiderio received his A.B. degree from Fordham College in 1963, an LL.B. degree from the University of Pennsylvania Law School in 1966, and an LL.M. degree from New York University School of Law in 1969. He served as a Captain in U.S. Army Intelligence from 1966 to 1968. He has extensive experience in conducting and defending depositions and in conducting trials and arguing appeals in both New York State and federal courts.

Mr. Desiderio has extensive litigation experience in representing both landlords and tenants in commercial and residential real estate litigation. His cases in this area have involved issues relating to ownership of title to property, the right to enforce contracts of sale, landlord obligations to furnish habitable dwellings, tenant obligations to meet conditions of their tenancy, and the applicability of common law and statutory warranties to

newly constructed or converted condominium and cooperative apartments. Mr. Desiderio also leads the firm's American With Disabilities Act Defense practice.

RICHARD D. EISENBERG, ESQ.

Richard D. Eisenberg is a partner at Eisenberg Tanchum & Levy LLP, a firm he co-founded in 1985. He is a transactional attorney, specializing in real estate matters. His work includes restaurant, office, and retail leases, and purchases, sales, and financings of commercial, mixed-use, and residential properties, as well as business transactional matters. He represents, among others, real estate developers and investors, lenders, management companies, restaurant owners, individuals purchasing and selling residences, celebrity chefs, and architects.

Mr. Eisenberg graduated *cum laude* from Harvard College in 1971, where he was a Harvard National Scholar. He is a 1975 graduate of Boston University School of Law. He currently serves as a Director of the Plymouth Rock Assurance Companies in New Jersey, and was formerly a Director of The Jewish Guild for the Blind and Dorling Kindersley Publishing Inc. He co-authored *Rights of Residential Loft Tenants* (1979) with Harold L. Stults, Jr.

HERBERT H. FELDMAN

Herbert H. Feldman founded Alpha Risk Management, Inc. in 1973. Alpha, a full-service risk management consulting firm not engaged in the sale of insurance, supports commercial real estate finance for mortgages as well as construction loans. Alpha has assisted a number of lenders with over \$50 billion in such loans and has a client base occupying more than 400 million square feet.

Prior to Alpha, Mr. Feldman served as an Infantry Sergeant and spent four years with Deloitte & Touche. Mr. Feldman also worked for seven years at Revlon, was Chief Financial Officer of a conglomerate, and was Chief Executive Officer of two multinational corporations.

Mr. Feldman is a Certified Public Accountant and earned his MBA in Finance at New York University where he also completed his doctoral studies. He has served as a director of several listed corporations as well as the Society of Risk Management Consultants; President of the Roslyn, Long Island Board of Education; and President of the Board of Trustees of the Brooklyn College Foundation.

Mr. Feldman has published several articles and has been a guest speaker for the American Management Association, the Risk and Insurance Management Society, the Society of Risk Management Consultants, the New York State Bar Association Commercial Leasing Committee, and the Practising Law Institute, as well as several law firms.

DEBORAH L. GOLDMAN, ESQ.

Deborah L. Goldman is Of Counsel at Joshua Stein PLLC. She focuses on commercial leasing work, and also handles hotel matters and all types of commercial real estate transactions with an emphasis on acquisitions, dispositions, hotel management agreements, and financings. She brings to her legal practice the benefit of an MBA in Real Estate Finance from Columbia Business School and the practical non-legal experience of having worked in the development department of Starwood Hotels and Resorts after completing Business School. She graduated *cum laude* from New York University Law School in 1992 and immediately began practicing commercial real estate law with the now-defunct Shea & Gould. Later, she worked in the real estate department at a number of large law firms, including Proskauer Rose LLP, Kramer Levin Naftalis & Frankel LLP, and Latham and Watkins LLP. She is currently the co-chair of the Commercial Leasing Committee of the New York State Bar Association and speaks regularly before real estate attorneys on commercial leasing issues. Debbie has also continued to use her JD and MBA to invest in real estate for herself and her family.

Some of Ms. Goldman's larger transactions have included the purchase of the Sands Hotel and Casino in Puerto Rico; acquisition and disposition of hotels for Starwood Hotels and Resorts; retail leasing in the tri-state area for Starbucks, JPMorgan Chase, Wachovia N.A., Dunkin' Donuts, T-Mobile, and Bally Sports Clubs; representation of the Manhattan Mall (Argent Ventures), Minskoff Equities, Mendik Realty Company, Emmes Asset Management, Developers Diversified Realty, and Vornado Realty Trust in multiple transactions; representation of Kleinberg, Kaplan, Wolff & Cohen on its lease of additional space at 551 Fifth Avenue; representation of the developer of a FedEx Ground distribution facility in Long Island City consisting of both the acquisition of a fee parcel and a ground lease; sale of 340 West Street, New York, New York; refinancing of the Carlyle Hotel in Manhattan and financing and refinancings of the Miami Design District for Crédit Agricole, and multiple in-line and ground leases for a major Mexican movie theatre company that is expanding in the United States. The FedEx Ground, 340 West Street, Crédit Agricole

and movie theatre lease transactions took place at Joshua Stein PLLC. All others mentioned took place at previous firms.

GARY A. GOODMAN, ESQ.

Gary A. Goodman is a partner in Dentons Real Estate practice. He represents owners of office buildings and shopping centers, as well as landlords and tenants in office, retail, and industrial leasing, long-term leasing, including net and ground leases and sales-leasebacks. His efforts on both the tenant and landlord side have earned him “Most Ingenious Deal of the Year” accolades by the Real Estate Board of New York on two different occasions. In addition to his leasing experience, Gary has a vast real estate finance practice, specifically in representing domestic and foreign institutional lenders and borrowers in fee and leasehold construction and term financings, refinancings, mezzanine financings and workouts.

KEVIN P. GROARKE, ESQ.

Kevin P. Groarke is a partner in Dentons Real Estate practice. He routinely represents owners as well as tenants in a wide variety of leasing transactions involving office and retail leases, ground leases, reciprocal easement and operating agreements, long-term net leases, leasehold financings and sale-leasebacks. In addition, Mr. Groarke represents private, institutional and sovereign investors and owners and developers in connection with complex joint ventures, acquisitions, dispositions, as well as development of a broad array of properties, including office buildings, shopping centers, multi-family residential, mixed-use projects, data centers, hotels, casinos, hospitals and other medical facilities, and the related senior and mezzanine financing aspects thereof.

JAMES S. GROSSMAN, ESQ.

James Grossman is a partner with the firm of Barclay Damon LLP. He has more than 42 years of experience handling real estate and real estate litigation matters, together with a history of representing not-for-profit organizations. Mr. Grossman has been involved in significant tax assessment administrative matters both at the local level and at the State Office of Real Property Services level as well as litigation involving every aspect of commercial and industrial real property tax valuation. He has also been prominent in the field of Real Property Tax Exemption, focused on educational, assisted living, and charitable organizations. Mr. Grossman has chaired the Tax Certiorari and Land Use & Planning Committees of the New York State Bar Association’s Real Property Law Section, as well as serving as Chair of the 5,000-member Real Property Section. He is former

president of the Monroe County Bar Association and a fellow of the American College of Real Estate Lawyers.

JOEL R. HALL, ESQ.

Joel R. Hall is a sole practitioner in Santa Rosa, CA and is Of Counsel to Bartko Zankel Bunzel Miller in San Francisco. He is a former Associate General Counsel of Gap Inc. Mr. Hall is recognized as an accomplished commercial lease negotiator on a national scale, frequent speaker and author on leasing topics for ICSC, the Georgetown Law Center Commercial Leasing Institute and several other professional leasing programs. He was named as a *Superlawyer* in the area of real estate for Northern California from 2012 through 2015 and is a member of the American College of Real Estate Lawyers. He is a graduate of Villanova Law School.

ANDREW L. HERZ, ESQ.

Andrew L. Herz is Of Counsel to Patterson Belknap Webb & Tyler LLP. He is a recognized authority and frequent lecturer in the areas of commercial office leasing and mortgage financing.

Mr. Herz received the 2016 New York State Bar Association's Real Property Law Section Professionalism Award for his "exceptional contributions of time and talent to New York real estate lawyers." The award identifies a person "possessing an outstanding level of competence, legal ability and achievement; a continuing civility and appreciation for others in his/her practice; a person who has engaged in mentoring of younger attorneys and who has been involved in Bar activities both on a state and local level."

Mr. Herz received his B.A. degree from Columbia College in 1968 and his J.D. degree from Columbia Law School in 1971.

In the area of commercial leasing, Mr. Herz served as Chair of the Leasing Committee of the American College of Real Estate Lawyers and Co-Chair of the Office Leasing Committee of the American Bar Association. As former Chair of the New York State Bar Association's Commercial Leasing Committee, he is the only New York real estate lawyer to have held all three such leadership posts in commercial leasing. In addition to bar association groups, for the past ten years, Mr. Herz has been a member of the Advisory Board and presenter at Georgetown University's Advanced Commercial Leasing Institute. Mr. Herz has taught intensive seminars on commercial leasing for the New York University Real Estate Institute and lectured for The Real Estate Board of New York, The Practising Law Institute, the *New York Law Journal*, The National Association

of Corporate Real Estate Executives, and numerous other industry groups. Mr. Herz has been an Adjunct Professor at Vanderbilt Law School and is presently an Adjunct Professor at Brooklyn Law School where he teaches Commercial Real Estate Transactions.

JAY B. ITKOWITZ, ESQ.

Jay B. Itkowitz is a partner at Itkowitz PLLC. He is a litigator, a strategist, and a trial lawyer who has represented hundreds of individuals and major real estate companies in New York City over the last 30 years in almost every type of litigation and transaction.

Mr. Itkowitz is admitted to practice in the State of New York, the U.S. District Court for the Southern, Eastern, and Northern Districts of New York and the District of Columbia, the United States Court of Claims, the United States Court of Appeals for the Second Circuit, and the Supreme Court of the United States

Mr. Itkowitz received his Juris Doctor from New York Law School with honors in 1977, where he published a note in the *New York Law School Law Review*, "The Title Guaranty Theory and Related Decisions: Are the Courts Interfering With Exemption 7 of the Freedom of Information Act?," 23 *New York Law School Law Review* 275, 1977. He also received the American Jurisprudence Award for Contracts.

During law school, Mr. Itkowitz was a student clerk for the Hon. Gerald Goettel, U.S. District Judge, Southern District of New York, and the Hon. Nicholas Tsoucalas, New York State Supreme Court, Kings County. Moreover, Jay contributed to a book on United States Supreme Court Justice Douglas, entitled *Independent Journey: The Life of William O. Douglas* by James F. Simon (Harper & Row, 1st ed., 1980).

Mr. Itkowitz received his Bachelor of Arts in English Literature from Queens College of the City University of New York in 1971. He began his legal career as an Assistant Corporation Counsel for the City of New York, in the General Litigation, Environmental and Tort Divisions. He was a journalist, investigative and general assignment reporter, and copy editor for newspapers including the *New York Daily News*, *New York Post*, *Long Island Press*, *Newark Star Ledger*, *National Enquirer*, and *Village Voice*.

MICHELLE MARATTO ITKOWITZ, ESQ.

Michelle Maratto Itkowitz is the owner of Itkowitz PLLC. She practices real estate litigation, has over 20 years of experience, and is best

known for her work in the area of commercial and complex-residential landlord and tenant law in the City of New York. She represents both landlords and tenants, and her core competencies include rent stabilization and DHCR matters, sublet, assignment, and short term leasing cases (like Airbnb), rent stabilization and regulatory due diligence for multi-family properties, residential tenant representation (including buyouts), good guy guaranty litigation, co-op and condominium litigation, loft law matters, and de-leasing buildings for major construction projects. She is also is very experienced in general commercial litigation.

Ms. Itkowitz publishes and speaks frequently on legal issues in real estate. The groups that she has written for and/or presented to include Lawline.com; The Columbia Society of Real Estate Appraisers; LandlordsNY; Lorman Education Services; Rossdale CLE, The Association of the Bar of the City of New York; The New York State Bar Association, Real Property Section, Commercial Leasing Committee; Thompson Reuters; The Cooperator; The New York State Bar Association CLE Publications; The TerraCRG Brooklyn Real Estate Summits; The Association of the Bar of the City of New York; BisNow; and SubletSpy.

Ms. Itkowitz regularly creates and shares original and useful content on real estate and law, including booklets, videos, and articles. As the “Legal Expert” for LandlordsNY.com, the first social platform exclusively for landlords and property managers, she answers members’ questions, writes guest blogs, and teaches. Ms. Itkowitz recently developed a seven-part, eight-hour continuing legal education curriculum for Lawline.com entitled “New York Landlord and Tenant Litigation.” Over 16,000 lawyers have purchased her earlier CLE classes from Lawline.com, and the programs have met with the highest reviews.

Ms. Itkowitz is admitted to practice in New York State and the United States District Court for the Southern District of New York. She received a Bachelor of Arts in Political Science in 1989 from Union College and a Juris Doctor in 1992 from Brooklyn Law School. She began her legal career at Cullen & Dykman.

BRADLEY A. KAUFMAN, ESQ.

Bradley A. Kaufman is a member of Pryor Cashman's Real Estate Group, where he heads up the firm's commercial office, retail, and industrial leasing practice. For more than 30 years, Mr. Kaufman has been responsible for acquisition, leasing, and financing transactions aggregating many millions of square feet, representing owners and tenants in New York City and nationally.

Mr. Kaufman has authored numerous book and leasing manual chapters, including in the 2003 version of the *ALI-ABA Lease Negotiation Handbook*, chapters in all editions of this publication, and articles in various publications on a wide range of topics in the commercial and retail leasing field, including an annual article in the *New York Law Journal* on leasing trends in the New York marketplace.

Mr. Kaufman was the Co-Chair of the New York State Bar Association's Real Property Section, Commercial Leasing Committee, from January 2002 through December 2013.

Mr. Kaufman received his A.B. from Hamilton College in 1979, and his J.D. from Fordham University School of Law in 1982.

ABRAHAM B. KRIEGER, ESQ.

Abraham B. Krieger focuses his practice in the area of real estate law at Meyer, Suozzi, English & Klein, P.C. Mr. Krieger's practice, where he served as Chair of the Real Estate Department for six years, includes representing businesses and individuals in commercial and residential real estate lending, sale, and lease transactions and real estate, lease and commercial litigation. An integral part of his practice includes representing commercial lenders and borrowers on real estate financing transactions and title insurance companies on defending fee title and mortgage validity and enforceability claims.

Mr. Krieger has been named to the New York Super Lawyers list as one of the top attorneys in New York from 2013–2016. In March 2012, Mr. Krieger was appointed to the Grievance Committee for the Tenth Judicial District, and in 2013 was appointed as its Chairman, where he served through the 2017 term. He has served on the NYSBA Real Property Section Executive Committee and its Subcommittees on Professional Conduct, and Due Diligence Lease Checklists and currently serves on the Real Property Financing Committee. He has been appointed as an expert witness and mediator in various real estate litigations by appointment of the Federal District Court, New York State Supreme and District Courts. He has served as Receiver and counsel to Receiver on major Nassau, Suffolk, Queens County, and Federal Court foreclosures. He received the Nassau Suffolk Law Services Pro Bono Attorney of the Month and Nassau County Bar's Pro Bono Award, Volunteers Lawyers Project. From 2008–2016, Mr. Krieger was recognized in the Long Island Business News Who's Who in Commercial Real Estate Law, and in LIBN's Ones to Watch in Commercial Real Estate Law. He is rated "AV Preeminent" by Martindale-Hubbell, the highest level in professional excellence, and

recognized by Long Island Pulse Magazine in 2010 through 2015, as one of the region's "Top Legal Eagles." Mr. Krieger was named a 2015 Access to Justice Pro Bono Provider by the Nassau County Bar. He also serves as a mentor in the NCBA's Call-A-Colleague program. Mr. Krieger is a frequent lecturer on real estate, professional conduct, and escrow management.

Mr. Krieger has served as an Adjunct Professor in the Real Estate Department at Hofstra University School of Law. He has published numerous legal and scholarly articles throughout his career in *The Nassau Lawyer*, *The New York Law Journal*, *Real Property Law Journal*, and *The ISLA Journal of International and Comparative Law* on "The Holocaust as Catalyst for International Justice." In March 2009, Mr. Krieger, along with other members of the World Jewish Congress, met in New York with the German Ambassador to the United Nations to discuss human rights issues.

ANDREW A. LANCE, ESQ.

Andrew A. Lance is a partner in Gibson, Dunn & Crutcher's Real Estate Practice Group and a resident in the New York office. Mr. Lance's clients include private real estate equity funds, hedge funds, corporate and individual developers and owners of office, retail, hotel, industrial, recreational, professional sports and entertainment real estate, mortgage and mezzanine lenders, REITs and other public and privately held companies investing in or using real estate. Mr. Lance also represents many not-for-profit organizations, particularly those building charter schools and those involved in the performing arts. Mr. Lance also leads the firm's leasing practice and is co-chair of the firm's hospitality practice.

Mr. Lance is a member of the American College of Real Estate Lawyers and a fellow of the American College of Mortgage Attorneys. Mr. Lance was ranked as a leading Real Estate lawyer by *Chambers USA: America's Leading Lawyers for Business* 2010. Mr. Lance is listed in *The Best Lawyers in America* 2010 and 2009 and in *New York Magazine's* "2009 New York Area's Best Lawyers" edition. Mr. Lance was the lead attorney for the transactions that won the Real Estate Board of New York's Most Creative Retail Deal of the Year Award twice in recent years: the relocation of Hard Rock Café to the former World Wrestling Entertainment site at Times Square (2004), and the lease by Walgreens of the entire building at One Times Square (2007).

Mr. Lance joined Gibson, Dunn & Crutcher in March 1999. He previously practiced law as Special Counsel with Sullivan & Cromwell in New

York from 1984 to 1993. Mr. Lance has been an Adjunct Professor at New York Law School since 1985, teaching Commercial Real Estate Leasing and Land Transfer and Finance, a Visiting Lecturer at Yale Law School, and a lecturer at the New York University Schack Institute of Real Estate teaching Real Estate Finance and Investment Analysis. He also is a frequent lecturer at programs of the Practising Law Institute, the New York State Bar Association, the International Council of Shopping Centers, and IMN Conferences. Mr. Lance earned his J.D. in 1983 from Yale Law School, where he was a member of the *Yale Law Journal*. He earned a bachelor of arts degree *cum laude* in 1980 from Princeton University and attended the University of Paris. Mr. Lance was a Fellow of the Coro Foundation Leadership New York Program for the 1999–2000 term.

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Andrew L. Herz, Esq.

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CHAPTER 47 NEW YORK STATUTES ON COMMERCIAL LEASING

Joshua Stein, Esq.

CHAPTER ONE

**INTRODUCTION:
THE LEASING STATE OF MIND**

Joshua Stein, Esq.

Your clients need space. Their current lease will expire soon, or they're opening a new location, or they're consolidating some functions. They need to be open and operating in six months or nine months or twelve.

Before they can open, though, they need to set up their new space just the way they want it—except they don't know what they want and they can't figure it out until they know what space they're talking about. And parts of their operation will be very difficult to move.

The person in charge of finding and moving to the new space might be very familiar with how real estate works—for example, if the tenant is a chain store that opens a new location every week.

If the tenant's business has nothing to do with real estate and it's a small company, though, then the lucky staff member overseeing the project may have no idea at all of what must be done. That person may look to you to provide the expertise and help them keep their job.

Any move or expansion brings with it uncertainty. What if the landlord can't deliver the space when they said they would? What if your client underestimated or overestimated their needs? And what happens if construction goes over budget or takes too long? What if your clients can't move out of their old space on time, before their old lease expires? What if everything goes great, as a real estate matter, but the company's business collapses or changes, or the company gets taken over or for any other reason the company needs to move again, so it no longer needs the space?

When a company makes a long-term commitment to a building, how long is too long? Would the company prefer flexibility or certainty? Does it want to bear the risk of possibly having to relocate again soon? Will it trade certainty for commitment?

The last few paragraphs suggest only the first few of potentially hundreds of practical business questions that any tenant must consider when negotiating a substantial new commercial lease. All these questions—and the larger business context they suggest—are also often part of the mix that tenant's counsel must consider in negotiating a lease.

The tenant will also want to understand how much the space will cost, and satisfy itself that even if the exact numbers cannot be predicted at lease signing, they will conform to the tenant's general expectations.

An owner of a building faces an entirely different set of questions and issues.

The value of any real estate is at its most solid if the real estate generates income—preferably reliable and steady income over a long term. To generate that income, an owner needs tenants in occupancy—preferably reliable and steady tenants over a long term (unless the owner thinks the rental market will shoot up quickly, in which case the owner might want a shorter term, although an owner’s tolerance for uncertainty will change over time). And the owner also wants to assure that the income stream will protect the owner from inflation.

The owner thinks about all these things in the shadow of future lenders, and what they will expect, want, and need from the building if the owner wants to obtain the best possible financing. Lenders look for reliable cash flow without interruption. Leases are supposed to provide it.

How can an owner get the right kinds of tenants into the building as quickly and cheaply as possible? How can the owner assure that they pay—and continue to pay—the highest possible rent? Or would the owner trade some rent for greater stability, longer-term leases, and more credit-worthy tenants?

If the owner needs to pay brokerage commissions and tenant improvement costs as the price of obtaining new tenants, does the owner have the money? If not, where will it find the money? The notion of just dipping into the owner’s pocket is unheard of in the world of real estate. Capital investments are typically financed through debt whenever possible.

And how can the owner be sure that these outlays to obtain new tenants will, in fact, give the owner the reliable income stream it wants and needs? Will the tenant stick around long enough to deliver the expected payoff for the landlord’s investment?

How do the current lease negotiations tie in to the owner’s long-term plans for the building? When does the owner plan to refinance? Does the owner plan to reposition the building? Change its use? Change its position or quality level in the market? Accumulate space for some other—more desirable—tenant? Sell? Eventually demolish or redevelop any time soon? The owner’s leasing decisions today can dramatically affect the actions the owner can take tomorrow.

In negotiating a lease, an owner and its counsel need to consider these questions and their answers, to try to assure that, at the end of the day, the transaction works for the owner and helps the owner meet its long-term needs and goals for the building.

Once a space user and a building owner find each other and work through the questions described above and many more, they negotiate and sign a lease. Then the two parties need to live with each other for the life of the lease. Their rights and obligations regarding the building will, in first instance, depend on the words of the lease. During their life together, here are some questions that may arise:

- Does the tenant need to change something about the leased space?
- Does the tenant want to sell its business or merge with some other company?
- Does the tenant want to change the nature of its business, so that instead of doing one thing it will now do something else and renovate its space accordingly?
- Does the landlord want to change the air conditioning system in the building or make other changes to accommodate a future tenant?
- Does the landlord want to change anything else about how the building operates—perhaps something as mundane as how the building processes messenger packages?
- Does the landlord want to refinance or sell or expand or demolish or even just rename the building?

In each case, a party's ability to do what it wants may, in the first instance, depend at least in part on what the lease says. The words of the lease will have been defined as part of the original transaction and original negotiations, a one-time event whose consequences will reverberate for both parties for the entire term of the lease.

When landlords and tenants sign leases, though, they often do it in the heat of the moment. The parties meet, feel some mutual attraction, then want to tie the knot, often with the same urgency as a pair of 18-year-olds at a wedding chapel in Las Vegas. The wedding ceremony may take 20 minutes, but the happy couple, the landlord and tenant, will have 20 years to regret it.

Unlike matrimonial law, though, the law of commercial leasing does not include the concept of divorce. Neither party to a lease can unilaterally (or relatively unilaterally) terminate the relationship. Unlike husband and wife, landlord and tenant are usually stuck with each other for the life of their lease.

This practical reality means that once a landlord and a tenant have accomplished their happy introduction, they both need to give significant thought to the lease that they ultimately sign. Although the step of signing a lease is crucially important—because it gives both parties some level of incremental certainty—both parties will have many opportunities to regret whatever the lease says in the short, medium and long term.

In the rush and excitement of getting a lease signed, both parties need to confirm that the lease properly considers their needs over time, and how those needs might change.

For a commercial leasing lawyer, that analysis begins by understanding the needs of the parties when they sign their lease. Some of those needs were suggested earlier in this discussion. But any tenant and any landlord will also have a variety of other needs and expectations.

A tenant's initial needs will depend largely on the nature of its business, what it plans to do in the space, and what the space needs to give the tenant so it can do those things.

This can require a complete understanding of the gritty details of how the tenant's business works. Where does the tenant's staff expect to park its cars? Does the tenant need signs? What kind of communications equipment does the tenant use? How does the tenant receive deliveries? Who are the tenant's competitors, and can the tenant tolerate them nearby? If the tenant is a store, how does it physically sell its goods? How much electrical power does the tenant need? The questions can go on and on.

Looking ahead, a tenant and its counsel must consider the myriad possibilities of changed circumstances. Some examples:

- What happens if the tenant no longer needs the space? Does the lease give the tenant an acceptable exit strategy?

- What if the tenant's technology and support needs change? For example, what if the tenant needs a new communications system or more air conditioning?
- Might the tenant need to change its business activities at this location? Its name?
- Will the tenant always need whatever package of services the landlord offers? More services? Fewer? Different?

A landlord takes a narrower view of the future.

As in the present, the landlord wants in the future to receive a reliable incoming cash flow, coupled with a predictable level of expenses.

Unless the landlord is in a branch of real estate operation that contemplates constant change (e.g., shopping malls or the renting of Broadway theaters to successive dramatic productions), the landlord and its lender want, above all, reliability, predictability, and no surprises. Change is tolerable only if the landlord can control it, or shift its costs and risks to someone else. This means a landlord may start the lease negotiations by trying to control almost everything, just to assure that nothing changes, at least in a way that might hurt the landlord's cash flow.

Tenants typically look for flexibility. Leasing lawyers who represent tenants need to know what kind of flexibility to ask for and need to ask their clients what kind of flexibility matters to them.

In negotiating a substantial commercial lease, the parties may need to consider carefully almost every issue that can possibly arise over a very long period regarding a single piece of real estate. These issues range from the fundamental to the mundane to the arcane.

To help commercial leasing lawyers identify those issues and do their job, this book gives them a practical set of tools, checklists, ideas, and sample documents. With a few exceptions, each chapter of this book covers a particular topic that arises again and again in commercial lease negotiations. In each case this book approaches that topic from the practical perspective of how to get a deal done, rather than in a legalistic vacuum.

Drawing from their experiences in the trenches of commercial leasing, the contributors have tried to identify—for both landlords and tenants—the issues that matter, and how those issues can reasonably be negotiated.

In addition to a couple of dozen chapters covering particular issues or “hot spots” in commercial lease negotiations, this book also includes two checklists that attempt to remind both tenants and landlords of the “silent issues” they should remember to raise (or at least consider raising) in negotiating any commercial lease. These checklists take a more comprehensive approach than the remainder of the book, and give lease negotiators a quick way to crosscheck their work and try to identify what they might have missed. (Many of the issues in the silent checklists turn out not to be as silent as the checklist authors originally intended. Some of those issues stare lease negotiators in the face, crying out for attention.) Both the landlord’s checklist and the tenant’s checklist are in at least their third editions and have been further updated for this book.

This work also includes many sample documents, including these, updated as appropriate for this third edition:

- A complete commercial lease suitable primarily for office space, but with a rider for retail space, as well as some other options.
- A set of “New York” clauses that any New York landlord will often want to include in any lease.
- The “model” nondisturbance agreement previously published by a subcommittee of the New York State Bar Association Real Property Law Section Commercial Leasing Committee.
- A sample demonstrating a sample rider that tenant’s counsel might attach to a New York City standard office lease.
- A comprehensive form of tenant estoppel certificate.
- A standby letter of credit suitable for use in place of a security deposit.
- A routine sublease for excess office space.
- A lease review/summary form for use by commercial mortgage lenders.

These and other sample documents included in this work were contributed by the editor and by some of the authors of this work. Each reflects the particular experience of whoever contributed it, and only through the moment of writing. None should be relied upon as a generic document that will always apply (as written) to any particular transaction. Any user

INTRODUCTION: THE LEASING STATE OF MIND

of any model document must examine it from beginning to end to confirm that it is appropriate and complete for any particular transaction. These models are provided merely as starting points or for cross-checking or developing other documents.

Many of the models, checklists and other materials in this book have been published elsewhere but updated for this book.

This work concludes with a collection of New York statutes that relate directly to commercial real estate leasing, with a few provisions from the New York City Administrative Code and other primary sources. These statutes have been abridged by removing outdated provisions and simplifying numbering and internal cross-references, to make them easier to understand, follow, and use. These changes are all marked. The commercial leasing statutes have been categorized and separately indexed by subject matter. This collection should help New York commercial leasing practitioners understand the significant body of statutory law that governs this area, and easily find particular provisions when necessary.

CHAPTER TWO

MODEL TERM SHEET FOR OFFICE LEASE

Joshua Stein, Esq.*

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MODEL TERM SHEET FOR OFFICE LEASE

VIA EMAIL; CONFIDENTIAL AND NONBINDING

[Date]

[Landlord or Landlord's Broker]

[Address]

[Address]

Re: [Building – Floors]

Dear _____:

On behalf of _____, we have been authorized to submit this proposal to lease space in the building identified above, based on these terms and conditions:

TENANT	
PREMISES	
SIZE OF PREMISES	_____ rentable square feet.
TERM	_____ years from Possession.
BASE RENT	_____/rsf in years _____ through _____; _____/rsf in years _____ through _____; _____/rsf in years _____ through _____.
ESCALATIONS	Proportionate share of Operating Expenses [over a base year of _____]. Proportionate share of Real Estate Taxes [over a base year of ____/____].
POSSESSION	Upon satisfaction of Delivery Conditions below.
RENT COMMENCEMENT	_____ months from Possession.
USE	

LANDLORD'S CONTRIBUTION	_____/rsf allowance for hard construction costs; up to 20% may be used for soft costs, cabling, and installed equipment.
LANDLORD'S WORK	
DEADLINE FOR LANDLORD'S WORK	
SUBLEASE AND AGREEMENT	Tenant may sublease or assign: (a) to affiliates without consent; and (b) otherwise, with Landlord's reasonable consent. _____ [Tenant and Landlord shall share 50/50 all profits associated with a sublease/agreement.]
SECURITY DEPOSIT	[____ months rent.] [To be determined based on review of Tenant's financial statements.]
GUARANTOR	
RENEWAL OPTION	One renewal option for five years after the initial term, at the [lesser] [greater] of Tenant's current rent as escalated or ____% of fair market value. Renewal exercise deadline ____ months before expiration.
RIGHT OF FIRST REFUSAL	Please indicate additional space on the ____ floor and timing for its availability. Tenant shall have the right of first refusal on all or any part of that space. Base rent for any additional space shall have the same pricing as the renewal option.
ELECTRICITY	Direct meter.

MODEL TERM SHEET FOR OFFICE LEASE

<p>DELIVERY CONDITIONS¹</p>	<p>1. All asbestos, ACM and other hazardous materials shall be removed from (i) any and all areas of the Premises, (ii) the toilets, underfloor ducts (if any), telephone, electric and other service closets and common areas, and (iii) all shafts, mechanical rooms and other areas in which Tenant will be performing work. All such areas shall be re-fireproofed as required by code and good construction practice. Landlord shall deliver an ACP-5 Certificate for the premises, showing Tenant's improvements are not an asbestos job. Any asbestos removal shall be performed by a licensed asbestos removal company.</p>
	<p>2. All existing tenant improvements in the premises (except core areas) shall be demolished from slab-to-slab (including interior partitioning, hung ceilings and support systems, lighting, floor tile and glue, carpeting and padding, unused cable, conduits, plumbing lines, miscellaneous steel and ductwork) and the premises shall be in a broom-clean condition, free of debris. Landlord shall repair damaged fireproofing on building columns.</p>
	<p>3. Landlord shall deliver floors and walls scraped and patched, ready for Tenant finishes. Floors shall be leveled.</p>
	<p>4. Landlord shall provide complete infrastructure with sufficient sprinkler capacity and reserve, including a valved outlet on each floor, to enable Tenant to install code compliant sprinkler system throughout the premises. Landlord shall separately reimburse Tenant for the cost of installing a sprinkler loop and sprinklers in the toilets and service areas of the premises.</p>

¹ These delivery conditions refer to a "typical" deal for an office lease. Adjust as appropriate for any particular transaction.

	5. All public areas, elevators, call buttons, indicator lights, toilets, core doors, fire pull stations, warden stations, etc. shall fully comply with code.
	6. Landlord shall upgrade core toilets to the standard of a Class A building, including new fixtures, new tiles (on walls and floors), new mirrors, replacement of all hardware, new partitions, new ceiling and new lighting, and strobes to be installed.
	7. Please indicate electrical capacity (watts/usable foot).
	8. Landlord shall provide building standard venetian blinds.
NON-DISTURBANCE	Tenant [requests/requires] at Lease signing a non-disturbance agreement from all mortgagees and ground lessors.
ALTERATIONS	Tenant may perform decorative and other minor alterations. Anything above a threshold requires Landlord approval, not to be unreasonably withheld. No alterations to exterior, structure, building systems, etc.
RESTORATION	Tenant need not restore at end of term.
SIGNAGE; DIRECTORY	Proportionate share.
BROKERAGE	Landlord to pay ____ one full commission only if and when the parties have a signed a Lease and all conditions to its effectiveness have been met, all through a separate brokerage agreement. ²
CONFIDENTIALITY	This proposal is submitted in strict confidence. Neither party shall disclose it except as required by law or to advisors or consultants who have agreed to maintain confidentiality.

2 Given the pitfalls of brokerage law, Landlord should consider signing something to similar effect with the broker (particularly a tenant's broker with whom Landlord might have no relationship) early in the process.

MODEL TERM SHEET FOR OFFICE LEASE

This proposal does not bind either party in any way, except the sections on “Brokerage” and “Confidentiality” and this paragraph. The parties may circulate drafts, comments, issues lists, emails, and other communications, with or without expressly reserving rights. Neither party shall rely on any such communications, which shall bind no one in any way unless and until the parties have executed, exchanged, and delivered final agreed documents.

Very truly yours,

[Signature]

CHAPTER THREE

OFFICE LEASING TERM SHEET: TENANT'S AGENDA

Joshua Stein, Esq.*

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OFFICE LEASING TERM SHEET: TENANT'S AGENDA

When an office tenant, particularly a major office tenant, negotiates a term sheet, the tenant and its advisers should consider adding at least some of these provisions to the term sheet, beyond the “obvious” provisions such as rent, base term, and scope of premises. By adding to the term sheet provisions like those below, a tenant can simplify and shorten Lease negotiations. Exactly which terms to raise will depend on all circumstances. It is the nature of this type of list to grow and never shrink. This list starts with the most important items – concessions that even a small Tenant might seek – and then includes other items in descending order. Anyone using this list must do so selectively and intelligently. No one should shovel words from this document mindlessly into some other document. Many of these terms also apply to other types of leases.

Landlord Services. Landlord will provide cleaning, security, maintenance, repairs, utilities, HVAC, freight and passenger elevator, and other services to a standard comparable to similar first-class buildings, for premises and common areas. Landlord will provide [at least __ cardkeys] [cardkeys equal to Tenant parking spaces], and replacements at nominal cost.

Use. Tenant may use as general office premises and customary incidental uses for Tenant and its employees, e.g., training, duplication, exercise room, food service, child care, and ATM.

Tenant's Alterations. No fee for plan review for tenant's initial build-out. Landlord must be reasonable, and pre-approve Tenant's initial build-out, to the extent defined at signing. No bonds. Landlord shall promptly sign permit applications. Tenant need not restore, except unusual and non-standard installations such as vaults and internal staircases. As a matter of due diligence, will Tenant's alterations raise any issues within the building, e.g., the need to enter other tenants' space?

Assignment and Subletting. No Landlord consent needed for transactions with Tenant affiliates; any merger, consolidation, or other transaction affecting Tenant; or transfer of Tenant's equity. Landlord shall not unreasonably withhold consent to other transactions. Landlord shall respond within 10 days. No recapture right. No profit share. Will Tenant sublet space to suppliers, consultants, or other counterparties?

TI Allowance. Tenant may apply to any “hard” or “soft” costs of Tenant's work, including network and other communications cabling. Disburse in installments as construction progresses, not only upon completion. Lien waivers for final disbursement only. Disburse any remaining

allowance to Tenant upon completion of work. If Landlord fails to disburse within 90 days after required to do so, Tenant may abate rent, plus interest at prime.

Operating Expenses. Limit to actual. One-year deadline to bill. After receiving Landlord's final bill for any operating year, Tenant will have 6 months to audit (18 months for base year), using any auditor of Tenant's choice. If audit discloses an overcharge of 3% or more, Landlord will pay all audit costs.

HVAC. Overtime fees must reflect Landlord's actual costs, allocated among multiple simultaneous users. Deadline to order overtime HVAC shall be 3 p.m. on same day. Regular HVAC hours shall be _____.

Utilities. If space is submetered, Tenant shall reimburse Landlord only for actual cost of submetered power at Landlord's tariff[, plus an administrative fee of ___%]. If Tenant requires additional power, Landlord will arrange it at Tenant's expense. If Tenant requires additional telecommunications service, Tenant may arrange it at Tenant's expense. Landlord will cooperate.

Legal Compliance. Tenant shall comply with legal requirements for Tenant's particular manner of use of the Premises. Landlord shall be responsible for all other compliance.

Environmental. Tenant shall have no liability for any environmental matters except arising from Tenant's acts or omissions in violation of law. Landlord will deliver the space [free of any asbestos or ACM] [with all asbestos or ACM abated in compliance with law].

SNDA. Landlord will deliver SNDA(s) at signing. Any present or future SNDA will not exculpate successor liability for (a) TI allowance; or (b) offsets or abatements accrued under express terms of Lease, provided Tenant gave mortgagee notice of Landlord's default.

Renewal Option. 95% of fair market value with no floor. Exercise deadline shall be 6 months before end of term, provided no uncured Event of Default. Option travels with Lease.

Insurance. Tenant may satisfy all insurance requirements by delivering appropriate certificates under Tenant's reasonable company-wide insurance program.

OFFICE LEASING TERM SHEET: TENANT'S AGENDA

Parking. If any tenant has reserved parking, Tenant will have equivalent rights, adjusted for relative occupancy.

Security Deposit and Default. Ideally, no security deposit. If a security deposit is required, then Tenant can provide letter of credit. Cure periods after notice of default: monetary, 10 days; nonmonetary, 30 days plus diligence. For first 30 days of holdover, prorate holdover rent daily at 125% of reserved rent. No liability for consequential damages or loss of next tenant.

Right of First Offer. Tenant shall have right of first offer for any available space in building. Tenant may assign this right as part of Lease.

Signage. Tenant may list (and later update) at least ____ individuals and Tenant affiliates in building directory. Tenant may use its share of any outdoor signage. Building will not be named for Tenant or its competitor.

Additional Facilities. Tenant may install and use reasonable rooftop communications facilities, such as satellite dishes. Tenant may install backup generators and fuel tanks at a location outside the premises as specified in Lease. No additional rent for these items.

Rent Abatement. Tenant can abate rent and exercise self-help rights if services are interrupted (or if Landlord's work interferes with Tenant's use and occupancy) for more than 3 business days, or any 10 days in 6 months. Tenant may offset rent, with interest at prime, if Landlord does not reimburse Tenant's costs within 30 days after receipt of an invoice.

Abatements and Incentives. Before signing, Tenant will need to understand available incentive programs and file preliminary applications as needed. Landlord shall cooperate. If Tenant's occupancy triggers real estate tax abatements, Tenant shall receive the sole benefit.

Exclusivity. For 45 days, these negotiations shall be exclusive and neither party shall negotiate with any other counterparty for a competing transaction.

CHAPTER FOUR

MODEL COMMERCIAL LEASE

Joshua Stein, Esq.*

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[4.0] I. DESCRIPTION

This Model Document consists of a generic commercial space Lease. It approaches the transaction primarily from a Landlord's perspective, but also reflects some concerns that a well-represented Tenant will raise. This Lease does not, however, seek to offer a "fair" or "balanced" resolution of issues. The latter, though perhaps a good idea, is more easily suggested than done. This Lease does, however, leave out some common "gotcha" clauses often found in Landlords' form leases.

The "base" Lease covers office space. For retail space, Exhibit B-3 offers provisions one can incorporate by reference or weave into the main Lease. Retail use will also require making appropriate changes to the "base" Lease, e.g., tightening the transfer and use restrictions.

When using this Lease for any particular building, one will always need to tailor it to that building, mostly for issues of use, utilities (for example, the "basic" Lease defines the Landlord's "Basic Services" to exclude electricity, and assumes direct metering with no Landlord involvement), construction, repairs, compliance with law, Landlord services (e.g., cleaning), pass-throughs, and operating requirements. When counsel starts a new leasing project—particularly a leasing program to cover all leases in a particular buildings as they arise—counsel should discuss these and other matters with the client. Buildings vary widely, as do Landlords and their expectations and standard operating procedures. Something "obvious" to one Landlord client may seem "bizarre" to another. And, in a perfect world, all leases in any given building will both (a) reflect the actual operations of that building; and (b) conform to one another.

Beyond those areas, though, any user must review, consider, and adjust the entire Lease as appropriate in context. A Landlord or its counsel may delete provisions that seem unnecessary or excessive under the circumstances. But almost every "excessive" provision in this Lease: (a) appeared at one point or another in a Lease that the author received from Landlord's counsel when representing a Tenant; and (b) may make all the difference in some future dispute. Because of its status as a "model" Lease, this document errs on the side of saying more rather than less. Any Landlord or Landlord's counsel can easily fix that. It's easier to delete than to identify what's missing.

After Exhibit B-3 (retail terms), this Lease includes optional language on rent adjustments; option terms; demolition; electricity variations (sub-

metering and rent inclusion as opposed to direct metering); treatment of so-called “profits” on transfer; and other matters. Some of these optional provisions might be regarded as overkill.

Like any other sample document, this one reflects many transactions where it was used, adjusted and negotiated. Some provisions in this Lease will not make sense for any particular future transaction. Past transactions might not have required provisions appropriate in some future transaction. Footnotes in this Lease discuss some issues, but not all issues or decision points.

Anyone using this Lease or any other model document must review it carefully from beginning to end to assure it is correct and appropriate for the particular transaction in the applicable market. The author makes no representation or warranty about whether this Lease satisfies the preceding sentence or is fully enforceable.

This Lease leaves blanks for most percentages and other numerical terms, which will vary with circumstances and context. For most time periods, this Lease provides a “typical” number of days.

For issues to consider, please see the Landlord’s Checklist of Silent Lease Issues (chapter 7) and Tenant’s Checklist of Silent Lease Issues (chapter 6), both co-authored by Joshua Stein, updated and reprinted for the third edition of this book. This Lease does not cover all issues in those checklists, but covers most of them.

This Lease seeks to follow principles of “Plain English” and straightforward legal writing. Many sentences are (relatively) short. The Lease expresses obligations in the active voice. It relies on defined terms instead of section cross-references and repeated “laundry lists.” The first few pages contain all deal-specific definitions and business terms. Many clients like that format. It simplifies future lease reviews. The last few pages of Exhibit B-1 define most other capitalized terms the Lease uses.

Considered as a whole, this Lease is relatively long and “full.” It also includes some nonstandard provisions driven by recent case law or the author’s experiences.

An earlier version of this Lease was reviewed in draft by Elissa G. Benudis, formerly of Latham & Watkins LLP and now with The LeFrak Organization; Andrew L. Herz of Patterson, Belknap, Webb & Tyler LLP; and Robert J. Shansky of Scarola Malone & Zubatov LLP. Lauren Silk, of

the author's legal staff, assisted in updating this Lease based on use in transactions. Blame only the author for any errors or misjudgments in this Lease. This model Lease also benefits from comments and negotiations from a range of clients and Tenant's counsel in many leasing transactions.

[4.1] II. OTHER DOCUMENTS

This document may need these exhibits, related documents or deliveries, additional information, conforming provisions in other documents, etc.

- *Authority, Etc.* Landlord may desire evidence of due execution and authorization. Occasionally, Landlord may even request an opinion of counsel. Opinions are, however, rarely requested except for very large leases or those with not-for-profit, foreign, governmental or diplomatic entities. This general laxity about opinions does not seem to have produced an epidemic of improperly executed, undelivered, unauthorized or unenforceable leases. One could require an officer's certificate on these matters—already more paper than industry standard and not particularly more useful or reliable than the representation and warranty already in the Lease itself.

- *Exhibits.* If necessary, attach space plan and other exhibits, including description of Landlord's Initial Work and Tenant's Initial Work, if Tenant wants it pre-approved. This Lease refers to some other possible exhibits, without samples. Most exhibits still require designation by exhibit letter. The process of obtaining exhibits will often amount to the critical path in getting any Lease done.

- *Guaranty.* If the Lease will be guaranteed, attach the form of Guaranty as an exhibit. The Guarantor's signature may be harder than the Tenant's to obtain, thus creating potential last-minute problems. Another Chapter of this work offers a model Lease Guaranty.

- *Landlord Waiver.* A retail Tenant may want Landlord (and perhaps its mortgagee(s)) to waive any liens against Tenant's personal property, and agree to let Tenant's asset-based lender enter the Premises and take possession of its collateral under certain circumstances. Landlord should review these waivers carefully, as they are often rather one-sided in favor of the lender, e.g., by giving the lender open-ended access rights after Lease termination free of any obligations at all.

- *Lender Approval.* If the Lease will require approval by Landlord's mortgage lender, Landlord's counsel should start the process early, and comply strictly with the requirements and procedures of the loan documents. The hardest part may consist of figuring out who currently services the loan, how to reach them and what they want to see when asked to approve a lease. And all of this will change every time the loan moves from one servicer to another. A "business" call before the "legal" call sometimes helps.

- *Letter of Credit.* If Tenant will use a letter of credit in place of a cash security deposit, this will need to be coordinated with the L/C issuer. The process can become tedious, especially to the extent the L/C issuer has (or Tenant causes the issuer to have) its own ideas about the form of L/C. To prevent these problems and delays, if a Lease will require an L/C, the parties should focus on it as one of the earliest and most important documents. If the L/C will exceed a year's rent, it should come from a guarantor and not from Tenant. Other chapters of this book address the use of L/Cs for leases.

- *Memorandum of Lease.* If Landlord is willing to record a memorandum of lease, then it must be prepared for signature, with all necessary tax returns and deliveries for recording. Sometimes, Landlord will want a release of the memorandum of lease to be deposited in escrow. This is, however, nonstandard and probably excessive in most transactions. If the parties do record a memorandum of lease, then New York law effectively requires them to amend the memorandum every time they amend the Lease, even if the amendment affects nothing disclosed in the memorandum.

- *Nondisturbance Agreement.* Ideally, at the moment of Lease signing, Landlord's counsel can handle this document as an adjunct to the process of obtaining lender consent to the Lease, if required. If Tenant will try to negotiate this document, get that process started as early as possible.

- *UCC Financing Statement.* If Landlord obtains a security interest in Tenant's personal property and wants that security interest to be meaningful, then file a UCC financing statement. New York law gives Landlord no automatic lien on Tenant's personal property. Any such liens are probably not "market standard" for Tenants with any negotiating strength at all.

[4.2] III. ADMINISTRATION

This document creates these and other issues and concerns for post-closing administration and follow-through.

- *Advice Memo to Landlord.* Landlord’s counsel will often want to give Landlord a summary of important dates, requirements and other provisions in the Lease. For a sample and some other advice on Lease administration, see the Chapter on “Living with Leases” in this work.

- *Commencement Date Notice.* If the Lease contemplates future delivery of the space, Landlord should remember to give whatever notices of commencement the Lease requires.

- *Dates.* Track any deadlines, delivery dates, or reminder requirements.

- *Estoppel Certificates; Other Deliveries.* Landlord may periodically request estoppel certificates (both from tenant and from any guarantor); financial statements; sales figures; ownership certificates; etc.

- *Letter of Credit.* A letter of credit requires extra administrative steps that are extremely important. See the Chapters of this book on letters of credit.

- *Security Deposit.* Handle Security in compliance with Law.

L E A S E

Landlord and Tenant enter into this Lease (this “Lease”) as of the first date when both have signed it (the “Signature Date”). This Lease consists of the signature page below and the following, all legally binding as if they appeared in the body of this Lease:

- *Basic Terms.* The Basic Terms attached as **Exhibit A** (“Basic Terms”), which identify some basic business terms and other matters about this Lease;

- *Supplemental Terms.* The Supplemental Terms attached as **Exhibit B-1** (the “Supplemental Terms”), which contain additional terms;

- *State-Specific Terms.* The State-Specific Terms attached as **Exhibit B-2** (also “Supplemental Terms”), which cover some state-specific matters;

• *Retail Terms.*¹ The Retail Terms attached as **Exhibit B-3** (also “Supplemental Terms”); and

• *Other.* Any other exhibits or attachments that this Lease identifies.

By signing below, Landlord leases the Premises to Tenant; Tenant takes and hires the Premises from Landlord; and the parties agree to all terms and conditions of this Lease.

LANDLORD

TENANT

By: _____

By: _____

Its: _____

Its: _____

Date Signed: _____

Date Signed: _____

Taxpayer I.D.: _____

Taxpayer I.D.: _____

Exhibits Attached:²

Simultaneous Deliveries:

A Basic Terms, With Index of Defined Terms

Check for Base Rent for ____ Month(s) (\$____)

B-1 Supplemental Terms

Evidence of Tenant’s Insurance³

B-2 Supplemental Terms (State-Specific)

L/C or Cash Security (\$____)

B-3 Supplemental Terms (Retail)

Personal Guaranty(ies)

W-9 for Interest on Security Deposit (If Cash)

1 Omit this paragraph for a non-retail lease. Adjust punctuation and placement of “and.”

2 Include all exhibits, such as Landlord’s Initial Work, form of L/C Security and form of Estoppel Certificate. Include building rules and construction rules as desired. Preferences for exhibits will vary. Reletter as appropriate.

3 Tenant should provide specimen evidence of insurance before Lease signing, so Landlord or its insurance adviser can review and hopefully approve it.

EXHIBIT A: BASIC TERMS

1. Identifying Information; Certain Terms and Conditions.

As used in this Lease, these terms have these meanings:

THIS TERM	MEANS									
“Anticipated Delivery Date”	_____									
“Base Operating Expenses”	Operating Expenses for the Operating Year that [starts on _____, 201____] [consists of calendar year 201____] [includes [the day __ that is days after] the Signature Date]									
“Base Property Taxes”	Property Taxes for the Property Tax Year that [starts on _____, 201____] [consists of 201___/ 201__] [includes [the day that is ___ days after] the Signature Date]									
“Base Rent”	<table><tr><td>Lease Year(s)</td><td>Annual</td><td>Monthly</td></tr><tr><td>_____</td><td>\$ _____</td><td>\$ _____</td></tr><tr><td>_____</td><td>\$ _____</td><td>\$ _____</td></tr></table>	Lease Year(s)	Annual	Monthly	_____	\$ _____	\$ _____	_____	\$ _____	\$ _____
Lease Year(s)	Annual	Monthly								
_____	\$ _____	\$ _____								
_____	\$ _____	\$ _____								
“Broker”	_____									
“Building”	The building commonly known as _____, and the underlying and adjacent land Landlord owns (or leases from a Master Lessor)									
“Commencement Date”	The Signature Date, except that if this Lease requires Landlord to perform any Landlord’s Initial Work, then the first date when either: (a) Landlord has [correctly Notified Tenant that Landlord has] Substantially Completed Landlord’s Initial Work or (b) Tenant has taken possession of the Premises to operate its business									
“Delivery Deadline”	__ days after Anticipated Delivery Date									
“Expiration Date”	The last day of the calendar month that includes the _____ anniversary of the day before the Commencement Date, subject to any: (a) Options this Lease gives Tenant; and (b) early termination under this Lease									

THIS TERM	MEANS
“Guarantor(s)”	<p>_____, a natural person having a residence address at _____</p> <p>_____, a _____ having a place of business at _____</p>
“Landlord”	<p>_____, a _____</p> <p>_____</p> <p>_____</p> <p>Attention: _____</p> <p>Telephone: _____</p>
“Landlord’s Contribution”	<p>\$_____</p>
“Landlord’s Counsel”	<p>_____</p> <p>_____</p> <p>Attention: _____, Esq.</p> <p>Client/Matter: _____</p> <p>or any successor Landlord’s Counsel Landlord designates from time to time in compliance with the Supplemental Terms</p>
“Landlord’s Initial Work”	<p>Only any Work that Exhibit __ describes</p>
“Operating Expenses Share”	<p>_____ %</p>
“Option Term(s)”	<p>A total of _____ Option Term(s), each for _____ years</p>
“Permitted Use”	<p>[Use of the Premises only as _____ space, to conduct a _____ business under this trade name: _____]^a</p>

a. Typically a Tenant will want a broader Permitted Use. A bankruptcy court may treat a very narrow Permitted Use as a transfer restriction and ignore it.

EXHIBIT A: BASIC TERMS

THIS TERM	MEANS
“Premises”	[The rentable area of the _____ floor of the Building, as Exhibit __ depicts] ^b
“Rent Commencement Date”	The [earlier] [later] of (a) the day before the date that is _____ months after the Commencement Date and (b) _____, 201__ ^c
“Rent Payment Account” (for wire transfers; checks go to Landlord’s mailing address above)	Account Name _____ Account Number _____ Bank _____ ABA Number _____ Bank Address _____
“Security”	\$_____, ^d subject to adjustment under the Supplemental Terms
“Security Deposit Bank”	_____ _____ _____, New York 1_____
“Tax Share”	_____% ^e
“Tenant”	_____, a _____ _____ _____ Attention: _____ Telephone: _____
“Tenant’s Completion Deadline”	_____ days after Commencement Date

- b. Describe Premises unambiguously. Avoid saying anything about the size of the Premises. Attach diagram if appropriate. Update list of exhibits.
- c. If Rent starts on Commencement Date, then say so and eliminate a Rent Commencement Date, with conforming changes.
- d. If this exceeds a year’s rent, it should come from a Guarantor and not from Tenant, because of bankruptcy concerns. See chapter 40 on letters of credit. The same concerns arise for cash security.
- e. If Operating Expenses Share and Tax Share are the same, change to just “Share.” In a mixed-use building, Landlord should focus on how to allocate Property Taxes. Retail space will probably drive more than its per-foot share of Property Taxes and future increases in Property Taxes. If Landlord allocates Property taxes based on square footage, Landlord may face a squeeze later.

THIS TERM	MEANS
“Tenant’s Counsel”	_____, Esq. _____ _____ Client/Matter: _____ or any successor Tenant’s Counsel Tenant designates from time to time in compliance with the Supplemental Terms
“Tenant’s Owners”	Person Percentage of Equity Interests _____ % _____ % _____ %
“Tenant’s Wattage”	Electricity (demand load) equal to _____ watts per usable square foot, ^f excluding electricity for HVAC

f. Leases often express Tenant’s permitted usage by reference to rentable square footage. This could later produce a debate over rentable square footage. One would prefer to specify a number of watts for the total Premises, but leases usually don’t do this.

2. Additional Terms for Retail Leases⁴

In addition, as used in this Lease, these terms shall have these meanings:

THIS TERM	MEANS
“ <u>Exclusivity Zone</u> ”	The Building
“ <u>Landlord’s Percentage</u> ”	_____%
“Minimum Hours”	_____ a.m. to _____ p.m. on Business Days _____ a.m. to _____ p.m. on all other days except _____
“Noncompete Zone”	All points within _____ miles from the closest boundary of the Land

⁴ Delete this table for a non-retail Lease. For a retail Lease, consider combining the two tables into one.

EXHIBIT A: BASIC TERMS

THIS TERM	MEANS
“Opening Deadline”	The later of (a) the date ____ months after the Commencement Date and (b) _____, 201__
“Plan Deadline”	___ days after Signature Date
“Tenant’s Exclusive Use(s)”	_____
“Tenant’s Trade Name”	_____

3. Additional Understandings

In addition to the agreements in the Supplemental Terms, Landlord and Tenant agree as follows:

a. *Guaranty*. On the Signature Date, each Guarantor is delivering to Landlord a Personal Guaranty (each, a “Guaranty”) in the form of **Exhibit** __.

b. *Heading*. [Additional agreement.]

c. *Heading*. [Additional agreement.]

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EXHIBIT B-1: SUPPLEMENTAL TERMS

These Supplemental Terms (the “Supplemental Terms”) constitute part of the Lease to which attached. Terms this Lease defines: (a) appear (with page numbers) in an Index of Defined Terms after the Basic Terms; and (b) can be used before being defined.

1. *Rent and Additional Rent*

1.1 *Obligation to Pay.* Tenant shall pay Landlord all Rent as this Lease requires, by good check or at Landlord’s request by wire transfer to the Rent Payment Account or as Landlord otherwise Notifies Tenant. Starting on the Rent Commencement Date, and continuing for the rest of the Term, Tenant shall pay Base Rent in equal monthly installments, on the first day of each calendar month, in advance. Landlord may, but need not, give Tenant prior Notice, demand, or invoice(s) for Base Rent. Tenant shall on the Signature Date prepay one month of Base Rent or such greater Base Rent as the Basic Terms require. Landlord shall credit that prepayment against Tenant’s first required payment(s) of Base Rent. Tenant shall pay Landlord, as additional rent, all Additional Rent, all within 20 days after receiving an invoice, whether in or after the Term.⁵

1.2 *Estimated Payments; Rent Adjustments.* For any Escalation Rent calculated for a period longer than a month, Landlord may require Tenant to pay on the first day of each month estimated equal payments based on Landlord’s reasonable projections over that period. Landlord may reasonably adjust those estimates at any time. The parties shall then make appropriate adjusting payments, without interest, for previous months, as Landlord reasonably requires. Except as this Lease otherwise provides, Landlord’s calculation, determination or estimate of any Additional Rent or Base Rent adjustment, if this Lease provides for one (a “Rent Calculation”) shall bind Tenant unless: (a) it is arbitrary, capricious, or manifestly erroneous; and (b) Tenant gives Landlord Notice of Tenant’s objection (with all reasonable grounds for it) within 30 days after receiving Landlord’s first invoice based on that Rent Calculation. If Tenant timely gives

5 Twenty days is on the generous side, but reflects common practices in Lease administration. Landlord could add: “To the extent that any Additional Rent arises from Tenant’s obligation to reimburse Landlord for any nonrecurring payment, Landlord may require Tenant to pay it before, simultaneously with, or as a condition to Landlord’s making that payment.” This is non-standard.

that Notice, then the parties shall cooperate to resolve the dispute. The existence of a dispute shall not entitle Tenant to any Offset.

1.3 *Partial Periods.* For any period within the Term of less than a calendar month, including any period in the Term before the first Lease Year or after the last Lease Year: (a) Landlord shall reasonably prorate Rent; (b) Tenant shall pay prorated Rent on the first day of the period; and (c) the parties shall have the same rights and obligations, equitably prorated, as in any other period in the Term. If, at any time, Tenant has prepaid or overpaid any Rent, then, unless this Lease terminated because of an Event of Default (in which case Landlord may first offset any amount owing from Tenant to Landlord), Landlord shall promptly refund any prepayment or overpayment.

1.4 *No Offset.* Tenant shall pay all Rent without offset, defense, claim, counterclaim, abatement, reduction, deduction, diminution, or exercise of recoupment rights (collectively, “Offset”).

1.5 *Abatement Period.* Notwithstanding anything to the contrary in this Lease, if any Event of Default or Transfer, except an Exempt Transfer, occurs before the Rent Commencement Date, then the Rent Commencement Date shall automatically accelerate to the date of that Event of Default or Transfer.

2. *Operating Expenses Escalation Rent*

2.1 *Estimates.* Before each Operating Year, or as soon as practicable, Landlord shall Notify Tenant of Landlord’s estimate (subject to updating from time to time) of Operating Expenses for that Operating Year. The previous Operating Year’s estimate shall apply until Landlord delivers a new one. Tenant shall pay Operating Expenses Escalation Rent to Landlord in equal monthly installments, in advance, by the first day of each calendar month, based on Landlord’s estimate.

2.2 *Annual Accounting.* As soon as reasonably practicable after each Operating Year, Landlord shall give Tenant a summary of that Operating Year’s actual Operating Expenses. If the summary shows: (a) Tenant overpaid Operating Expenses Escalation Rent, then Landlord shall within 30 days refund the overpayment or agree to give Tenant an equivalent credit against Rent next coming due; or (b) Tenant underpaid Operating Expenses Escalation Rent, Tenant shall pay Landlord the deficiency.

2.3 *Proration for Partial Lease Year.* If Landlord adjusts Landlord's Operating Year, then Landlord shall prorate Operating Expenses Escalation Rent.

2.4 *Adjustment for Occupancy Factor.* If the Building is less than 95% occupied on average in an Operating Year, Landlord shall adjust Operating Expenses as if the Building had been so occupied. If Landlord does not furnish any particular tenant(s) any work or service includible in Operating Expenses, then Landlord shall calculate Operating Expenses as if Landlord did furnish that work or service to such tenant(s). Although this Lease requires Landlord to incur certain costs, that does not mean Landlord must exclude them from Operating Expenses if they otherwise constitute Operating Expenses.

3. *Property Tax Escalation Rent*

3.1 *Payment.* Tenant shall pay Property Tax Escalation Rent in equal monthly installments (as Landlord reasonably calculates), by the first day of each calendar month, so that at least one calendar month before Landlord must pay any Property Taxes, Landlord has received from Tenant all Property Tax Escalation Rent based on those Property Taxes.

3.2 *Contests and Refunds.* Nothing in this Lease requires Landlord or permits Tenant to contest any Property Taxes or assessment. If Landlord receives a refund of Property Taxes (in or after the Term), then Landlord shall apply it first to reimburse Landlord's reasonable costs of obtaining it, including appraisal, accounting, and Legal Costs, to the extent not already included in Property Taxes for a Property Tax Year in the Term. Any balance of that refund shall be treated as an adjustment of Property Taxes for the Property Tax Year to which it relates. To the extent that such adjustment indicates Tenant overpaid Property Tax Escalation Rent for any Property Tax Year, Landlord shall, if no Default exists, refund that overpayment without interest. If, for any Property Tax Year, Property Taxes are below Base Property Taxes, then for that Property Tax Year Tenant need not pay Property Tax Escalation Rent, but Tenant shall receive no credit against, or other reduction of, any other Rent for that or any other period.

3.3 *Other Taxes.* Tenant shall pay any and all taxes or Government-imposed charges or impositions (except Property Taxes) assessed on: (a) this Lease or the Rent; (b) any leasehold interest or personal property of any kind, owned by or placed in, on, or about the Premises by Tenant; or (c) Tenant's connection to or use of Utilities.

4 *Use*

4.1 *Permitted and Prohibited Uses.* Tenant shall use the Premises only for the Permitted Use(s), provided in each case that Law allows each such Permitted Use,⁶ and for no other purpose. Tenant shall not cause, suffer, or permit anyone to use the Premises for any Prohibited Use. Tenant shall comply with all commercially reasonable insurance company requirements for the Premises and the Building. Tenant shall not allow the Premises to become vacant or abandoned.⁷ Tenant shall not use or occupy the Premises, or permit the Premises to be used or occupied, in any way that requires Landlord to make any Alteration. Landlord need not enforce against Tenant any restriction in this Lease, or notify Tenant of any breach of any such restriction. Failure to enforce any restriction shall not waive it.

4.2 *Conditions to Occupancy.* Notwithstanding anything to the contrary in this Lease, Tenant shall not take possession of, begin Tenant's Initial Work in, or otherwise use or occupy the Premises unless Tenant has delivered to Landlord (as this Lease requires) for Tenant's Initial Work: (a) complete plans and specifications, approved by Landlord and, to the extent Law requires, stamped "Approved" by the Department of Buildings; (b) a copy of Tenant's building permit, if Law requires one; (c) all Insurance Documents; (d) the Security; (e) if enforceable, Lien Waivers from all Contractors; and (f) copies of Tenant's construction contract(s). Notwithstanding anything to the contrary in this Lease, until Tenant has satisfied the foregoing conditions, Landlord may exclude Tenant from the Premises, which shall not constitute a constructive or actual eviction or give Tenant any rights or claims.

5. *Landlord's Delivery of Premises*

5.1 *"As Is" Condition.* Except to the extent that this Lease requires any Landlord's Initial Work: (a) Landlord shall deliver the Premises to Tenant vacant in its "as is" condition on the Signature Date, subject to reasonable wear and tear; (b) Tenant shall perform all Work for the Premises; (c) Landlord shall have no obligation to obtain a certificate of occupancy or perform any Work; and (d) Tenant acknowledges, represents, and warrants that Tenant has inspected the Premises and is fully satisfied with its "as is" condition and present condition and state of repair, if any, on the Signature Date. Except as this Lease expressly allows, Tenant shall not

6 Tenant may ask Landlord for assurances on legally permitted uses. Tenant should review the certificate of occupancy for the Premises.

7 For an office Lease, Landlord will often not care about the previous sentence.

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modify, alter, or disturb any post, column, mechanical or other system, or Structure component located within the Premises.

5.2 *Variations from Plans.* Any description or depiction of the Premises in this Lease is only an approximation. It might not include, or might inaccurately show, existing conditions. Neither party shall have any rights or obligations because of variations between any such description or depiction and the Premises as delivered. The Premises and the Rent are not subject to remeasurement, survey, or adjustment for “rentable square footage,” “loss factor recalculation,” or any other recomputation or recalculation of any kind.⁸

5.3 *Landlord’s Initial Work.* If the Basic Terms define any “Landlord’s Initial Work,” Landlord shall perform it in conformity with Law and in a good and workerlike manner with only new materials. Landlord may make minor changes in Landlord’s Initial Work as advisable in Landlord’s judgment. Landlord shall Notify Tenant of those changes on request. To the extent any exhibit to this Lease states that Landlord’s Initial Work has been completed, Tenant approves Landlord’s Initial Work and its state of completion as stated in the exhibit.

5.4 *Changes in Landlord’s Initial Work.* Landlord need not make changes that Tenant requests in Landlord’s Initial Work (“Change Orders”). If Tenant requests, and Landlord approves, any Change Order, Tenant shall pay Landlord’s additional costs (including architectural and design costs) of that Change Order, plus an Administrative Fee. To the extent Landlord reasonably determines that Change Order(s) delayed Landlord’s Initial Work, that delay shall constitute “Tenant Delay.” On request, Landlord shall give Tenant a nonbinding estimate of any charges or Tenant Delay that a proposed Change Order would cause.

5.5 *Tenant Delay.* If Tenant delays or impairs Landlord’s prosecution of Landlord’s Initial Work, then “Tenant Delay” shall include that delay. After Landlord has Substantially Completed Landlord’s Initial Work, Landlord may deem the Commencement Date to have occurred (after taking into account any delay that Landlord caused) as of when it would have occurred but for Tenant Delay. Landlord shall also have other remedies for Tenant Delay as this Lease provides.

5.6 *Completion of Landlord’s Initial Work.* Landlord anticipates Landlord will Substantially Complete Landlord’s Initial Work and deliver

⁸ Adjust this sentence if Landlord wants the right to remeasure the space.

the Premises to Tenant by the Anticipated Delivery Date. Landlord shall orally advise Tenant when Landlord has Substantially Completed Landlord's Initial Work (the "Substantial Completion Notice"), which notice Landlord shall promptly confirm in writing. That notice shall nevertheless be effective when given orally.⁹ Landlord shall give Tenant a written punchlist of work that remains to be accomplished for Landlord to fully complete Landlord's Initial Work (the "Punchlist"). Landlord shall have no liability to Tenant, and shall not be in breach under this Lease, if Landlord fails to Substantially Complete Landlord's Initial Work and deliver the Substantial Completion Notice to Tenant by the Anticipated Delivery Date.

5.7 Delivery Deadline. If, as of the Delivery Deadline, Landlord has not given Tenant the Substantial Completion Notice, then for every day thereafter until Landlord has given Tenant the Substantial Completion Notice, Tenant shall be entitled to a one-day extension of the Rent Commencement Date. [If, as of the date ___ days after the Delivery Deadline, Landlord has still not given Tenant a Substantial Completion Notice, then Tenant may, within 10 days, give Landlord Notice that Tenant desires to terminate this Lease. If, as of the date 30 days after that Notice, Landlord has still not given Tenant the Substantial Completion Notice, then this Lease shall automatically terminate and neither party shall have any obligations or liability, except Landlord shall return the Security and prepaid Rent.]¹⁰

5.8 Extension of Time. Landlord may extend the Anticipated Delivery Date and the Delivery Deadline from time to time by Notice to Tenant: (a) for Force Majeure; (b) for Tenant Delay; and (c) as this Lease otherwise expressly allows.

5.9 Acceptance of Landlord's Initial Work. By entering the Premises to commence Tenant's Initial Work, Tenant shall, except as this paragraph provides, be deemed to have agreed that Landlord has fully completed and satisfactorily performed Landlord's Initial Work (except as listed in the Punchlist) and the Commencement Date has occurred. Landlord shall complete Punchlist Work in a reasonable time after the Commencement Date. The parties shall cooperate to coordinate Punchlist Work with Tenant's Initial Work. In place of any other Landlord guarantee or war-

⁹ Tenant would prefer a written Notice. Such requirement will just defer the Rent Commencement Date by a couple of days.

¹⁰ Bracketed language is optional but sometimes seen. If Tenant actually terminated the Lease, then a very strong Tenant could also require Landlord to reimburse Tenant's costs.

ranty: (x) to the extent that Landlord obtains any warranty or guarantee for Landlord’s Initial Work, Landlord shall on request assign it to Tenant, if permissible; and (y) Tenant may, for ___ days after the Commencement Date (the “Defect Reporting Period”), Notify Landlord of defects in Landlord’s Initial Work. Landlord shall reasonably promptly correct those defects provided Tenant has not covered or worsened them. Any such defect shall not entitle Tenant to any Offset. After the Defect Reporting Period, Tenant shall be deemed to have accepted Landlord’s Initial Work in its entirety except defects of which Tenant Notified Landlord in the Defect Reporting Period.¹¹ Nothing in the previous sentence limits Landlord’s continuing obligations of maintenance and repair, if any, under this Lease or Law.

5.10 *Asbestos Compliance.* Landlord represents and warrants that to Landlord’s knowledge the Premises contain no asbestos (or asbestos-containing materials) in violation of Law.¹²

6. *Work, Generally*

6.1 *Landlord’s Consent Required.* Tenant may not perform Work without Landlord’s prior consent. Provided no Default exists, Landlord shall not unreasonably withhold consent to reasonable Work to the Premises, provided it does not affect any Structure, outside Building appearance, part of the Building except the Premises, or Building System, and otherwise complies with this Lease. Tenant shall give Landlord at least 10 Business Days prior Notice of proposed Work. If Tenant does any Work that violates this Lease, Tenant shall on demand remove or correct it in a way reasonably satisfactory to Landlord. At Landlord’s option, Landlord may do so at Tenant’s expense, plus an Administrative Fee.

6.2 *General Requirements.* Tenant shall perform all Work in a good, workerlike, diligent, first-class and first-quality manner using new and first-quality materials, in a way that does not materially interfere with, damage, annoy, or inconvenience Landlord, other tenants, or any of their activities. Tenant’s Work shall not: (a) adversely affect Building Systems; (b) increase Tenant’s usage of those systems beyond the usage this Lease allows; or (c) require any change or penetration of the Structure, except ceiling or flooring elements solely within the Premises. To the extent that, as a result of Tenant’s Work, any Law requires any other Work or action in the Premises or Building, including any inspections and maintenance,

11 Tailor as appropriate, such as for “phased” build-out, or eliminate any guarantee or warranty.

12 Make sure this assurance is correct.

Tenant shall cause that Work or other action to be performed, except to the extent Landlord elects to do so at Tenant's expense, plus an Administrative Fee. Within 30 days after completing any Work, except Minor Work, Tenant shall give Landlord "as-built" plans showing that Work, if Tenant obtained them for any other purpose. If Landlord reasonably estimates the cost of any Tenant Work, including Tenant's Initial Work, would exceed the Bonding Threshold, then Tenant shall comply with such additional requirements as Landlord establishes (including, at Landlord's option, disbursement procedures, bonding, a guaranty from a guarantor satisfactory to Landlord or other measures) to assure lien-free completion. If Landlord requires, Tenant shall defer filing Tenant's building permit application until Landlord has filed any preliminary filing necessary to enable Landlord to qualify for any available tax abatement or deferral. All Work Tenant performs or initiates shall be performed at Tenant's sole expense and risk. If Law requires Tenant to obtain a building permit for any Work, then Tenant shall: (a) do so; (b) do the Work with reasonable diligence; (c) promptly close out Tenant's permit; and (d) give Landlord any certificate of occupancy required by Law promptly after completion.

6.3 Plan Submission. Before Tenant starts any Work, except Minor Work, Tenant shall give Landlord complete plans and specifications, for Landlord's reasonable approval. Landlord shall endeavor to respond to any plans (or schematics, concept drawings, preliminary drawing, or sketches, if Tenant submits them) within 15 days after submission. If Landlord reasonably objects to Tenant's submission, Tenant shall revise and resubmit it for Landlord's approval. Tenant shall reimburse Landlord's reasonable third-party costs for review of Tenant's submissions, e.g., architect fees. Tenant shall pay Landlord, as an oversight fee, an amount equal to 6% of the estimated cost of any Work. Tenant shall not start Work unless and until Tenant has obtained any approvals Law requires and, except for Minor Work, Landlord has reasonably approved the Work, Tenant's Contractors and the contracts with Tenant's Contractors. Tenant shall construct Tenant's Work in substantial compliance with approved plans and specifications.

6.4 Filings. If Law requires Landlord's signature on any filing with any Government for Tenant's Work, then Landlord shall sign it, provided no Default exists and Tenant's filing is truthful, accurate and reasonably satisfactory to Landlord, and imposes no liability, obligation or unreimbursed cost on Landlord. At Tenant's option and risk, Tenant may make any filing before Landlord has approved Tenant's Work. Landlord's signature on a pre-filing shall not be deemed Landlord's approval of Tenant's

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Work. Tenant shall Indemnify Landlord regarding any filing Landlord signs at Tenant's request.

6.5 *Operating and Construction Requirements.* Tenant shall comply with Landlord's reasonable Operating Requirements and Construction Requirements as established from time to time, provided they apply by their terms to all tenants and do not unreasonably discriminate against Tenant. [As of the Signature Date, Landlord's Operating Requirements appear in **Exhibit** __ and Landlord's Construction Requirements in **Exhibit** __.]

6.6 *Contractors.* Tenant Parties shall use only Contractors that: (a) have all licenses and permits Law requires; and (b) have given Landlord any Insurance Documents Landlord reasonably requests. Landlord may reasonably disapprove any Contractor Tenant engages, or require Tenant to select from an "approved list" of Contractors, at least three for each trade if reasonably possible. If, however, any electrical, life safety, mechanical or HVAC Work involves connection to Building Systems, Tenant must use Contractors Landlord designates. Tenant shall, to Landlord's satisfaction, bond all Contractors whose (sub)contract amount exceeds the Bonding Threshold, under bonds naming Landlord as an additional obligee. If in Landlord's reasonable judgment failure to do so would, may or does cause labor disharmony, Tenant Parties shall use only union Contractors. Tenant shall cause its Contractors to deliver Lien Waivers to Landlord when and as Landlord requires, to the maximum extent Law allows. Even if Landlord has approved a Contractor, Landlord may revoke that approval (and require the Contractor to leave), by Notice to Tenant, if Landlord reasonably determines later experiences with that Contractor have been unsatisfactory.

6.7 *After Completion.* All Tenant Work shall become Landlord's property when Tenant has completed and paid for it, subject to the Article on "End of Term."

6.8 *Payment.* Tenant shall promptly pay for all labor, services, materials, supplies and equipment (alleged to have been) furnished in, at, for or about the Premises, to or on behalf of any Tenant Party. If any Lien is filed based on (alleged) acts or omissions of any Tenant Party or otherwise because of any Work Tenant initiates, then Tenant shall Notify Landlord immediately. Within five Business Days after receiving notice of any Lien, Tenant shall bond or discharge it. Tenant may, however, contest it in a way satisfactory to Landlord, but only if: (a) no Default exists; (b) Tenant gives Landlord security as Landlord reasonably requires; and (c)

the contest causes no default under Landlord's Financing. If Tenant bonds or contests a Lien, then Tenant shall do so diligently, in a way reasonably satisfactory to Landlord, and give Landlord written progress reports promptly on request. If any Lien becomes subject to foreclosure proceedings, then within two Business Days Tenant shall bond or discharge it. In addition to any other Landlord's right or remedy, if Tenant does not perform any obligation under this paragraph, Landlord may (but need not) pay any Lien or demand the Contractor foreclose. Tenant shall reimburse Landlord for those payments, plus an Administrative Fee. If Law establishes procedures so Landlord can disclaim responsibility for Liens, Tenant shall take such actions as Landlord requests to give Landlord the benefit of those procedures. Notwithstanding anything to the contrary in this Lease, Tenant need not remove any Lien from Landlord's Work. Nothing in this Lease constitutes Landlord's consent or request, express or implied: (a) to any Contractor to perform any labor or furnish any materials; or (b) to subject Landlord's property to any Lien.

6.9 *Agreed Work.* To the extent Landlord agrees to perform any Work at Tenant's request (except any Work, repairs or maintenance this Lease requires Landlord to perform), Tenant shall pay Landlord for its cost, plus an Administrative Fee.

6.10 *Cabling.* Tenant shall properly label its Cabling in a way reasonably satisfactory to Landlord. To the extent Cabling passes through floor slabs or fire-rated walls, Tenant shall install fire-stopping material to properly seal openings around that Cabling, all as Law requires. If Tenant abandons or stops using any Cabling, Tenant shall promptly remove it in compliance with this Lease and Law.

7. *Tenant's Initial Work*

7.1 *Tenant's Obligation.* By Tenant's Completion Deadline, Tenant shall prepare the entire Premises for occupancy for Permitted Use(s) and complete (and obtain a temporary or permanent certificate of occupancy for) Tenant's Initial Work, all in compliance with this Lease. Tenant shall thereafter at all times maintain that certificate of occupancy. From the Signature Date until Tenant has completed Tenant's Initial Work and opened for business, Tenant shall keep Landlord fully informed of progress of Tenant's Initial Work. On request, Tenant shall meet with Landlord at a reasonable frequency to report on that progress.

7.2 *Plan Development.* Tenant shall give Landlord a complete set of plans and specifications for Tenant's Initial Work, collectively a complete

filing for Tenant's Initial Work in form suitable for filing with the Department of Buildings, all for Landlord's reasonable approval, by the Plan Deadline. Tenant shall file those plans and specifications with the Department of Buildings, and give Landlord proof of filing, within 10 days after Landlord approves them. Time is of the essence on Tenant's compliance with the Plan Deadline.

7.3 Landlord's Contribution. If the Basic Terms define a Landlord's Contribution, then Landlord shall contribute to Tenant's Initial Work an amount not to exceed Landlord's Contribution. Landlord shall disburse Landlord's Contribution in monthly installments, in proportion to the progress of Tenant's Initial Work (as Landlord reasonably determines), subject to Tenant's compliance with these requirements.¹³ Landlord shall make each disbursement within 10 Business Days (or at Landlord's option simultaneously with the next available draw under Landlord's Financing, but no later than 60 days after Tenant's submission) after Tenant has delivered these, all reasonably satisfactory to Landlord: a disbursement request; backup invoices for Tenant's costs for Tenant's Initial Work; a certificate of Tenant's architect confirming that Tenant's Initial Work to date substantially complies with the approved plans and specifications; progress Lien Waivers; evidence of the proper application of previous disbursements of Landlord's Contribution; and such other deliveries as Landlord reasonably requests. Tenant shall not be entitled to any disbursement in any Default Period. Tenant may not use Landlord's Contribution for furniture, equipment, Cabling (except as this paragraph permits), architectural or engineering fees, or any item not constituting improvements to real property. Tenant may apply up to __% in aggregate of Landlord's Contribution (to the extent disbursed) to these items as Landlord reasonably approves for Tenant's Initial Work: (a) architectural and engineering fees; and (b) Cabling.

7.4 Completion. Within 30 days after completing Tenant's Initial Work, Tenant shall give Landlord full and complete computer aided-design "as-built" plans showing Tenant's Initial Work.

8. *Utilities and Services*

Landlord shall furnish Basic Services for the Premises. Tenant may request Landlord to provide Additional Services, if reasonably available

¹³ Landlord may prefer to disburse the entire Landlord's Contribution only on completion, based on considerations of cash flow and credit. Even in a Landlord's market, Landlords usually agree to disburse in installments, sometimes only two (one at the beginning, one at the end).

to Landlord and the Premises. Landlord need not, however, make available more than the Operating Expenses Share of the total capacity of any available Additional Services. To the extent Tenant uses Additional Services, Tenant shall pay Landlord, at Landlord's regular rates as adjusted from time to time, for those Additional Services. Landlord grants Tenant a license in the Term (except in any Default Period) to use Utility and Communications Service hookups and outlets in the Building as Landlord designates to serve the Premises. The parties further agree as follows.

8.1 *Tenant's Usage.* Tenant shall use Utilities and other facilities in a safe manner that does not exceed their capacity. Tenant shall pay for Tenant's consumption of all Utilities, including demand charges. If Tenant's consumption exceeds the Operating Expenses Share of the capacity of any Utility, Tenant shall either reduce consumption or request that Landlord, in its sole discretion, arrange more capacity as Tenant reasonably requires, at Tenant's expense, plus an Administrative Fee.

8.2 *Costs.* Tenant shall reimburse Landlord's cost, as Landlord reasonably calculates it, of the following (plus an Administrative Fee): (a) installing or operating any meter, submeter or other device or service (and related wiring, conduits, panels and service fees) to measure Tenant's use of Utilities; (b) installing, modifying, operating, maintaining and repairing any equipment (including standard HVAC equipment) Landlord deems necessary to balance the temperature for the Premises and/or any equipment required for any Additional Services Tenant requests or because of Tenant's activities; and (c) keeping account of or determining any Additional Services Tenant uses.

8.3 *Balancing.* If the temperature otherwise maintained anywhere in the Premises by the HVAC system is adversely affected by: (a) the type or quantity of any lights, machines, or equipment (other than typical office equipment) Tenant uses in the Premises; (b) occupancy of the Premises by more than one person per ___ square feet; or (c) any rearrangement of partitioning or other improvements in the Premises, then at Tenant's sole cost, Landlord may install any equipment, or modify any existing equipment Landlord deems necessary to restore the temperature or rebalance the system. Tenant shall cooperate with Landlord and comply with any Building Rules for proper functioning and protection of HVAC. Landlord has no responsibility for any HVAC to maintain temperatures in, or because of, any computer or communications rooms, machine rooms, conference rooms, food service areas, or other areas of high concentration of personnel or electrical usage, or any other use beyond consumption normally required for office equipment, including matters referred to in

the first sentence of this paragraph. Landlord shall have no liability for any loss or damage from any HVAC inadequacy.

8.4 *Communications Services.* Tenant shall arrange and promptly pay when due for all Communications Services, including Cabling and new hookups, except as this Lease states otherwise. Landlord need not provide any Communications Services. Tenant shall pay the provider(s) of any Communications Services directly for all usage in or at the Premises. Tenant shall not resell any Communications Services at the Building.

8.5 *Interruption.* Landlord's obligations to provide Basic Services, Additional Services and any Utilities are subject to: (a) Tenant's compliance with Building Rules and Law; (b) shutdowns for maintenance, repairs or security; and (c) Force Majeure. Any interruption in, or failure or inability to provide, the foregoing for any reason shall not constitute an eviction, constructive or otherwise, or impose on Landlord any liability. Tenant waives any existing or future Law allowing Tenant to terminate this Lease or assert any claim against Landlord for that interruption, failure or inability. Landlord shall have no liability (and Tenant shall have no Offset) for inconvenience or harm (including damage to Tenant's computer hardware, software, or data) caused by stoppage or reduction of Utilities or services.

8.6 *Energy Shortages.* If, in Landlord's reasonable judgment, it is necessary or desirable because of any Government recommendation to reduce energy consumption, then Tenant shall comply with Landlord's reasonable, uniform and nondiscriminatory energy reduction measures provided (unless Law requires otherwise) those measures do not affect Tenant's operating hours.

8.7 *Elevator and Stairs.* Tenant shall have the nonexclusive right to use Building passenger elevator(s) for access to the Premises 24 hours a day, seven days a week, 365/366 days a year, except during reasonable closures for breakdowns, repairs, or maintenance. Landlord shall have no liability for those closures. When the elevator is closed or broken, Tenant may use the stairs Landlord designates. If the Building has a freight elevator, then Tenant may use it only in compliance with Building Rules and upon paying Landlord's freight elevator charges as set from time to time. Tenant shall schedule deliveries of building materials and freight only outside Business Hours.

8.8 *Construction Period Utilities.* During Tenant's Initial Work, if Landlord allows Tenant to connect to Landlord's Utilities, then Tenant

shall comply with Landlord's reasonable instructions, requirements and procedures, and pay Landlord for Tenant's consumption, as Landlord reasonably estimates it, plus an Administrative Fee.

8.9 *Interference with Tenant's Business.* To the extent that Landlord exercises any right under this Lease to enter, or interrupt any services to, the Premises, Landlord shall reasonably endeavor to minimize any disruption to Tenant's business. This shall not, however, require Landlord to hire overtime help or entitle Tenant to any Offset. Landlord shall reasonably endeavor to provide advance oral notice of any such entry or interruption when reasonably possible.

9. *Electricity*

9.1 *Direct Metering.* Tenant shall obtain its electricity directly from Power Company. Tenant shall reimburse any actual third-party out of pocket costs that Landlord incurs because of installation of Tenant's electricity lines or meters. Tenant shall not, without Landlord's reasonable consent, do any Work affecting the electrical system or any lines, in each case, unless within and exclusively serving the Premises. Tenant shall not change electricity providers without Landlord's consent, unless that provider fails to deliver reasonable service on a consistent basis, in which case the parties shall work together to identify a replacement provider.

9.2 *Power Company Requirements.* Tenant shall comply with Power Company's rules, regulations, terms, tariffs and conditions that govern service, equipment and wiring. Tenant has determined that Building risers are capable of supplying Tenant's Wattage to the Premises. If a survey by Landlord's engineer determines that Tenant needs more electricity than Tenant's Wattage, and additional riser(s), supply line(s), or other equipment need(s) to be installed, Landlord shall so Notify Tenant. Within five Business Days after receiving that Notice, Tenant shall stop using that additional electricity. The parties shall cooperate to arrange additional electricity service, to the extent reasonably available to the Building, all at Tenant's expense, plus an Administrative Fee. Landlord shall not be liable in any way to Tenant for any failure or defect in the supply or character of electric service furnished to the Premises by reason of any requirement, act, or omission of Power Company or for any other reason not attributable to Landlord's intentional misconduct.

9.3 *Shutdown.* Landlord may shut down electrical energy to the Premises when necessitated by safety, repairs, Work, connections, upgrades, or for any other reason relating to the Building electrical system

(“Electrical Work”), whether for the Premises, any other tenant space, or any Common Area. Landlord shall reasonably endeavor to: (a) give Tenant reasonable prior oral notice of any shutdown; and (b) not shut down Tenant’s electrical energy for Electrical Work in Business Hours, unless required by an emergency, Power Company, or Law. Landlord shall have no liability to Tenant for any loss, damage, or expense that Tenant incurs due to any electricity shutdown or Electrical Work.

9.4 *Electricity Impairment.* Any Electricity Impairment shall not: (a) constitute an actual or constructive eviction of Tenant, in whole or in part; (b) entitle Tenant to any Offset; (c) entitle Tenant to any damages, or impose any liability on Landlord, on account of any loss, expense or damage, direct or indirect, of Tenant; (d) relieve or release Tenant from any obligation under this Lease; or (e) entitle Tenant to terminate this Lease. Tenant waives all benefits of any Law permitting Tenant to terminate this Lease because of any Electricity Impairment.

9.5 *Cost of Consumption.* Tenant shall make its own arrangements with Power Company (including posting any deposits) for payment and pay directly for all costs of electrical service to the Premises, including demand and usage charges. Landlord shall not be responsible for those costs. All meters, equipment and facilities within the Premises required to obtain electricity for the Premises shall be solely the responsibility of Tenant and Power Company. Landlord shall have no obligations regarding those matters, subject to any express obligations under this Article. Even though Tenant may install its own direct service, Landlord may retain, at Landlord’s cost, sufficient service capacity with Power Company, as Landlord’s engineer determines, to satisfy all base building (HVAC, elevator, etc.), public light and power requirements and electrical requirements for all other leasable space in the Building, but this shall not limit Landlord’s obligation to reserve for Tenant sufficient capacity to deliver Tenant’s Wattage to the Premises. To the extent insufficient electrical power remains for Tenant, Tenant shall at its expense obtain new electrical service, including negotiations with Power Company, the cost of building a vault, paying rent for the space to house a new vault, cost of new switchgear, distribution costs for those electrical services, and reimbursement of Landlord’s third party expenses, all in a way that does not diminish or impair present or potential Utility service to the rest of the Building. Except to the extent that Landlord elects otherwise, all electrical equipment shall remain in place as Landlord’s property when this Lease expires. Tenant shall give Landlord copies of Tenant’s direct utility bills promptly on request.

9.6 *Electrical Devices.* Tenant shall not use any device in the Premises that: (a) uses current in excess of 110 volts; or (b) would cause Tenant's electrical demand load to exceed Tenant's Wattage. Tenant shall not connect with electric current except through existing outlets in the Premises or additional outlets installed in the Premises as part of Work that comply with this Lease.

9.7 *Energy Reporting.* If any Law requires Landlord to calculate and report on Utility consumption in the Building, then Tenant shall promptly comply with Landlord's reasonable requests for information from Tenant so Landlord can comply with that Law.

9.8 *Rebates.* If Power Company pays any rebate to either party for installations of equipment, that rebate shall belong to [Landlord] [whichever party paid for that installation of equipment].

10. *Cleaning*

10.1 *Generally.* Tenant shall maintain the Premises in a clean, neat, safe and orderly condition. Tenant shall keep the Premises free from vermin and perform pest spraying and extermination as Landlord reasonably requires. Tenant shall adopt and implement other sanitation and health programs as Landlord reasonably requires from time to time. If Landlord from time to time designates any cleaning, window cleaning, plant care, or maintenance contractor, then Tenant shall engage its services, and engage no other contractor for those services, provided the fees of Landlord's contractor are reasonably competitive. Tenant shall clean the interior of all windows that serve the Premises, all as Law requires. Tenant shall not clean the exterior of any windows. Landlord shall do so under a reasonable schedule. If Tenant desires additional window cleaning, Tenant may order it, at Tenant's expense, directly from Landlord's window cleaning contractor. If Landlord and Tenant cannot agree on whether the fees charged by Landlord's designated contractor are competitive, Landlord and Tenant shall each obtain two bona fide bids for that work from qualified contractors in the City. The average of the four bids shall be the standard of comparison. Tenant may use its own employees to clean the Premises, including windows.

10.2 *Garbage.* Tenant shall keep the Premises and the Common Areas serving the Premises free from Garbage resulting from Tenant's operations. [Tenant shall be solely responsible for its Garbage removal at its expense.] Tenant shall comply with Landlord's instructions on Garbage storage and separation, and keep Tenant's Garbage storage area in a

clean and sanitary condition satisfactory to Landlord, whether or not any Tenant Party caused any unsatisfactory conditions in that area. Tenant shall collect in accordance with Law and Landlord's procedures all Garbage produced, caused by, or otherwise resulting from the use, occupancy, and operation of the Premises, Tenant's Work, the conduct of Tenant's business, or otherwise from Tenant's activities in the Premises. [Landlord shall be responsible for Garbage pickup and removal.] To the extent that Tenant generates Garbage beyond that normally generated by typical office activities, Tenant shall reimburse Landlord for Landlord's extra costs, as Landlord reasonably estimates them. Landlord may from time to time establish, and Tenant shall comply with, a reasonable schedule for Garbage collection.

10.3 *Landlord's Cleaning.* Provided that Tenant complies with its cleaning obligations under this Lease, Landlord shall, on Business Days, provide routine janitorial and cleaning services, limited to emptying and removing general office refuse, dusting, and light vacuuming, all in accordance with Landlord's reasonable cleaning specifications for the Building in effect from time to time.¹⁴ Landlord's obligations shall not include any cleaning or janitorial work the need for which arises from any unusual or extraordinary activities in the Premises, including preparation of food, move-in, move-out, removal of furniture crates, and the like.

11. *Compliance with Law*

11.1 *Generally.* Tenant shall promptly and timely comply with all Laws, whether that compliance requires work or remedial measures to the Premises (excluding Structure) that are ordinary or extraordinary, foreseen or unforeseen, or expenditures that are capital in nature, and otherwise perform all actions necessary or appropriate to preserve and keep in full force and effect all Approvals, but only to the extent that the need for that compliance arises from Tenant's particular manner of use or occupancy of the Premises or acts or omissions. If any Law requires actions or expenditures be undertaken generically for space being used for the Permitted Use, Landlord shall be responsible for those actions and expenditures. If, as a result of Tenant's activities, any Law requires any Work in Common Areas, then Landlord shall perform that Work at Tenant's expense, in a way reasonably satisfactory to Landlord.

11.2 *Approvals.* Except to the extent that Landlord elects by Notice to Tenant to seek to obtain them at Tenant's expense, Tenant shall at its

¹⁴ Tenant may wish to attach cleaning specifications.

sole cost and expense obtain every Approval necessary or appropriate for Tenant's Work, and give Landlord copies of them promptly after issuance.

11.3 *Right to Contest.* Tenant may, in its name, contest, in any manner Law allows, the validity or enforcement of any Law that applies to Tenant, and may defer compliance with that Law (a "**Contest**"), but only so long as: (a) no Default exists; (b) Tenant Notifies Landlord of the Contest; (c) in Landlord's reasonable judgment, the Contest exposes Landlord to no (1) material risk of any liability or penalty, (2) risk of criminal liability or (3) material risk that the Building may be subject to any Lien or mandatory sale; (d) the Contest complies with Landlord's Financing; and (e) if Landlord requires, before starting a Contest involving compliance whose cost Landlord reasonably estimates could exceed 15% of Tenant's annual Base Rent, Tenant has delivered to Landlord a surety bond or other security reasonably satisfactory to Landlord (and satisfactory to Landlord's Lender/Lessor(s)), to Indemnify Landlord and its Lenders/Lessors against Tenant's Contest. Tenant has no right to contest Property Taxes or any underlying assessment(s).

12. *Repairs and Maintenance*

12.1 *Tenant's Obligations.* Tenant shall maintain the Premises and all equipment and fixtures in and serving solely the Premises (excluding the Structure), and all signs for the Premises, in first-class condition, repair and appearance. Tenant shall make all repairs necessary or appropriate to the Premises and all equipment, fixtures and systems in and solely serving the Premises (including mechanical, electric and plumbing systems and any Utility lines installed by or for Tenant), excluding in each case the Structure. Tenant shall make all repairs and improvements to the Premises (excluding the Structure) that Law requires, except to the extent Landlord's responsibility under this Lease. Tenant shall make all repairs in a way satisfactory to Landlord and in compliance with the provisions of this Lease on Work. Tenant shall paint all painted surfaces and treat all architectural finishes in the Premises as often as required, in Landlord's reasonable determination, to maintain them in first-class condition and to a consistent standard of appearance throughout the Premises.

12.2 *Landlord's Obligations.* Landlord shall perform, and Tenant need not perform, maintenance and repairs affecting these elements of the Building, except (at Landlord's option, but at Tenant's expense, plus an Administrative Fee) to the extent the need for those repairs directly or indirectly arose from any Tenant Party's negligent or intentional acts or omissions (including Tenant's Work), from any activity conducted in the

Premises or Tenant's particular manner of use or occupancy of the Premises, or to the extent that this Lease expressly requires Tenant to maintain or repair the Building or the Premises: Common Areas; Structure; Utility lines serving the Building as a whole, but not Tenant's distribution lines; Building exterior; any areas of the Building or Land except the Premises (unless required to be maintained by third-party Utility providers); and plumbing in any restroom Landlord installed. Except to the extent that this paragraph requires Landlord to repair and maintain the Building or this Lease requires Landlord to restore Landlord-Restored Damage, Landlord shall have no obligation to maintain or repair the Building or the Premises. Tenant waives any Law: (a) inconsistent with the foregoing or (b) that allows Tenant to make repairs at Landlord's expense. Landlord shall perform under this paragraph in accordance with standards for Comparable Buildings. Nothing in this paragraph: (a) limits any express obligations of Landlord under this Lease; or (b) requires Landlord to maintain or repair Tenant's Initial Work or other Work Tenant initiated.

12.3 *Equipment.* Tenant shall pay Landlord for the cost to repair any equipment that serves only Tenant or the Premises, to the extent that Landlord repairs it. Landlord need not repair or maintain that equipment except to the extent Landlord agrees to do so in writing.

12.4 *Miscellaneous.* Tenant shall promptly replace any broken door closers or burnt-out light bulbs serving the Premises. If the Premises is located on the ground floor, or to the extent that windows separate the Premises from any pedestrian walkway, Tenant shall maintain, repair and replace the windows of the Premises. Otherwise, if any exterior window breaks: (a) Landlord shall replace it; and (b) Tenant shall reimburse Landlord's reasonable expense in doing so, plus an Administrative Fee, if in Landlord's reasonable determination any Tenant Party caused that breakage.

12.5 *No Damage.* No Tenant Party shall destroy, deface or damage the Building. Tenant shall repair (or, at Landlord's option, reimburse Landlord for the cost to repair, plus an Administrative Fee) any damage any Tenant Party causes, all in a way satisfactory to Landlord.

12.6 *Notice of Repairs.* Tenant shall promptly Notify Landlord of condition affecting the Building that this Lease or Law requires Landlord to repair. Landlord shall have no obligation to maintain, repair or replace until a reasonable time after Landlord receives that Notice.

13. *Operations*

13.1 *Building Rules.* Tenant shall comply with all Building Rules. If Tenant fails to Notify Landlord of Tenant's reasonable objection to any new or changed Building Rule within 15 days after Landlord Notifies Tenant of it, then Tenant shall have waived any right to object to it. Landlord shall have no: (a) obligation to enforce Building Rules against any tenant; or (b) liability to Tenant for any other tenant's breach of any Building Rule. Landlord may enforce any Building Rule against Tenant whether or not Landlord actively enforces it against other tenant(s).

13.2 *No Interference.* Tenant shall not interfere with, diminish or impair the peace, quiet or comfort of Landlord, other tenants or other Persons in the Building or in the neighborhood near the Building, or otherwise materially adversely affect the environment at, around or near the Building. Tenant shall not cause or permit unreasonable noise, vibration or sounds to be emitted from the Premises. Tenant shall not cause or permit any odors or fumes to be released from the Premises, and shall take all actions reasonably necessary, in Landlord's reasonable determination, to eliminate odors. Tenant shall conduct no activities that cause odors or fumes.

13.3 *No Discrimination.* No Tenant Party shall discriminate against any Person in violation of Law. Tenant shall timely prepare and submit such reports, forms, questionnaires and other documents as any Government from time to time requires to evidence compliance with this paragraph.

13.4 *Storage.* Tenant shall not store or otherwise locate, leave or install any bicycle, cart, equipment, food deliveries, Garbage, inventory or other personal property of any kind anywhere in or near the Building outside the Premises. Landlord may, without notice, remove anything that violates the previous sentence. Tenant shall pay Landlord the cost of that removal, plus a fee of \$50 per occurrence.

13.5 *Deliveries and Access.* Tenant shall receive deliveries and obtain access to the Premises only under procedures and schedules that Landlord reasonably approves or establishes.

13.6 *Signage.* Except as this Lease expressly permits, Tenant shall attach no banner, streamer, decal, poster or other temporary or permanent sign or posting of any kind to the exterior of the Building (include any window of the Building), or in the Premises (including the interior side of any window) at any location visible outside the Premises. Window treatments and signs require Landlord's prior written approval, not to be

unreasonably withheld so long as they otherwise comply with this Lease. Nothing in this paragraph prevents Tenant from installing any signs that Law requires.

13.7 *Building Directory.* For each floor in the Premises, Tenant may without charge have ___ listing(s) in any Building directory, in Landlord's standard format. If Landlord allows additional listings, or at Tenant's request modifies, supplements or replaces, any listing previously posted for Tenant, Tenant shall pay Landlord's reasonable fee for those listings.

13.8 *Conservation and Recycling.* Tenant shall comply with all Laws that apply to the Premises or to Landlord (and all reasonable voluntary programs that Landlord adopts from time to time) on collection, conservation, disposal, reclamation, recycling or separation of water, Garbage and other matter (liquid or solid) Tenant generates.

13.9 *Common Areas.* Tenant and its employees and invitees may use the Common Areas in the Term, in common with Landlord and other persons Landlord authorizes from time to time, subject to Building Rules. Landlord shall operate, manage, equip, light, repair, clean and maintain the Common Areas as Landlord reasonably determines appropriate. Landlord may temporarily close any Common Area for repairs or Work, to prevent dedication to the public or accrual of prescriptive rights or for any other reason, but Tenant shall nevertheless be entitled to access to the Premises. Landlord shall have sole and exclusive control of the Common Areas. Landlord may from time to time restrain any use or occupancy of the Common Areas except as Building Rules allow, subject however to Tenant's rights to access to the Premises under this Lease. Tenant's rights in the Common Areas are subject to rights of Landlord, Landlord's other tenants and the invitees and licensees of all the foregoing, to use the Common Areas in common with Tenant. Tenant shall keep the Common Areas free and clear of obstructions created or permitted by Tenant or resulting from Tenant's operations. If in Landlord's opinion any unauthorized persons use Common Areas because of Tenant's presence in the Building, then Tenant, upon Landlord's demand (or, at Landlord's option, Landlord at Tenant's expense, plus an Administrative Fee), shall restrain that unauthorized use by appropriate proceedings.

13.10 *Building Access.* Landlord may promulgate from time to time procedures for Building access. Tenant shall comply with them. If Landlord establishes access control equipment or procedures, this imposes no obligations on Landlord. Landlord shall have no liability or responsibility if that equipment or procedures malfunction or fail to operate. Landlord

has no obligation to establish or promulgate any security procedures for the Building or to require any tenant to implement security procedures. Tenant shall be solely responsible for access control in the Premises. Tenant's installation or material modification of any equipment or device for that purpose constitutes an Alteration.

14. *Landlord's Access and Work*

14.1 *Throughout Term.* Landlord and its designees may enter the Premises on reasonable oral notice to Tenant to: (a) inspect, including to ascertain Tenant's compliance with this Lease; (b) perform repairs or Work, if any, that this Lease permits or requires of Landlord; (c) supply services this Lease requires; (d) in the last year of the Term, show the Premises to prospective tenants; and (e) show the Premises to prospective purchasers or mortgagees.

14.2 *Reservation.* Landlord reserves and excepts from the Premises elevator shafts, elevator lobbies, riser spaces, stairways, other circulation areas, chambers, shafts, electrical, telecommunications, and janitorial closets, and all other mechanical spaces in the Building as Landlord designates from time to time. The Premises do not include the structure or exterior surfaces (except Tenant's Façade) of exterior walls. Landlord reserves and excepts from the Premises the right to install, maintain, use (including turning valves on and off), repair and replace pipes, ducts, conduits, valves, wires and appurtenant fixtures leading through the Premises, either in their locations at the Signature Date or at locations that, to the extent reasonably practicable, will not materially interfere with Tenant's use of the Premises. Tenant shall not cover, conceal or impair ready access to any pipe, duct, conduit, valve, wire or appurtenant fixture of Landlord unless Tenant complies with Landlord's reasonable requirements to assure future access. During any Work Landlord or its designee does in the Premises or as reasonably necessary to facilitate Work elsewhere, Landlord or its designee may bring materials and equipment into or through the Premises at reasonable times and on reasonable Notice to Tenant (which may be oral). Landlord's exercise of its rights under this paragraph shall not constitute an eviction or entitle Tenant to any Rent abatement or damages for loss or interruption of business or otherwise.

14.3 *Emergency.* Landlord may enter the Premises without notice or liability to Tenant in the event of an emergency.

14.4 *Keys.* Tenant shall give Landlord keys (and any other devices necessary to obtain access to the Premises, e.g., security cards and codes)

to all doors to and in the Premises, except vaults and similar secure areas that (a) were designated as such on plans Landlord approved; and (b) do not constitute a substantial part of the Premises.

14.5 *Landlord's Work.* Landlord may, from time to time, perform or allow others to perform Work on the Building interior or exterior, including Building Systems, Facade, glass, elevators, hallways and lobby. Landlord shall have no liability to Tenant, and Tenant shall be entitled to no Rent abatement, because of that Work, including installation of sidewalk bridges, sheds, scaffolds or other temporary structures, or any noise, vibration or other disturbance to Tenant's business at the Premises, including partial blockage of access to the Premises (provided Tenant still has reasonable access) any Work may cause. Landlord and its designees shall have access to the Premises at all reasonable times, upon reasonable notice, to perform that Work, without liability. Except in an emergency or upon Tenant's failure to perform repairs as this Lease requires, this paragraph does not give Landlord the right to enter the Premises to perform repairs that this Lease requires Tenant to perform. Tenant shall comply with Landlord's reasonable requirements to facilitate Work elsewhere in the Building, provided Landlord does not materially impair Tenant's use and occupancy of the Premises.

15. *Indemnity*

15.1 *Tenant's Obligation.* Tenant shall Indemnify Landlord and its Lenders/Lessors against: (a) any occurrence at, in, on, upon, or about the Premises, except to the extent caused by Landlord's gross negligence or willful misconduct; (b) Tenant's occupancy or use of the Premises, or performance of any Work; (c) any Lien caused by any Tenant Party's act or omission; (d) any act, omission or negligence of any Tenant Party, including failure to comply with Law or with this Lease; and (e) any damage to the Building and costs (including security costs) incurred because of protests, vandalism or other acts of third parties (including Tenant's employees and any union(s) representing, purporting to represent or seeking to represent them) directed at Tenant or caused by Tenant's occupying the Premises.

15.2 *Litigation.* If Landlord or any Lender/Lessor is made a party to any litigation for which this Lease requires Tenant to Indemnify Landlord (or any action of any kind against a Tenant Party) then, at Landlord's option, Tenant shall undertake Landlord's or that Lender/Lessor's defense. Tenant shall Indemnify Landlord and each Lender/Lessor against

that litigation. Tenant shall pay all costs, including Legal Costs, that Landlord or any Lender/Lessor pays or incurs in any such litigation.

16. *Insurance*¹⁵

16.1 *Obligations to Insure.* Tenant shall obtain and maintain throughout the Term liability insurance for the Premises and fire, hazard, special perils and other casualty insurance (including extended coverage and vandalism and malicious mischief endorsements) for Tenant's Work, any Tenant improvements and Tenant's contents at the Premises.

16.2 *Requirements.* Tenant's insurance shall be in such amounts, and provide such coverages, as Landlord requires from time to time, except to the extent that Tenant establishes that Landlord's requirements exceed those in Comparable Buildings. As of the Signature Date, Landlord requires liability insurance of \$5,000,000 in combined single limit liability coverage for bodily injury and property damage. If Tenant sells alcoholic beverages, then Tenant shall maintain liquor sales and dram shop liability coverage in amounts as Landlord reasonably requires. All insurance shall be written by companies licensed to do business in the State and otherwise reasonably satisfactory to Landlord with a Best's rating of A or better and financial size category of at least Class VII, or such higher standard as Landlord reasonably requires. Deductibles and terms and conditions of Tenant's insurance shall be subject to Landlord's reasonable approval. All policies and certificates of insurance shall state the carrier cannot cancel or refuse to renew without giving Landlord at least 30 days prior Notice (10 days in the case of nonpayment). Tenant's liability insurance shall include contractual liability coverage for the "Indemnity" requirements of this Lease.

16.3 *Additional Requirements.* Tenant shall also obtain and maintain insurance reasonably satisfactory to Landlord for plate glass (to the extent this Lease makes Tenant responsible for window repairs), water damage, lost profits, lost business, business interruption, completed operations, personal property, computers, hardware, software, data, electronic and electrical equipment, merchandise and products.

16.4 *Certificate Holders.* Tenant's insurance shall name all Certificate Holders as additional insured(s) as their interest(s) may appear (or loss payee in the case of building insurance) or as Landlord reasonably

¹⁵ Landlord's insurance advisers should review this article, and will always have comments.

requests. Landlord may designate (or terminate) any Certificate Holder(s) from time to time.

16.5 *Insurance Documents.* On the Signature Date, Tenant shall deliver to Landlord the following (collectively, the “Insurance Documents”): (a) original policies of all insurance this Lease requires, or (if Landlord permits) form ACORD-28 evidence of that insurance reasonably satisfactory to Landlord; (b) evidence that each Certificate Holder is named as this Lease requires and that Tenant’s insurance fully complies with this Lease; (c) proof of payment of at least one year’s premiums; and (d) if Tenant delivers certificate(s) of insurance, then evidence reasonably satisfactory to Landlord that Tenant’s insurance agent can bind the carrier.¹⁶ Tenant shall deliver renewal Insurance Documents at least 30¹⁷ days before any Insurance Document or the underlying policy expires, whichever occurs first.

16.6 *Waiver of Subrogation.* Each party shall attempt to cause its insurance carriers to agree to a Waiver of Subrogation. If any insurance policy cannot be obtained with a Waiver of Subrogation, or if one is obtainable only at additional cost, then the party undertaking to obtain the insurance shall Notify the other of that fact. The other shall have 10 Business Days after receipt of Notice to (a) direct the party undertaking to provide insurance to place it with a company reasonably satisfactory to the other party that will issue it with a Waiver of Subrogation at no greater cost, or (b) agree to pay the additional premium. To the extent the parties obtain insurance with a Waiver of Subrogation, the parties release each other, and their Related Parties (and Landlord’s Lenders/Lessors, as to claims by Tenant), from any claims for damage to any Person or the Premises that are caused by or result from risks that such policies cover.¹⁸

16 We all know that insurance certificates provide little comfort; hence clause “d.” In the real world, most people accept insurance certificates, for what (little) they’re worth. Landlord might conceivably also ask Tenant’s insurance broker to provide a letter confirming that Tenant’s insurance program matches Lease requirements. If Landlord cares about that—and Landlord should!—then Landlord should arrange for its own review, and not rely on Tenant’s insurance broker.

17 Tenants typically try to reduce this number as much as possible, ideally to zero, based on the reality that no one renews insurance until the last minute. Even if Landlord rejects those attempts, insurance will still often create a last-minute scramble. Can Landlord obtain backup coverage in case of a loss during a brief lapse in insurance? A Landlord’s level of concern will vary depending on the type of insurance Tenant must maintain.

18 Many insurance policies automatically include a Waiver of Subrogation. This paragraph may no longer be necessary.

16.7 *Compliance.* Tenant shall not use the Premises in any way that results in a premium increase, or a cancellation, for any insurance for the Building. Without limiting Landlord's remedies, if because of the nature or manner of Tenant's use of the Premises Landlord cannot obtain and maintain any insurance whose amount, cost, scope, form and coverage are reasonably acceptable to Landlord, then Tenant shall pay any resulting increased premiums.

16.8 *Modification of Insurance Requirements.* Landlord may from time to time, by Notice to Tenant, reasonably and in any event consistent with Comparable Buildings: (a) modify or increase any insurance requirements of this Lease; or (b) require additional insurance coverages, if appropriate (for either "a" or "b") in the judgment of Landlord's insurance advisor, for any reason, including risks of Tenant's use of the Premises, inflation-related adjustments, to comply with Landlord's Financing, or because of changed circumstances.

16.9 *Blanket Insurance.* Tenant may provide any required insurance under blanket policy(ies) covering other premises that Tenant or its Related Parties own, occupy or operate, so long as, in Landlord's reasonable judgment, those policies comply as to terms, amounts and scope of coverage with this Lease and provide a separate fund to draw on for only this Lease and the insurance this Lease requires, regardless of claims made elsewhere.

17. *Casualty and Condemnation*¹⁹

17.1 *Casualty Affecting Building.* If a casualty causes any Landlord-Restored Damage that materially impairs Tenant's use of or access to the Premises, then: (a) provided no Default exists, Landlord shall reasonably promptly repair the Landlord-Restored Damage unless either party validly terminates this Lease; (b) Base Rent and Escalation Rent shall equitably abate so long as Landlord has not substantially completed repair of the Landlord-Restored Damage; (c) Tenant's obligations under this Lease shall not otherwise change; (d) the paragraph on "Tenant-Restored Damage" shall apply; and (e) this Lease shall not terminate. Landlord shall be entitled to all proceeds from insurance Landlord procured.

17.2 *Landlord's Right to Terminate.* If (a) the reasonably estimated cost to repair Landlord-Restored Damage exceeds an amount equal to

¹⁹ These provisions will vary with circumstances, depending in part on the size and nature of the Lease and the larger Building.

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[\$ _____] [____% of the annual Base Rent as then in effect]; or (b) the cost to repair exceeds available insurance proceeds by more than [\$ _____] [____% of the then current annual Base Rent] (except by operation of the deductible under Landlord's property insurance); or (c) Landlord reasonably estimates that repair would take longer than 240 days, then Landlord may terminate this Lease by Notice to Tenant.

17.3 *Tenant's Right to Terminate.* If Landlord cannot or does not elect to terminate this Lease because of Landlord-Restored Damage, then Tenant shall remain fully liable for Tenant's obligations under this Lease, except as this Lease expressly states, unless: (a) Landlord reasonably estimates the Landlord-Restored Damage will take more than 180 days to repair; (b) no Default exists; and (c) within 30 days after the Casualty or Condemnation Tenant Notifies Landlord that Tenant desires to be released from this Lease and elects to terminate this Lease.

17.4 *Tenant-Restored Damage.* If a Casualty or Condemnation causes any Tenant-Restored Damage but does not cause any Landlord-Restored Damage, or if Landlord has repaired the Landlord-Restored Damage, then thereafter: (a) Rent shall not abate; and (b) Tenant shall reasonably promptly restore the Tenant-Restored Damage, all in compliance with the Work provisions of this Lease. Tenant may receive proceeds of all casualty insurance Tenant procured for Tenant-Restored Damage. Landlord may, however, require that a disbursement agent, selected by Tenant and reasonably satisfactory to Landlord, hold proceeds for disbursement under reasonable procedures reflecting progress of restoration. If Tenant-Restored Damage occurs in the last 24 months of the Term and prevents Tenant from conducting business in the Premises, then Tenant may terminate this Lease provided that Tenant: (a) cures any Default; (b) gives Notice to Landlord of termination within 30 days after the Casualty or Condemnation; and (c) assigns to Landlord all casualty insurance (including time element insurance but only up to the Rent otherwise payable under this Lease) proceeds otherwise payable to Tenant.

17.5 *Condemnation.* If any Condemnation occurs, then: (a) Landlord may, by Notice to Tenant, terminate this Lease; and (b) if the Condemnation relates to more than 50% of the Premises and materially impairs Tenant's ability to conduct its business, and no Default exists, then Tenant may, within 30 days after Landlord's Notice to Tenant of the Condemnation, terminate this Lease effective as of the date of that Condemnation. The entire Condemnation award shall belong to Landlord, except any sum expressly awarded to Tenant for trade fixtures, goodwill, and moving costs, provided it does not reduce any payment to Landlord

(or any Lender/Lessor) and Tenant cures any Default. If neither party properly terminates this Lease because of a Condemnation, then the provisions of this Lease on Landlord-Restored Damage and Tenant-Restored Damage shall apply.

18. *Hazardous Substances*

Tenant Parties shall not cause or permit to occur at, from or about the Building any: (a) generation, manufacture, processing, production, refining, storage, transportation or use of any Hazardous Substance, except in customary volume reasonably necessary for Tenant's business in compliance with industry standards and Law; (b) violation of any Environmental Law; or (c) Hazardous Substance Discharge. Tenant shall: (1) comply with all Environmental Laws that apply to any Tenant Party or its activities; (2) make all submissions to, provide all information required by and otherwise fully comply with all requirements of, any Government relating to "1"; (3) if any Government requires any clean-up plan or measures because of any Hazardous Substance Discharge that any Tenant Party causes or arising from any Tenant Party's activities: (i) immediately Notify Landlord; (ii) prepare and submit the required plans and all related bonds and other financial assurances; and (iii) carry out all such clean-up plans; (4) promptly give Landlord all information Landlord reasonably requests about matters referred to in this paragraph; and (5) Indemnify Landlord against any Tenant Party's violation of this paragraph.

19. *Assignment or Subletting*

19.1 *General Prohibition.* Landlord entered into this Lease with Tenant based on Tenant's skills in operating the Permitted Use(s) and an analysis of Tenant's reputation and credit. To induce Landlord to enter into, and as part of the consideration for, this Lease, Tenant agrees that (except as this Lease expressly permits) Tenant shall not cause or permit any Transfer without Landlord's prior written consent, which Landlord [may (except as this Lease otherwise expressly states) withhold for any reason or no reason] [shall not unreasonably withhold provided Tenant has complied with and satisfied: (a) the section of this Lease on "Recapture"; and (b) the "Conditions and Limitations to Landlord's Consent" set forth below]. Any Transfer made in violation of this Lease shall be null, void and of absolutely no force or effect, and shall constitute an Event of Default.

19.2 *Entity Transactions.* If Tenant, any constituent entity of Tenant or any Guarantor is a corporation, partnership, limited liability company,

or other entity, then (unless the ownership interests in that entity are publicly traded) any transaction set forth below affecting that entity or its Equity Interests shall constitute a Transfer of this Lease, whether or not within Tenant's control. All transactions from the Signature Date to the date in question shall be aggregated.

19.2.1 *Equity Interest Transfer.* Any direct or indirect transfer, including by merger or consolidation, producing a change in ultimate beneficial ownership, of ___% or more of the Equity Interests of Tenant (or the direct or indirect ownership of those Equity Interests at any tier of direct or indirect ownership of Tenant) whether to the same or different transferees.

19.2.2 *Other Ownership Change.* Any increase or decrease in Equity Interests or any direct or indirect constituent entity or any other transaction of any kind, the effect of which is to increase or decrease by more than ___% the direct or indirect beneficial ownership of Tenant held by any Person(s).

19.3 *Exempt Transfers.* Landlord consents to any Exempt Transfer, if it satisfies the "Conditions and Limitations to Landlord's Consent" in this Lease.

19.4 *Recapture.* If Tenant seeks Landlord's approval of a Transfer (excluding an Exempt Transfer), then Tenant shall promptly give Landlord all information and documents Landlord reasonably requests for that Transfer, including a nonbinding term sheet signed by both parties, containing all material economic terms, but not necessarily fully negotiated and executed closing documents for that transaction. Beginning on the date when Tenant requested Landlord's approval and ending 30 days after Tenant has provided all information and documents the preceding sentence requires, Landlord may, by Notice to Tenant (a "Recapture Notice"), terminate this Lease²⁰ as of the date (the "Recapture Date") that is, at Landlord's option by Notice to Tenant: (a) the day immediately

20 Particularly in Landlord-friendly leasing markets, some leases allow Landlord to choose between recapturing the space and continuing the Lease while stepping into the shoes of the proposed subtenant or assignee. The second option allows Landlord to maintain the rental income under this Lease while also benefitting from whatever good deal the assignee or subtenant was able to negotiate. Such provisions require some care in drafting, to assure that the shoes Landlord steps into allow Landlord to do whatever it wishes with the recaptured space. Tenant will argue that Landlord should either recapture by terminating the Lease (thus cutting off Tenant's losses), or agree not to unreasonably stand in the way of Tenant's transaction, but Landlord should not be able to both retain the Lease revenues and frustrate Tenant's exit transaction. Landlord views all of this as a reasonable revenue opportunity of the type that periodically arises as a result of building ownership.

before the proposed effective date of the Transfer; (b) the date 90 days after delivery of the Recapture Notice; or (c) any date between “a” and “b” that Landlord designates. If Landlord timely gives a Recapture Notice, then the “Expiration Date” shall be accelerated to the Recapture Date. If Tenant’s proposed Transfer affects only part of the Premises (the “Recapture Space”), then this Lease shall terminate only for the Recapture Space. It shall continue to apply, in a proportionate manner as Landlord reasonably determines, to the remaining Premises. Landlord shall, at Tenant’s expense (including an Administrative Fee), install demising walls and other Work as necessary to permit separate occupancy of the Recapture Space. [If Landlord does not timely give a Recapture Notice, then Landlord shall not unreasonably withhold Landlord’s consent to the proposed Transfer, provided that Tenant consummates it: (a) in a way substantially consistent (and fully consistent in all material economic respects) with the information Tenant gave Landlord under this paragraph; and (b) within 45 days after Landlord’s approval.]²¹

19.5 *Conditions and Limitations to Landlord’s Consent.* If Landlord consents to any Transfer including Landlord’s consent to any Exempt Transfer provided for in this Lease, Tenant shall comply with these requirements and conditions for that Transfer. These requirements and conditions apply to any Transfer, including any Exempt Transfer, any Transfer this Lease expressly allows and any Transfer for which Landlord must act reasonably in consenting or not.

19.5.1 *Conditions Precedent.* Tenant shall give Landlord at least 15 days prior Notice of the Transfer, with a processing fee of \$____. The proposed Transfer (except an Exempt Transfer) shall be consummated within 45 days after Landlord’s consent. No Transfer shall be consummated if: (a) any Default exists, unless cured at or before the Transfer; or (b) Tenant has not completed Tenant’s Initial Work and performed any other obligations this Lease requires Tenant to perform by Tenant’s Completion Deadline or any other date.

19.5.2 *Advertising.* Any advertising or circulars on availability of the Premises for Transfer shall be subject to Landlord’s reasonable approval. Any publicized asking price per rentable square foot shall equal or exceed Landlord’s then current asking price.

19.5.3 *Separate Occupancies.* The Premises shall in no event contain more than [a single legal occupancy] [____ separate legal occupancies].

²¹ The preceding sentence usually appears in a “market standard” Lease.

19.5.4 *Transferee*. Without otherwise limiting any other restriction that applies to any Transfer, no Transfer shall be made to any Person, even if otherwise permitted, if Landlord reasonably determines that such Person or its Related Party: (a) has, in the preceding year, materially defaulted under any commercial lease; (b) is disqualified from entering into contracts with any Government; (c) otherwise has a poor credit record or business reputation; (d) has been convicted of a felony; (e) is immune from suit, an agency or instrumentality of any Government, or a religious or political organization; (f) occupies other space in the Building, unless fully occupied at the time; (g) competes, or has at any time been in litigation, with Landlord or its Related Party; or (h) would violate Landlord's Financing.

19.5.5 *Closing Requirements*. For an Assignment, the transferee shall assume all obligations under this Lease. All references to "Tenant" in this Lease shall then refer to the assignee, except where the context requires otherwise. The transferee shall deliver to Landlord any documents Landlord reasonably requires to evidence the transferee's due execution of the Lease assumption. The transferor shall: (a) retain full liability under this Lease, not merely liability as a surety or guarantor; and (b) before closing, execute and deliver to Landlord documents reasonably satisfactory to Landlord to confirm that liability. Any Default affecting a transferor shall be deemed a Default. If Landlord holds any guaranty(ies), then all principals of the assignee shall join in such Guaranty(ies). That joinder shall not release or limit any obligation of any previous Guarantor(s).²²

19.5.6 *Subordination, Attornment, Etc.* For any sublease or similar transaction, if this Lease terminates or is cancelled: (a) the subtenant or other transferee shall attorn to Landlord, at Landlord's option; and (b) if Landlord accepts payment from the subtenant or other transferee but does not request attornment in writing, then Landlord shall not have accepted that subtenant or other transferee as a direct tenant and Landlord may terminate its rights at any time. The documents for any such transaction shall, and shall be deemed to, incorporate by reference the preceding sentence.

19.5.7 *Increase of Security*. If at the time of any Assignment, the Security is less than ___ months' then-current Base Rent, then Tenant shall increase the Security to that amount.

22 Tenant will often negotiate a release of any guaranty if a replacement Guarantor steps in and meets a certain financial standard.

19.5.8 *Post-Closing*. Within 10 days after any Transfer, Tenant shall give Landlord an unredacted and complete copy of all documents for that Transfer, all reasonably satisfactory to Landlord.

19.5.9 *Miscellaneous*. Tenant shall pay all transfer and other taxes (and interest and penalties) assessed or payable for any Transfer. Landlord's consent (or waiver of its rights) for any Transfer shall not waive Landlord's right to consent to a later Transfer.

19.6 *Tenant's Ownership*. If Tenant is a corporation, limited liability company, or other entity (unless publicly traded), then: (a) Tenant represents and warrants that as of the Signature Date, Tenant's Owners own 100% of the Equity Interests of Tenant; and (b) on Landlord's reasonable request, Tenant shall deliver to Landlord a certified statement by Tenant's outside accountant listing all direct and indirect owners and officers of Tenant and their then-current Equity Interests.

19.7 *Effect of Assignment*. If Landlord receives notice of any Assignment and a copy or purported copy of the instrument(s) actually or purportedly effecting that Assignment, then without limiting Landlord's remedies under this Lease Landlord may (provided that Landlord acts in good faith) deal with the purported transferee as "Tenant" under this Lease for all purposes, including Lease amendments. Provided that Landlord acts in good faith, Landlord need not inquire as to the genuineness or accuracy of any instrument of Assignment or purported copy of any such instrument.

20. *Incremental Value*

If Tenant Transfers this Lease, except an Exempt Transfer, for consideration of any kind (including a sublease of any or all Premises at a subrent exceeding the Base Rent and Escalation Rent, as Landlord reasonably allocates them on a per-square-foot basis (the "Excess Subrent")), then Tenant shall pay Landlord, as additional consideration for Tenant's occupancy of the Premises, an amount (the "Incremental Value Payment") equal to 50%²³ of an amount (the "Incremental Value") equal to the sum of (a) that consideration and any Excess Subrent minus (b) Tenant's Transaction Costs. Tenant shall pay any Incremental Value Payment at closing of the Transfer and monthly for Excess Subrent. Consideration

23 This usually seems to be 50% in New York City office and small retail leases. Stronger retail tenants can sometimes eliminate the concept entirely, or helpfully suggest that they will agree to it only if Landlord also agrees to participate in "losses" and not just "profits" on a sublease.

shall include the aggregate amount of payment(s) for Tenant's furnishings, fixtures and equipment, but only to the extent they exceed Tenant's adjusted basis for federal income tax purposes, as certified by Tenant's outside certified public accountant. For a Sublease with Excess Subrent, Tenant shall amortize Tenant's Transaction Costs over the term of that Sublease (including any option terms) in a way reasonably satisfactory to Landlord. Tenant's "Transaction Costs" means Tenant's actual bona fide third party out of pocket costs of the Transfer, including brokerage commissions, attorneys' fees, cost of new Work, and other actual and reasonable third party expenses that Tenant would not have incurred but for the Transfer, all as reasonably approved by Landlord.²⁴ Landlord shall make all calculations and determinations under this paragraph. Landlord's reasonable determination or calculation shall be final. Tenant shall give Landlord information, documents, and invoices Landlord requires to make those calculations and determinations. If Tenant does not, Landlord may estimate them. That estimate shall govern unless and until Tenant establishes it is wrong. If Landlord requires, Tenant shall confirm the amount and timing of Incremental Value Payment(s) in writing before the Transfer closes, unless: (a) the Transfer is a Bankruptcy Transfer; (b) a bona fide dispute exists on the Incremental Value Payment; and (c) delay in closing would impair Tenant's ability to reorganize. To the extent Tenant receives any consideration for any Transfer for which Tenant owes an Incremental Value Payment, that consideration constitutes Landlord's property. Tenant shall hold it in trust for Landlord and promptly give it to Landlord. The requirement to pay Incremental Value Payments does not prevent, limit, restrict or impair Tenant in any way from Transferring this Lease, to the extent this Lease otherwise allows any Transfer. To the contrary, the obligation to pay Incremental Value Payments merely allocates any Incremental Value created between the Signature Date and the date of Transfer from any increase in rental value of the Premises, thus defining the scope of the parties' property interests under this Lease. Landlord owns any Incremental Value to the extent this paragraph provides. The value of the Lease to Tenant, whether or not a Bankruptcy Event exists, must be adjusted based on the parties' freely negotiated sharing of any Incremental Value from a Transfer. That negotiated sharing does not limit Tenant's ability to close any Bankruptcy Transfer or any other Transfer this Lease permits.

21. *Quiet Enjoyment*

²⁴ Tenant will often want to include vacancy period and free rent, plus anything else Tenant can think of.

So long as no Event of Default exists, Tenant shall peaceably and quietly hold and enjoy the Premises for the Term, without hindrance or interruption by Landlord or any other Person(s) lawfully claiming by, through or under Landlord, subject to the terms of this Lease and any matters to which this Lease is subordinate. Nothing in this Lease gives Tenant any easement of light, air or view.

22. *Option Term(s)*

If the Basic Terms grant Tenant any Option Term(s) (each, an “Option”), then for each Option:

22.1 *Exercise.* Landlord must receive Notice of Tenant’s exercise of an Option for a particular Option Term in this period (the “Option Exercise Period” for that Option Term): (a) beginning on the date 24 calendar months before the first day of the Option Term; and (b) ending at 5:00 p.m. on the last Business Day before the date 12 calendar months before the first day of the Option Term. Time is of the essence for Tenant’s exercise of any Option. Any purported exercise of any Option shall be null and void if: (a) given at any time except in the Option Exercise Period for that Option; (b) any Transfer of this Lease (except an Exempt Transfer) has occurred during or before that Option Exercise Period; (c) any previous Option expired without exercise; or (d) at the time of exercise or the last day of the Term (before the Option Term), an Event of Default exists. Tenant waives any right that Tenant might otherwise have to require Landlord to accept Tenant’s exercise of an Option outside the Option Exercise Period. Tenant assumes full responsibility to maintain a record of any Option Exercise Period. If Landlord waives strict compliance with any Option Exercise Period, that waiver shall not apply to any later Option Exercise Period. If Tenant validly exercises an Option in an Option Exercise Period, then the “Term” shall extend to include the corresponding Option Term, and the “Expiration Date” shall become the last day of that Option Term.

22.2 *Failure to Exercise.* If Tenant does not validly exercise an Option in its Option Exercise Period, then the Term shall unconditionally expire and terminate as of the then-applicable Expiration Date. After that, Tenant shall have no rights to the Premises, nor any right to exercise any other Option(s). Tenant waives and disclaims any rights under, and covenants not to assert, any Law that would extend any Option Exercise Period or validate any Option exercise outside an Option Exercise Period.

22.3 *Option Terms.* In any Option Term, this Lease shall continue on the same terms that applied in the last Lease Year before that Option Term, except as follows. Unless the Basic Terms provide otherwise, Base Rent in any Option Term shall be the greater of (a) the Base Rent in the last Lease Year before the Option Term;²⁵ and (b) Fair Market Rent as of the first day of the Option Term. Tenant shall also continue to pay all Additional Rent, except that Base Operating Expenses and Base Property Taxes shall use a Base Operating Year and a Base Property Tax Year that both include the first day of the Option Term. Landlord need not provide any Landlord's Initial Work or Abatement Period for any Option Term. After any Option Term, Tenant shall have no further Option Term(s) except to the extent that the Basic Terms provide for them.

22.4 *Definition: Fair Market Rent.* The "Fair Market Rent" means, given market conditions in the Option Exercise Period, the Base Rent that a hypothetical tenant and a hypothetical landlord would agree upon for the Premises, assuming a hypothetical lease for a term equal to the Option Term and otherwise on all the terms of this Lease (including a new Base Operating Year and a new Base Property Tax Year, each of which shall include the first day of the Option Term) as they apply in the Option Term. That Base Rent shall be periodically adjusted in accordance with any periodic Base Rent adjustments that applied under this Lease before the Option Term.²⁶ Fair Market Rent shall: (a) take into account those subsequent adjustments; (b) assume Landlord delivered the Premises to Tenant in its then-current condition, with no need for any Work, and allowed an Abatement Period or other "free rent" or rent abatement consistent with then current market conditions (although Tenant shall not be entitled to any Abatement Period); and (c) otherwise take into account all applicable provisions of this Lease. [If the Option Term is less than seven years, then Fair Market Rent in each year of the Option Term shall be determined as if the Option Term were seven years. The Fair Market Rent as so determined shall apply within the actual Option Term.]²⁷

22.5 *Notice from Landlord; Tenant's Rights.* Within 30 days after Tenant exercises any Option, Landlord shall Notify Tenant of Landlord's proposed Fair Market Rent for the Option Term ("Landlord's Fair Market

25 This "floor" is probably unreasonable but it is market standard except in very Tenant-friendly situations. If the Lease contemplated annual bumps, Landlord would like the "floor" to include the usual annual bump for that year.

26 Explain very specifically how future Base Rent adjustments will work.

27 Bracketed language responds to the fact that some people believe it may be hard to determine Fair Market Rent for Lease terms below seven years, because they are rarely agreed to.

Rent Notice”). Late delivery of Landlord’s Fair Market Rent Notice shall not adversely affect either party’s rights. Tenant may, by Notice given within 15 days after receipt of Landlord’s Fair Market Rent Notice (a “Dispute Notice”), dispute Landlord’s proposed Fair Market Rent and invoke this appraisal procedure. If Tenant does not deliver a timely Dispute Notice, Base Rent in the Option Term shall be based on Landlord’s Fair Market Rent Notice.

22.6 *Commencement of Appraisal Process.* The parties shall endeavor, for 15 days after Landlord’s receipt of Tenant’s Dispute Notice, to agree upon Fair Market Rent. If the parties cannot, Landlord shall request that the President of [the Real Estate Board of New York, Inc.] (or if that organization does not exist, its successor or a similar industry organization Landlord designates), select a qualified real estate appraiser that is not a Related Party of either party (the “Arbitrator”) to resolve the dispute. All communications between Landlord or Tenant and the Arbitrator shall be in writing with a copy to the other party.

22.7 *Two Proposals.* Within 15 days after selection of the Arbitrator, Landlord and Tenant shall each simultaneously submit to the Arbitrator (with a simultaneous copy to the other party) a written proposal of Fair Market Rent, with any written supporting information the submitter desires to include.

22.8 *“Baseball” Selection.* The Arbitrator shall within 30 days after selection choose either (a) Landlord’s Fair Market Rent; or (b) Tenant’s Fair Market Rent, whichever (“a” or “b”) the Arbitrator believes is closer to Fair Market Rent. The Arbitrator shall have no authority to set any Fair Market Rent except “a” or “b.” The Arbitrator shall certify it has considered all information it considers relevant, but need not otherwise justify, substantiate, or explain its choice. The Arbitrator’s determination shall bind the parties in the affected Option Term. In no event, however, shall Base Rent in any Option Term be less than Base Rent in the last Lease Year before that Option Term.

22.9 *Payments.* Until the Arbitrator has selected Landlord’s or Tenant’s Fair Market Rent, Tenant shall pay Base Rent consistent with Landlord’s Fair Market Rent. If the Arbitrator selects Tenant’s Fair Market Rent, Landlord shall promptly refund to Tenant any previous excess payments of Base Rent, with interest on that excess at the Prime Rate.

23. *End of Term*

23.1 *Automatic Termination.* This Lease shall terminate on the Expiration Date with no need for Landlord to Notify Tenant of that termination. Tenant waives any Notice to vacate or quit the Premises on the Expiration Date.

23.1 *Required Condition of Premises.* Unless Landlord elects otherwise by Notice to Tenant, or as this paragraph otherwise states, at the Expiration Date Tenant shall: (a) leave the Premises vacant, in good broom-clean condition; (b) remove Tenant's personal property, signs and Work; (c) repair all damage from the foregoing; (d) leave any HVAC that Tenant installed or maintained in good working condition; and (e) give Landlord all documentation for Tenant's HVAC service contracts. Tenant need not, however, repair any damage, or remove any Work, to the extent that: (x) in Landlord's reasonable judgment not doing so would not reduce the desirability or rentability of the Premises or materially increase the next tenant's fixturing or demolition costs (for example, failure to remove raised floors, vaults or other special installations would increase the next tenant's costs); (y) any damage arises from reasonable wear and tear; or (z) this Lease otherwise expressly excuses Tenant from performing that repair or removal.²⁸

23.2 *Cabling.*²⁹ By giving Notice before (or within 30 days after) any termination of this Lease, Landlord may elect to: (a) retain any or all Cabling; or (b) remove any or all Cabling and restore the Premises and risers and other common areas to their condition before Tenant installed its Cabling (the "Cabling Restoration Work"). Landlord shall perform Cabling Restoration Work, or may require Tenant to perform Cabling Restoration Work, in either case at Tenant's sole cost and expense. Landlord's rights and Tenant's obligations under this paragraph shall survive expiration or termination of this Lease. If Landlord elects to retain Cabling, Tenant covenants that Tenant: (a) shall be the sole owner of that Cabling, with good right to surrender it; and (b) Tenant shall leave all Cabling in good condition, working order, properly labeled at each end and in each closet and junction box and in safe condition, free of Liens. Notwithstanding anything to the contrary in this Lease, Landlord may retain Tenant's Security Deposit after expiration or sooner termination of

28 The preceding sentence is more Tenant-friendly than many Leases, but represents a common agreed outcome. Landlord could edit this Lease to require removal of all Work, creating a future profit center for Landlord.

29 This requirement, a response to the ever-increasing tangle of abandoned wiring that accumulates in any Building, is nonstandard. A Tenant may consider it excessive. Landlord may prefer to drop the notice requirement and make up its mind now on what Landlord will require.

the Lease until the earlier of these events: (a) Landlord elects to retain the Cabling; or (b) Tenant has completed and paid for Cabling Restoration Work. If Tenant fails or refuses to pay all costs of Cabling Restoration Work within 10 Business Days after receiving Landlord's bill, Landlord may pay it from Tenant's Security Deposit, but this does not limit or waive any other right or remedy.

23.4 *Abandonment.* If Tenant leaves any property, including property in which a third party has any interest, in the Premises after the Expiration Date, then Landlord may dispose of it at Tenant's expense, or keep it as abandoned property. If Tenant has removed Tenant's property from the Premises (except property this Lease requires or allows Tenant to leave), and Landlord reasonably determines Tenant does not intend to return, Landlord may immediately enter, and perform Work in, the Premises. That shall not entitle Tenant to any Rent abatement or claims against Landlord, or affect this Lease or Tenant's obligations.

24. *Security for Tenant's Performance*

24.1 *Delivery and Use of Security.* On the Signature Date, Tenant is depositing with Landlord the Security.³⁰ Landlord shall hold it in compliance with Law. If Law requires, Landlord shall hold (and notifies Tenant that Landlord holds) the Security in Security Deposit Bank. Landlord may change Security Deposit Bank by Notice to Tenant. Tenant shall not assign or encumber any Security or attempt to do so. Any such action shall not bind Landlord. Landlord may apply Security to pay any Rent not paid when due. This shall not limit Landlord's other remedies. After Landlord applies any Security: (a) Landlord shall reasonably promptly Notify Tenant; and (b) Tenant shall replenish the Security on demand. The Security shall remain constant except: (a) if the Base Rent increases, Landlord may require Tenant to increase the Security in proportion;³¹ and (b) as this Lease otherwise provides. Tenant may not use Security to pay Rent. Within a reasonable time after the Expiration Date, unless the Expiration Date occurred because of an Event of Default, Landlord shall return any remaining Security.

24.2 *Tax Documents.* Tenant certifies under penalty of perjury: (a) its correct Taxpayer Identification Number is as stated below its signature; and (b) the Internal Revenue Service has not notified it that it is subject to

30 If Security exceeds a year's Base Rent, this may create bankruptcy issues. See Chapters of this work on letters of credit.

31 Clause "a" is nonstandard, but a reasonable Landlord requirement.

back-up withholding. Tenant shall promptly on request complete, sign and return to Landlord any document that Landlord reasonably requests for Tenant's receipt of interest on the Security. Notwithstanding anything to the contrary in this Lease, subject to Law: (a) the Security shall not bear interest until Tenant has given Landlord a filled-out and signed "W-9" form; and (b) before Landlord remits to Tenant any interest on the Security, Landlord may apply it to increase the Security as this Lease requires.

24.3 *Transfer.* If Landlord transfers Landlord's interest in the Premises, then Landlord shall turn over the Security to the new Landlord and reasonably promptly Notify Tenant of Landlord's transfer, the new Landlord's name and address, and any change in Security Deposit Bank. When the transferor Landlord has done so, it shall no longer be responsible for the Security. Only the new Landlord shall be responsible, until it has applied or transferred the Security in compliance with this Lease.

24.4 *Bankruptcy.* Immediately before any Bankruptcy Event affecting Tenant, unless Landlord elects otherwise in writing, the entire Security shall automatically be deemed to have been applied as follows, whether or not Landlord actually does so: (a) first, to pay unpaid Rent for periods before the Bankruptcy Event; and (b) second, to Landlord in partial payment of Landlord's damages for Tenant's Default. Landlord may disburse the Security accordingly.

24.5 *Use of L/C Security.* If the Security exceeds \$50,000,³² then Tenant may, except in a Default Period, substitute a letter of credit (the "L/C Security") for all cash Security, as follows.

24.5.1 *Form and Delivery of L/C Security.* If Tenant elects to deliver L/C Security, then Tenant shall provide Landlord, and maintain in full force and effect throughout the Term, a letter of credit substantially in the form of **Exhibit** __ issued by an issuer reasonably satisfactory to Landlord ("L/C Issuer"),³³ in the amount of the entire Security, with an initial term of at least one year. If, at the Expiration Date, any Rent remains uncalculated or unpaid, then: (a) Landlord shall with reasonable diligence complete any necessary calculations; (b) Tenant shall extend the expiry date of the L/C Security from time to time as Landlord reasonably

32 If the Security exceeds a year's rent, then Landlord should insist on obtaining the Security, or an L/C, from the Guarantor and not from the Tenant. See the Chapters of this work on letters of credit.

33 Landlord may want to set standards for L/C Issuer, e.g., a New York Clearinghouse Bank and a net worth of at least \$_____.

requires; and (c) in that extended period, Landlord shall not unreasonably refuse to consent to an appropriate reduction of the L/C Security. Tenant shall reimburse Landlord's Legal Costs, as estimated by Landlord's counsel, in handling Landlord's acceptance of L/C Security or its replacement or extension. Tenant shall pay all L/C Issuer fees for issuing, amending, extending, replacing or accommodating any transfer of L/C Security.

24.5.2 Noncompliant L/C Security. On the Signature Date, Landlord may accept L/C Security that does not comply strictly with **Exhibit** __. Landlord may then, for 60 days after the Signature Date, by Notice, require Tenant to have the L/C Security modified or reissued to comply strictly with **Exhibit** __ (a "Corrective Reissuance"). If Tenant does not accomplish a Corrective Reissuance within 60 days after that Notice, then Landlord may draw the entire L/C Security and hold the proceeds as cash Security. If Tenant's L/C Security delivered on the Signature Date strictly complies with **Exhibit** __, then Landlord's counsel shall, on request, waive Landlord's right to require a Corrective Reissuance.³⁴

24.5.3 Release of Security. If Tenant delivers to Landlord satisfactory L/C Security in place of the entire Security, Landlord shall remit to Tenant any cash Security Landlord previously held.

24.5.4 Drawing Conditions, Procedures. Landlord may draw on the L/C Security, and hold and apply the proceeds in the same manner and for the same purposes as the Security, if: (a) an uncured Event of Default exists; (b) a Default exists and Landlord cannot legally Notify Tenant of that Default; (c) as of the date 45 days before any L/C Security expires (even if that scheduled expiry date is after the Expiration Date) Tenant has not delivered to Landlord an amendment or replacement for the L/C Security, reasonably satisfactory to Landlord, extending the expiry date to the earlier of (i) six months after the then-current Expiration Date or (ii) the date one year after the then-current expiry date of the L/C Security; (d) the L/C Security provides for automatic renewals, Landlord asks L/C Issuer to confirm in writing the current L/C Security expiry date and L/C Issuer fails to do so within 10 Business Days; (e) Tenant fails to pay (when and as Landlord reasonably requires) any bank charges for Landlord's transfer of the L/C Security; (f) L/C Issuer ceases, or announces that it will cease, to maintain an office in the City or in Florida where

³⁴ This paragraph seeks to prevent last-minute emergencies on the form of L/C Security. The advantage of having and resolving such emergencies is that one less loose end remains after the parties sign the Lease. Therefore, Landlord may prefer to delete this paragraph and insist on fully compliant L/C Security on the Signature Date.

Landlord may present drafts under the L/C Security; (g) any credit rating of L/C Issuer has been significantly impaired, as reasonably determined by Landlord; (h) L/C Issuer has been seized, shut down or taken over by any Government or is the subject of any Bankruptcy Event; or (i) Tenant is the subject of any Bankruptcy Event.³⁵ This paragraph does not limit any other provisions of this Lease allowing Landlord to draw the L/C Security under stated circumstances.

24.5.5 Unsuccessful Draw. If Landlord seeks to draw on L/C Security when this Lease permits, but L/C Issuer refuses to pay that attempted draw for any reason except curable defects in Landlord's presentation, then Tenant shall promptly pay Landlord the amount that Landlord properly sought to draw on the L/C Security. The parties shall cooperate to simultaneously reduce the face amount of the L/C Security by the amount so paid.

24.5.6 Interference with Draws. Tenant shall not seek to enjoin, prevent or otherwise interfere with Landlord's draw on L/C Security, even if it violates this Lease. Tenant acknowledges that the only effect of a wrongful draw would be to substitute cash Security for L/C Security, causing Tenant no damage. Landlord shall hold the proceeds of any draw in the same manner and for the same purposes as cash Security.³⁶ In the event of a wrongful draw, the parties shall cooperate to allow Tenant to post replacement L/C Security simultaneously with the return to Tenant of the wrongfully drawn sums, and Landlord shall on request confirm in writing to L/C Issuer that Landlord's draw was erroneous.

24.5.7 Changes in L/C Security. If Landlord transfers its interest in the Premises, then Tenant shall at Tenant's expense, within five Business Days after Landlord's request, deliver (and, if L/C Issuer requires, Landlord shall consent to) an L/C Security amendment naming Landlord's grantee as substitute beneficiary. If the required Security changes while L/C Security is in force, then Tenant shall deliver (and, if L/C Issuer requires, Landlord shall consent to) a corresponding L/C Security amendment.

25. *Defaults and Events of Default*

35 Although the Lease allows Landlord to draw on a Tenant Bankruptcy Event, does that suffice to support a draw under the L/C if a Tenant Bankruptcy Event actually occurs?

36 If the Security exceeds a year's Base Rent, language like this sentence could help support claims that Landlord must "disgorge" part of the security. As a better strategy, Landlord should have the Security come from a Guarantor rather than from Tenant. See Chapter 38.

25.1 *Definition: "Event of Default."* Occurrence of one or more of these events shall constitute an "Event of Default." If and only if Tenant fully cures an Event of Default before Landlord has validly commenced to exercise remedies for it, then that Event of Default shall no longer exist for any purpose and Landlord may not exercise any rights or remedies for that former Event of Default.³⁷

25.1.1 *Nonpayment of Base Rent.* Tenant fails to pay any Base Rent as this Lease requires, and (subject to "Chronic Late Payment," below) that failure continues for five Business Days;

25.1.2 *Nonpayment of Additional Rent.* Tenant fails to pay any Additional Rent when this Lease requires, and (subject to "Chronic Late Payment," below) that failure continues for five Business Days after Notice from Landlord.

25.1.3 *Chronic Late Payment.* Tenant fails to pay any Rent, including Base Rent or Additional Rent, or make any other payment, when and as due under this Lease, if, in the last 18 months, Landlord has Notified Tenant two or more times of late payment of any Rent. (This paragraph shall not obligate Landlord to give Tenant any Notice, not otherwise required under this Lease, of any late payment of Rent.)

25.1.4 *Transfer.* If Tenant makes a Transfer requiring Landlord's consent without obtaining that consent as this Lease requires.

25.1.5 *Nonperformance.* If any Default occurs and, after Landlord gives Tenant a Default Notice, that Default continues for this period:³⁸

25.1.5.1 *Insurance.* For failure to provide insurance or Insurance Documents, three Business Days.

25.1.5.2 *Documentation.* For failure to deliver (and sign, where required) any document except Insurance Documents this Lease requires, including plans and specifications, concept drawings, schematics, sketches, an Estoppel Certificate or any other required document(s), 15 days.

37 If a Guaranty exists, then the Guaranty should state that Notice to Guarantor constitutes an adequate substitute for Notice to Tenant. That should protect Landlord from any surprises resulting from the automatic stay in a Tenant bankruptcy.

38 Modify these periods as appropriate. A typical Lease would allow 30 days (plus up to 60 additional days for due diligence) for all nonmonetary defaults, but this seems excessive for some.

25.1.5.3 *Liens*. For failure to comply with obligations on Liens, five Business Days.

25.1.5.4 *Date for Performance*. For failure to perform any nonmonetary covenant that must be performed by a specified or ascertainable date or on or within a specified or ascertainable date or period after the Signature Date, the Commencement Date or Tenant's Completion Deadline, 15 days.

25.1.5.5 *Restrictions and Prohibitions*. For failure to comply with any restriction, prohibition or other negative covenant in this Lease, five Business Days.

25.1.5.6 *Other—Basic Nonmonetary Cure Period*. For any other Default that can reasonably be cured within that period, the Basic Nonmonetary Cure Period.

25.1.5.7 *Other — Due Diligence*. For any other Default that cannot reasonably be cured in the Basic Nonmonetary Cure Period, Tenant shall have up to 90 more days, beyond the Basic Nonmonetary Cure Period, to the extent Tenant reasonably needs it, to cure the Default, but only if: (a) Tenant endeavors diligently and with continuity to cure it; and (b) Tenant acknowledges in writing that the Default exists, and (if Landlord requests) delivers an Estoppel Certificate and increases the Security by Landlord's reasonable estimate of the cost to cure the Default. Landlord shall promptly refund that increase in the Security if Tenant actually cures the Default before it becomes an Event of Default.³⁹

25.1.6 *Matters Affecting Guaranties*. Any Guarantor: (a) is a natural person and dies or becomes disabled unless, within 60⁴⁰ days, a replacement Guarantor, satisfactory to Landlord, has executed and delivered to Landlord a replacement Guaranty in the same form;⁴¹ (b) fails to perform any obligation under any Guaranty, including failure to deliver any

39 This details are unusual and perhaps excessive.

40 This period ranges from 30 to 90 days in most leases. Tenant may prefer to establish a standard that a replacement Guarantor must meet, such as: (a) dollar amount of net worth or liquid assets, perhaps subject to CPI adjustment; (b) stated multiple of annual Base Rent; or (c) at least the same financial strength that the original Guarantor had, tested either as of Commencement Date or as of Guarantor's death or disability. Guarantors do die or become disabled, so Tenants legitimately worry about this particular Event of Default, but a risk-tolerant Tenant might be willing to "deal with it later if it ever happens."

41 Tenant may argue that "a" is unnecessary because Guarantor's estate will remain bound by the Guaranty, but "a" is fairly standard.

required document or information, and does not cure that failure within 10 days after Notice to Tenant or Guarantor; (c) purports to revoke, rescind, cancel, or limit any Guaranty; or (d) asserts in writing that any Guaranty is partially or wholly unenforceable.

25.1.7 *Bankruptcy Events.* Any Bankruptcy Event occurs affecting Tenant or any Guarantor and that Bankruptcy Event either: (a) was voluntarily initiated by (or with the collusion of) the Person it affects; or (b) is not dismissed, cancelled, vacated, discharged, and rescinded within __⁴² days.

25.1.8 *Vacancy.* If Tenant abandons the Premises and does not reoccupy the Premises within 15 days after Notice from Landlord.

25.1.9 *Other Leases.* If (a) Tenant or its Related Party is a party to any other lease with Landlord or its Related Party;⁴³ (b) the tenant under that other lease is in default beyond applicable cure periods (or the landlord under that other lease is entitled to terminate it); and (c) Landlord elects to treat the circumstance described in clause “b” as an Event of Default.⁴⁴

25.2 *Default Notices.* If any Default occurs, then Tenant shall promptly give Landlord Notice of that Default. If, for any Default, Law requires Landlord to give Tenant notice and opportunity to cure, then Tenant shall have only the greater of: (a) any Notice and opportunity to cure this Lease requires or (b) any notice and opportunity to cure Law requires. Tenant’s notice rights and opportunities to cure shall not be sequential or cumulative. If Landlord complies with the greater of “a” or “b,” then Landlord need not also comply with the other (“b” or “a”) before exercising remedies.

26. *Remedies for Default*

If any Default occurs, then subject to Law, Landlord shall have these rights and remedies, which shall be cumulative and in addition to any other rights and remedies of Landlord:

42 Fill in with a number typically between 60 and 180. As a trend, the cure periods for involuntary Bankruptcy Events seem to be getting shorter.

43 Tenant may want to limit to refer only to other leases in the Building.

44 This paragraph may be excessive, but a Landlord may appreciate it if a multilocation Tenant begins to suffer distress.

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26.1 *Injunction.* Landlord may obtain a court order enjoining Tenant from continuing the Default. Tenant acknowledges that damages are not an adequate remedy for any nonmonetary Default.

26.2 *Security.* Landlord may apply the Security to cure or partially cure any Default. Tenant shall promptly replenish and restore the Security so applied. Landlord may, by Notice to Tenant (after any application of Security to cure any Default), thereafter increase the Security required under this Lease by an amount of Security equal to an additional two months of then-current Base Rent.⁴⁵

26.3 *Landlord's Cure.* Landlord may cure the Default. Tenant shall pay Landlord: (a) all costs Landlord incurs in doing so; plus (b) an Administrative Fee. Nothing in this paragraph, or in any Notice stating Landlord intends to or may cure any Default, shall limit or excuse Tenant from any obligation under this Lease or any Default, permit Tenant to delay performing any such obligation, or impose any obligation whatsoever on Landlord. If Landlord gives Tenant Notice that Landlord intends to cure any Default, Landlord may revoke that Notice, with or without Notice, and without prejudice to Landlord. If Tenant has repeatedly or chronically failed to perform any continuing or repeated obligation, then Landlord may by Notice to Tenant (and continuing so long as Landlord determines) perform that obligation itself or through a third-party contractor.⁴⁶ Tenant shall reimburse Landlord for all costs Landlord thereby incurs, plus an Administrative Fee.

26.4 *Late Payments.* If Landlord has not yet received any Rent by 5:00 p.m. on the third Business Day after the date when this Lease first requires payment, whether or not that late payment constitutes an Event of Default or Landlord gives any Notice of that late payment, then Tenant shall pay Landlord both: (a) interest on the unpaid Rent, from the date originally due until the date Landlord actually receives it, at a rate equal to the greater of (i) the Prime Rate plus 5% per annum; or (ii) 1% per month; and also (b) a late charge equal to the greater of: (i) \$50; and (ii) 5% of the late Rent. The late charge compensates Landlord for inconvenience and staff time to handle a late payment. It is not a penalty or interest. Landlord may apply late payments to unpaid Rent in any order.

45 The preceding sentence is nonstandard. Could Landlord apply it repeatedly if multiple Defaults occur?

46 Preceding sentence is nonstandard. It arises from sad experiences.

26.5 *Good Funds.* If twice in any 12 months either (a) Landlord receives any Rent more than five days late; or (b) the bank dishonors any Rent check (except due to defects in endorsement), then Landlord may by Notice require Tenant to pay Rent only in Good Funds. So long as that requirement exists, if Tenant purports to pay Rent by any form of payment except Good Funds, Landlord may either impose a fee equal to the late charge that would apply for a late payment of that Rent, or reject the non-complying payment and deem the Rent not paid. In the latter case, Landlord shall have all rights and remedies for nonpayment of Rent. If for 12 months Tenant pays by Good Funds all Rent when first due and payable, then Tenant may revert to personal checks if this Lease otherwise permits them.⁴⁷

26.6 *Damages.* Tenant shall pay all damages Landlord incurs by reason of any Default, plus Landlord's out of pocket costs and expenses, e.g., bank fees for returned checks. Landlord may recover damages at any time after Default, including after the Term.

27. *Remedies for Event of Default*

If an Event of Default occurs, then Landlord may exercise any or all of these remedies, which shall be cumulative, and all other remedies at law, in equity or under this Lease, subject in all cases to Law.

27.1 *Termination of Tenant's Rights.* Landlord may terminate Tenant's right to possession of the Premises by any lawful means. In that case, this Lease and the Term shall terminate (and the "Expiration Date" shall be redefined to become the date of that termination, except for purposes of Tenant's liability for damages) and Tenant shall immediately surrender possession to Landlord as this Lease requires. That termination shall not limit or terminate Tenant's obligation to pay damages.

27.2 *Taking of Possession.* Landlord may re-enter and take possession of the Premises with or without process of law and remove Tenant, with or without having terminated this Lease. This is an express right of re-entry for Landlord.

27.3 *Security Devices.* Landlord may change locks or other security devices for the Premises.

⁴⁷ This paragraph is uncommon although sometimes seen. It gives Landlord an intermediate remedy for chronic payment problems, and an ability to identify future payment problems earlier than otherwise.

27.4 *Subrent.* Landlord may direct any subtenant of Tenant to pay Landlord directly any subrent. Landlord shall apply it against any Rent as Landlord designates. Landlord’s collection of subrent from any subtenant shall not cause Landlord to have any direct relationship with, or become the direct landlord of, any subtenant.⁴⁸

27.5 *Damages.* If an Event of Default occurs, Landlord may recover “Benefit of Bargain” damages or “Reserved Rent Less Reletting” damages as described below:

27.5.1 *Reserved Rent Less Reletting.* So long as Landlord has not terminated this Lease, Landlord may recover the Rent, when and as due and payable, less (in the case of this paragraph only) Landlord’s actual proceeds of reletting net of Landlord’s actual costs of reletting.

27.5.2 *Benefit of Bargain.* Whether or not Landlord terminates this Lease, Tenant shall pay Landlord the present value, calculated at a discount rate of 3% per annum, of the excess of the total Rent under this Lease (assuming Additional Rent continued to increase at the same average rate as it did from the Commencement Date to the date of calculation) over the fair market rental value of the Premises for the balance of the Term (without regard to any premature termination of the Term because of Tenant’s Event of Default), all as Landlord reasonably calculates and determines. If Tenant actually pays Landlord all “Benefit of Bargain” damages, then Landlord shall no longer be entitled to recover “Reserved Rent Less Reletting” damages.

27.6 *No Separate Actions.* Notwithstanding anything to the contrary in any Law, Landlord need not commence separate actions to enforce Tenant’s obligations for each month’s Rent not paid, or each month’s accrual of damages for a Default, but may bring and prosecute a single combined action for all such Rent and damages.

27.7 *Continue Lease.* Landlord may at Landlord’s option maintain Tenant’s right to possession. In that case, this Lease shall continue in effect and Landlord may continue to enforce this Lease, including the rights to collect Rent and to exercise remedies for nonpayment.

48 As a result of unusual New York jurisprudence, New York leases require a “conditional limitation” remedy. For possible language, please see the chapter on State-specific lease clauses.

27.8 *Tenant's Waiver.* Tenant waives all claims for damages or other relief by reason of Landlord's reentry, repossession, changing of locks or other security devices, or exercise of other rights or remedies for Default.

27.9 *No Obligation to Relet.* Landlord need not relet the Premises or otherwise mitigate or limit damages from any Default or Event of Default.⁴⁹ If Landlord does relet: (a) that shall not constitute a surrender or its acceptance; and (b) reletting proceeds shall first be reduced by Landlord's costs, including Legal Costs, brokerage and fixturation. If Landlord relets any Premises in combination with other space, then Landlord shall reasonably allocate Landlord's proceeds and costs. If Landlord relets any Premises on an arm's-length basis, then the rents on reletting shall be conclusively presumed to be the fair and reasonable rental value of the area relet.

27.10 *No Surrender.* Landlord's exercise of any remedies for an Event of Default, or receipt of Tenant's keys or other access control devices for the Premises, shall not constitute Landlord's acceptance or Tenant's surrender of the Premises. Any surrender must be in writing and signed by the parties.

27.11 *Bankruptcy Transfer.* If a Bankruptcy Transfer occurs, the transferee shall be deemed without further act or deed to have assumed all obligations under this Lease on and after the effective date of that Bankruptcy Transfer, including any obligation to replenish and increase the Security. Any such transferee shall execute and deliver to Landlord an instrument confirming that assumption.

27.12 *Scope of "Rent."* Notwithstanding anything to the contrary in this Lease, all Rent, whether or not expressly denominated as rent, shall constitute rent under Bankruptcy Law.

28. *Additional Provisions on Landlord's Rights and Remedies*

28.1 *Legal Costs.* Tenant shall reimburse Landlord for (or at Landlord's option pay directly) all Legal Costs Landlord incurs as a result of: (1) any of these, unless Tenant prevails in substantially all respects: (a)

⁴⁹ The previous sentence conforms to traditional New York common law for commercial leases. New York is in a minority of states on that issue. New York law could change. Hence, the contractual language in the previous sentence. Landlord could go a step further and add: "Tenant acknowledges that Tenant has the same ability as Landlord to seek potential replacement tenants for the Premises. If Tenant believes Landlord should consider replacement tenants for the Premises, then Tenant shall find and propose them."

any litigation or dispute between Landlord and Tenant; (b) any claim that either party makes against the other arising from this Lease or the parties' landlord-tenant relationship; (c) any Default or Event of Default, including preparation of Default Notices and consultations on the Default, whether or not Landlord exercises any remedy; or (d) Landlord's enforcing any remedies against Tenant; (2) any Bankruptcy Event affecting Tenant; (3) Landlord's reviewing, considering or processing any request that Tenant makes relating to this Lease (including any request for Landlord's consent to any matter) or the Premises, whether or not Landlord agrees or consents to it; and (4) any Transfer. If any matter described in clauses "1" through "4" is initiated but terminates for any reason without final judgment or resolution, then that termination shall not limit Tenant's obligation to reimburse or pay directly Landlord's Legal Costs, unless under the circumstances Tenant has substantially prevailed in all respects. Without limiting the previous sentence, Tenant's cure of any Default shall not limit Tenant's obligation to reimburse or pay directly Landlord's Legal Costs incurred because of that Default.

28.2 *Holding Over.* If Tenant remains in the Premises after the Expiration Date Landlord will suffer injury that is substantial, difficult, or impossible to measure accurately, and in all likelihood substantially in excess of the Rent. The parties therefore agree that if Tenant remains in the Premises after the Expiration Date, then in addition to Landlord's other rights and remedies, Tenant shall pay Landlord, as liquidated damages and not as a penalty, for each month (or any part of a month) in which Tenant holds over in the Premises after the Expiration Date, a sum equal to 200% (reduced to 150% in the first 60 days of holding over) of the greater of: (a) the monthly total Base Rent and Escalation Rent that was payable under this Lease in the last full Lease Year before this Lease terminated; and (b) the then-current monthly fair market rental value of the Premises. The parties acknowledge that Landlord's actual damages would be difficult or impossible to quantify. They have accordingly agreed on the foregoing liquidated measure of damages. If Tenant holds over for more than 30 days, then Tenant shall Indemnify Landlord regarding that holdover. That indemnity that include an obligation to compensate Landlord for Landlord's loss of a subsequent Tenant for the Premises and any claims made against Landlord by any subsequent Tenant because Landlord fails to deliver possession when required.⁵⁰ Nothing in this

50 The last two sentences have become "standard" in New York leases after a court imposed similar liability on a holdover tenant. Strong tenants will try to reject them, noting that when Landlord negotiates the "next" lease Landlord can build in appropriate protections. Does this indemnification undercut the liquidated damages provided for elsewhere in this paragraph?

Lease allows Tenant to retain possession of the Premises after the Expiration Date. In any holdover occupancy, Tenant shall continue to have all its obligations under this Lease, except the holdover liquidated damages described in this paragraph shall replace Base Rent and Escalation Rent.

28.3 *NO JURY TRIAL.* BOTH PARTIES IRREVOCABLY WAIVE ALL RIGHTS TO TRIAL BY JURY IN ANY ACTION, PROCEEDING, COUNTERCLAIM OR OTHER LITIGATION ARISING OUT OF OR RELATING TO THIS LEASE, THE RELATIONSHIP OF LANDLORD AND TENANT, THE ENFORCEMENT OF THIS LEASE, TENANT'S USE OR OCCUPANCY OF THE PREMISES, ANY CLAIM OF INJURY OR DAMAGE ARISING BETWEEN LANDLORD AND TENANT, OR ANY ACTIONS OR OMISSIONS OF EITHER PARTY IN CONNECTION WITH OR RELATING TO THIS LEASE, THE PREMISES, THE BUILDING, OR THE LAND.

28.4 *Counterclaims.* If Landlord commences any proceeding for nonpayment of Rent or holding over, or any other summary proceeding relating to this Lease, Tenant shall interpose no counterclaim of any nature in those proceedings, even if the counterclaim relates to Landlord's alleged failure to provide services to Tenant or alleged impairment of Tenant's right to possess, use, or enjoy the Premises, unless failure to assert that counterclaim would waive it, unless Landlord agrees in writing not to assert that waiver. Tenant may assert any such claim in a separate action. Tenant acknowledges this right gives Tenant an adequate remedy. Tenant's obligation to pay Rent is an independent and absolute obligation under this Lease.

28.5 *No Right of Redemption.* Tenant waives any right of redemption provided for by Law.

28.6 *No New Cure Period.* Landlord's delay in exercising any rights or remedies shall not waive any Event of Default or any right or remedy. Landlord may exercise Landlord's remedies for an Event of Default (unless cured) at any later date, without giving Tenant any new Notice or cure period.

28.7 *Effect on "Tenant Delay."* "Tenant Delay" shall include a period equal to any Default Period.

28.8 *Accord and Satisfaction; Partial Payments.* No payment by Tenant or Landlord's receipt of a lesser amount than the amount this Lease requires Tenant to pay shall be anything except a payment on

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account. No endorsement or statement on any check or any letter with any payment shall constitute an accord or satisfaction. Landlord may accept any such check or payment without prejudice to Landlord's right to recover the balance of Rent due or pursue any other remedy. Notwithstanding any endorsement on any check or any statement to the contrary in any letter with any check or payment, Landlord shall apply any partial payment to such items as Landlord determines appropriate. After Landlord applies any partial payment, the remaining balance due shall remain due and payable.

28.9 *No Waiver.* Landlord's acceptance of Rent, with or without knowledge of any Default, shall not waive any Default or Landlord's rights or remedies. Landlord's failure to enforce any requirement of this Lease, to bill Tenant for any Rent or to exercise any right or remedy shall not waive Landlord's right to do so, regardless of how long that failure has continued or the circumstances of its continuation. Landlord's acceptance of Rent from any Person except Tenant shall not be deemed Landlord's acceptance of that Person as a tenant and shall not give that Person any rights in the Premises. Any such payment shall be made solely on Tenant's account. Landlord's acceptance or enforcement of any Guaranty or Security shall not limit or waive Landlord's rights or remedies.

28.10 *Deemed Delivery of Invoice.* To the extent that this Lease or Law requires Landlord to deliver an invoice as a condition to collecting any Rent, if Landlord has not delivered any such required invoice, then Landlord's commencement of any action (or exercise of any other rights or remedies) against Tenant to collect that Rent shall be deemed an adequate substitute for delivery of an invoice, and Landlord shall have no obligation to deliver an invoice as a condition to Rent collection.

28.11 *Dishonored Check.* If Tenant's bank dishonors any check for any payment made on signing this Lease (except due to defects Landlord caused), then Landlord may redeposit the check and either: (a) if it is again dishonored, rescind this Lease (except Tenant's obligations under this paragraph), enforce the check (and Tenant shall pay Landlord's Legal Costs of that enforcement), and hold the proceeds of the check as liquidated damages for removing the Premises from the market while dealing with Tenant; or (b) continue this Lease and require Tenant to increase the Security (in the entire Term) by an amount equal to two months of Base Rent.

29. *Commercial Rent Control*

If any Government enacts Commercial Rent Control, then *Tenant* shall, under documentation satisfactory to Landlord: (a) waive all rights and benefits under Commercial Rent Control; and (b) both during and after the effectiveness of Commercial Rent Control take any actions, consistent with Law, that Landlord requires to give Landlord the full economic benefit of this Lease as originally negotiated and entered into. When Commercial Rent Control terminates, including by judicial decision, Tenant shall pay Landlord an amount equal to the Rent Landlord lost from Commercial Rent Control (i.e., the difference between the Rent this Lease required, including holdover rent after the Expiration Date, if applicable, and the maximum rent that Commercial Rent Control allowed Landlord to collect), with interest at the Prime Rate from the date Landlord suffered each element of loss. This Section shall survive the Expiration Date.⁵¹

30. *Notices and Amendments*

30.1 *Notices.* All Notices must be in writing. Unless Law otherwise provides, Notices shall be given by: (a) hand; or (b) Federal Express or any similar means of overnight delivery under which an independent third party in the business of delivering written communications requests and retains a receipt for delivery. Two unsuccessful delivery attempts to the last address provided for by a party under this Lease (or one affirmative refusal to accept delivery) shall be deemed actual delivery. Notices shall be addressed to the parties at their addresses in the Basic Terms[, except that Notice to Tenant after the Commencement Date may be directed to the Premises]. Notices sent in accordance with this Lease shall be effective on the first Business Day after dispatch, or when actually delivered if earlier. The date any Notice was sent may be evidenced by the delivery service. Either party may change its Notice address by Notice. Tenant's Notice address must be a street address and may not be a post office box. Without limiting any provisions of this paragraph on effectiveness of Notices, any Notice to Tenant shall be effective for all purposes if and when Tenant actually receives it, whether or not it complied with this paragraph. A copy of any Notice to Landlord under this Lease shall, at the same time and by the same means, be simultaneously transmitted to such additional party(ies), including Landlord's Lender/Lessor(s), at such address(es), as Landlord from time to time designates by Notice.

51 Language similar to this paragraph often appears in leases, but is probably not worth the space it occupies. If Landlord wants to beef up the language on Commercial Rent Control, see the Optional Provisions at the end of this Lease.

30.2 *Amendments.* This Lease (including this paragraph) may not be Changed except by a written Change executed and delivered by the party to be charged. Circulation of a draft Change to this Lease shall not bind or obligate anyone. To the extent so provided in any Landlord's Financing of which Tenant has received Notice, any Change affecting this Lease shall not be effective without written consent by the applicable Lender/Lessor. No party shall rely on any purported oral amendment(s) or oral waiver(s) purportedly affecting this Lease. Each party acknowledges that reliance on a purported oral amendment or oral waiver is unreasonable.

30.3 *Authority of Certain Persons.* Any Notice, time extension, or written waiver of any terms of this Lease may be executed by an attorney on behalf of his or her client, or by Landlord's managing agent, if any, for Landlord.

31. *Limitation of Landlord's Liability*

Tenant acknowledges that Landlord would not enter into this Lease unless it contained this Article, which controls over everything else in this Lease. These limitations of Landlord's liability are cumulative. They shall benefit any Person that is, from time to time, Landlord under this Lease, including any Successor Landlord.

31.1 *Acceptance of Premises.* Tenant has examined and is familiar with and satisfied with the condition of the Premises. Tenant accepts the Premises and all means of access thereto "as is," except for performance of any Landlord's Initial Work. Except as this Lease expressly states, Landlord makes no representations or warranties on the Land, the Building, the Premises, the surrounding area, Permitted Use(s), Tenant's business prospects; any physical, environmental or other condition; zoning; square footage, area or size; title or ownership; compliance with Law; means of access; pedestrian traffic or suitability for Tenant's business; competition or the lack of it; certificate of occupancy; state of repair; mold; HVAC; fire sprinklers; Building Systems or Utilities; any assessment, status, abatement, or deferral; level of past, present or future Property Taxes; vaults; past, present, or future, uses or tenancies of the Building; flood plains; wetlands; paranormal conditions; health or environmental hazards or conditions, whether known or unknown and whether or not presently identified or recognized as constituting or creating a health or environmental risk; Hazardous Substances; any other building materials; radiation; radio waves; noise; future construction; any other conditions created by or arising from modern technology, as it exists from time to time; the identity or business activities of other tenants, the

terms and conditions of the leases of other tenants in the Building or elsewhere; or any other matter whatsoever, whether or not listed, whether similar to or different from those matters specifically listed. Landlord shall have no responsibility for security or crime prevention measures at the Building or in the Premises. Except as this Lease expressly states, Landlord shall have absolutely no liability for any defects or faults, latent or patent, in the Building (but this does not limit Landlord's express obligations under this Lease) or any obligation to provide any services or take any other actions for Tenant.

31.2 *Waiver of Certain Claims.* Landlord, its Related Parties and its Lenders/Lessors shall have no liability to Tenant or any Tenant Party, and Tenant specifically waives and agrees (on its own behalf and on behalf of all Tenant Parties) not to assert any claims against Landlord or its Related Parties or Lenders/Lessors, for any loss, damage, claim or injury of any kind arising at, on, upon, in or about the Building or the Premises (including any loss of, or damage to, any fixtures, equipment, merchandise or other property belonging to Tenant, installed or left in the Premises), unless that loss was both (a) caused solely by Landlord's gross negligence or intentional acts; and (b) not insured or reasonably insurable against by Tenant. Landlord shall have absolutely no liability for water or other damage caused by breakages or leaks in any pipes in the Building, regardless of who owns, installs or maintains them. Tenant expressly assumes the risk of any that damage. Landlord shall have absolutely no liability for any damage caused to Tenant's computer hardware, software, or data, or other electronic or electrical equipment of any kind. Tenant specifically waives and releases Landlord from any liability for: (a) any loss against which Tenant is insured or against which this Lease requires Tenant to purchase insurance; and (b) damages for lost profits or lost business. Tenant's waivers in this paragraph shall be fully effective even if Tenant has notified Landlord, or Landlord is otherwise aware, of the nature and scope of Tenant's potential loss. Nothing in this Lease imposes on Landlord any obligation as a fiduciary to Tenant.

31.3 *Nonrecourse.* Notwithstanding anything to the contrary in this Lease, Landlord's liability under this Lease is limited to and shall not extend beyond Landlord's Interest. Tenant may not enforce any judgment for Landlord's breach of this Lease against any assets or property of Landlord (or of any general partner, shareholder, or other equity interest holder of Landlord) beyond Landlord's Interest. Landlord shall have no personal liability under this Lease. These limits on Landlord's liability shall not apply to Landlord's: (a) failure to apply Security (including pro-

ceeds of any L/C Security) as this Lease requires; or (b) obligation to comply with any equitable or declaratory relief, provided it does not require Landlord to spend money.

31.4 *Landlord's Review and Consent Rights.* If Landlord reviews or provides comments on anything requiring Landlord's consent, such review and comments are solely to protect Landlord. They create no warranty or duty to Tenant or anyone else. Any Landlord consent requirements are solely for Landlord's benefit. Landlord may waive any of them. Tenant shall not rely on Landlord's consent to evidence anything except Tenant's compliance with the requirement to obtain that consent.

31.5 *Transfer.* If Landlord assigns, conveys, or otherwise transfers its estate in and to the Building, then the transferee shall be deemed to have assumed and succeeded to Landlord's rights and obligations under this Lease. The transferor shall be relieved of all liability as Landlord under this Lease, except that the transferor shall remain responsible for the Security until the transferor delivers it to the transferee. Each Landlord's obligations under this Lease shall bind that Landlord only while it holds Landlord's interest under this Lease. Any deed of the Building shall automatically assign Landlord's interest in this Lease and shall fully evidence the transfer of Landlord's rights to the grantee. No separate assignment or assumption of such interest or rights shall be necessary.

31.6 *Landlord's Default.* Notwithstanding anything to the contrary in this Lease, before Tenant exercises any right to terminate this Lease for Landlord's default (including any termination right expressly provided for, or implied, by Law) or to claim a partial or total eviction (actual or constructive) for Landlord's alleged default, or any other right or remedy against Landlord, Tenant shall Notify Landlord of the alleged default. That Notice shall refer to this paragraph. Landlord shall then have the Basic Nonmonetary Cure Period to cure the alleged default. If Landlord cannot reasonably do so within that period, that period shall continue as Landlord reasonably requires to cure the alleged default, provided that in the extended part of the cure period Landlord: (a) endeavors to cure the alleged default diligently and with reasonable continuity; and (b) allows Tenant a reasonable rent abatement for any Premises that, because of Landlord's default, Tenant cannot use and has actually vacated. Landlord's rights to notice and opportunity to cure do not limit any cure rights of any Lender/Lessor.

32. *Landlord's Financing*

32.1 *Lenders/Lessors; Amendments.* At any time or from time to time, Landlord may: (a) designate any Lender/Lessor(s); or (b) terminate designation of any Lender/Lessor(s), except to the extent that Landlord (or the Lender/Lessor, with Landlord's written concurrence) has Notified Tenant that any such termination needs the Lender/Lessor's written concurrence. If a (prospective) Lender/Lessor requires any documentation regarding this Lease (including amendment(s) or confirmation of rights of Lenders/Lessors), then Tenant shall enter into that documentation, except an Adverse Amendment.

32.2 *Subordination.* This Lease shall be subject and subordinate to all Landlord's Financing (and all its covenants, conditions, terms and provisions), and all matters to which Landlord's Financing is subordinate, except as this Lease expressly states. This subordination is self-operative and automatic. No further instrument of subordination shall be necessary. Tenant shall, within 10 Business Days after demand, without charge, execute any instrument Landlord or any Lender/Lessor requests to confirm that subordination, upon the Lender/Lessor's standard form.

32.3 *Optional Priority.* Any Mortgagee may at any time elect in writing that this Lease shall have priority, in whole or in part (as the Mortgagee specifies) over the Mortgagee's Mortgage. If a Mortgagee gives Tenant a copy of any such election, then so long as the Mortgagee has not revoked it, this Lease shall have priority over that Mortgage, whether this Lease is dated before or after the date of that Mortgage, except as to matters (e.g., application of casualty or condemnation proceeds) for which the Mortgagee does not elect to make this Lease prior to that Mortgage.

32.4 *SNDA Protection for Tenant.* If the Building is at any time subject to any Landlord's Financing and the Premises consists of at least _____, then at Tenant's request Landlord shall use reasonable efforts to obtain for Tenant an SNDA from each Lender/Lessor. Landlord need not spend money or litigate to obtain an SNDA. Tenant shall reimburse Landlord's Legal Costs and other out of pocket costs in seeking an SNDA, including any payment due the Lender/Lessor. Landlord's failure to obtain an SNDA shall not limit Tenant's obligations in any way.

32.5 *Assignment to Lender/Lessor; Successor Landlord Liability.* If Landlord assigns this Lease to any Lender/Lessor, conditionally or otherwise, then the Lender/Lessor shall have no liability under this Lease unless and until it becomes a Successor Landlord and expressly assumes this Lease. Notwithstanding anything to the contrary in this Lease, any Successor Landlord shall have no liability to Tenant for Landlord's acts,

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omissions or defaults; not be subject to any Offset Tenant might have had against Landlord; and not be bound by any prepayment (except a prepayment this Lease requires) of more than one month's Rent (except the Security, to the extent the Successor Landlord actually received it) or any Change made after the date Tenant has received Notice of the corresponding Lender/Lessor without that Lender/Lessor's consent (to the extent the applicable Landlord's Financing documents required that consent).

32.6 *Lender/Lessor's Cure Rights.* Tenant shall accept performance of any Landlord obligation by any Lender/Lessor. A Lender/Lessor shall not be deemed to have assumed this Lease by performing any Landlord obligation or by demanding that Tenant pay Rent to Lender/Lessor, or otherwise have any obligations or liability under this Lease, unless and until that Lender/Lessor assumes this Lease in writing. If Landlord or any Lender/Lessor so requests by Notice to Tenant, then Tenant agrees that: (a) Tenant shall give that Lender/Lessor, by overnight delivery, a copy of any Notice of default served on Landlord; and (b) if Landlord does not cure the default in Landlord's cure period, then that Lender/Lessor shall have an additional period (up to 90 days) to do so, or if that default cannot be cured within that time, then such additional time necessary if within that reasonable period Lender/Lessor commences and diligently pursues the remedies necessary to cure that default (including completion of an Enforcement Proceeding if necessary), in which event Tenant shall not terminate this Lease while Lender/Lessor is pursuing such a proceeding and endeavoring to cure Landlord's default(s).

32.7 *Effect of Enforcement Proceeding.* Tenant shall have no right to terminate this Lease on account of an Enforcement Proceeding. Tenant agrees, at the option of any Successor Landlord, and only if that Successor Landlord by Notice so elects, to either, at the option of that Successor Landlord: (a) attorn to that Successor Landlord and accept it as Tenant's successor Landlord and perform for Successor Landlord's benefit all provisions of this Lease to be performed by Tenant with the same force and effect as if Successor Landlord were the landlord originally named in this Lease; or (b) enter into a new lease with Successor Landlord as landlord, for the remaining Term, on the same remaining terms and conditions as this Lease. This paragraph shall benefit any Successor Landlord and shall be self-operative if a Successor Landlord elects to invoke it. No further instrument shall be required to give effect to this paragraph. If any Successor Landlord requests, Tenant shall execute, from time to time, instruments confirming and implementing this paragraph, in form satisfactory

to Successor Landlord, acknowledging that attornment or new lease and the terms of Tenant's tenancy.

33. *Brokers*

Landlord and Tenant each represents and warrants that in negotiating and consummating this Lease it has dealt with no broker, finder or similar party except Broker, whose commission(s) Landlord shall pay unless the Basic Terms state otherwise. Each party shall Indemnify the other against any breach or alleged breach of that representation and warranty.

34. *Related Documentation and Deliveries*

34.1 *Estoppel Certificates.* Tenant shall, within 10 Business Days after Landlord's request from time to time, sign and deliver (and cause any Guarantor to sign and deliver) to Landlord an Estoppel Certificate directed to such Person(s) as Landlord requests. Any Estoppel Certificate shall bind Tenant and any Guarantor, whether or not the addressee demonstrates detrimental reliance, and shall constitute a binding representation and warranty by Tenant.

34.2 *No Recording.* Tenant shall not record this Lease or any memorandum of it. If Tenant violates the previous sentence, then Tenant shall be deemed at Landlord's option to have committed an incurable Event of Default. Landlord may then record a "Notice of Termination" of this Lease, which notice shall be effective without Tenant's signature.

34.3 *Further Assurances.* Each party shall execute and deliver such further documents, and perform such further acts, as reasonably necessary to achieve the parties' intent as expressed in this Lease and so each party can achieve and obtain the rights and benefits this Lease contemplates (including, in Landlord's case, all rights and benefits of Landlord's estate in the Building and as necessary or appropriate in Landlord's reasonable judgment to comply with any Law), or as any of Landlord's Lender/Lessor(s) may request, provided in each case that documentation conforms to this Lease, is not an Adverse Amendment and (if signed by Landlord) repeats the "Nonrecourse" provisions of this Lease in a way satisfactory to Landlord. Tenant may not require Landlord to sign anything in a Default Period.

34.4 *Evidence of Compliance.* Tenant shall, promptly on request, give Landlord such written proof as Landlord reasonably requests to evidence and confirm Tenant's compliance with this Lease. Tenant shall on

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request give Landlord copies of receipts, paid bills or other proof satisfactory to Landlord that Tenant has made all third-party payments this Lease requires of Tenant.

34.5 *Governmental Benefits.* If Landlord desires to apply for (or continue to qualify for) or otherwise obtain any governmental, tax or other benefit available to Landlord for the Building or any other real property Landlord owns (including any tax abatement or tax deferral program, any special tax treatment available to Landlord under state or federal income tax law and any other reduction or deferral of any tax payable by Landlord), which benefits do not materially adversely affect Tenant, and those applications require cooperation by Tenant, then Tenant shall provide such reasonable cooperation (including execution of amendments to this Lease as necessary to satisfy conditions to those benefits or if otherwise necessary to enable Landlord to claim them) as Landlord requires, provided that cooperation does not require Tenant to sign an Adverse Amendment.⁵²

35. *Additional Leasing Provisions*

35.1 *Building Name.* Landlord may at any time adopt any name, or change the name or address, for the Building. Tenant shall not refer to the Building by any name or address except those Landlord or the U.S. Postal Service designates.

35.2 *Excavations.* Tenant shall comply with any Law on access to the Premises for any excavation on adjacent land. Tenant shall not, by reason of that excavation, have any claim against Landlord for damages, indemnity or suspension, diminution, abatement or reduction of any Rent. Any payment made in the Term for any excavation on adjacent land shall belong to Landlord.

35.3 *Other Uses.* Except to the extent, if any, this Lease expressly provides for it, Tenant has no right to control, limit or restrict any Person's use of any space outside the Premises.

35.4 *Signs.* Landlord may post "For Rent" signs at, on or near the Premises in the last 12 months of the Term.

35.5 *Survival.* Tenant's indemnity obligations, Tenant's obligations and Landlord's rights in the event of Tenant's holding over after the Expi-

⁵² Consider providing for a per-diem administrative fee for failure to sign and return these documents when needed, or any other documents this Lease requires Tenant to sign for Landlord.

ration Date or upon the occurrence of an Event of Default (including Tenant's obligation to pay damages or any other payments on account of post-termination Rent under this Lease), and all other rights and obligations that by their nature would arise or continue after this Lease expires or terminates shall survive expiration or termination.

35.6 *Vaults; Appurtenant Space.* If the Building has a basement, cellar, courtyard, atrium, or vault, then the Premises does not include, and Tenant shall have no right to use or occupy, any such space, except to the extent that this Lease expressly gives Tenant that right. Tenant shall have no right to use or occupy any mechanical or outdoor space, recreational space, nonpublic parking facilities, or other space except the Premises in, at, or appurtenant to the Building, except to the extent Landlord so permits in writing. If Landlord permits Tenant to use or occupy any vault appurtenant to the Building, then: (a) Tenant shall pay all vault taxes, rent, and other charges assessed for the vault; (b) that occupancy is under a revocable license; and (c) if any such license is revoked or the size of any vault diminished, Landlord shall incur no liability, and Tenant shall be entitled to no compensation or Offset.⁵³

36. *General*

36.1 *Confidentiality.* Tenant shall not disclose any terms or conditions of this Lease (including Rent),⁵⁴ or give a copy of this Lease to any third party, and Landlord shall not release to any third party any nonpublic financial information or nonpublic information about Tenant's ownership structure that Tenant gives Landlord, except: (a) if required by Law or in any judicial proceeding, provided that the releasing party has given the other party reasonable Notice of that requirement, if feasible; (b) to a party's attorneys, accountants, brokers and other bona fide consultants or advisers, provided they agree to be bound by this paragraph; or (c) to any bona fide prospective Lender/Lessee, assignee, or subtenant, provided they are instructed in writing to comply this paragraph.

36.2 *Consents; Reasonableness.* Any reference to Landlord's consent or approval means Landlord's prior written consent. Wherever this Lease states that a party's consent or approval shall not be unreasonably withheld, it shall not be unreasonably conditioned or delayed. Tenant waives any claim (for damages or other relief of any kind, except as this paragraph expressly allows) that Landlord has unreasonably withheld,

53 If Tenant obtains antenna rights, revise this as appropriate or limit to a Default Period.

54 Perhaps the confidentiality should apply only to Rent.

delayed, or conditioned Landlord's consent or approval in breach of any applicable provision of this Lease. In the event of a determination favorable to Tenant (i.e., that Landlord acted unreasonably when this Lease required Landlord to act reasonably), the requested consent or approval shall be deemed granted. Landlord shall, however, have no liability for refusal or failure to consent or approve. Tenant's sole remedy for Landlord's unreasonably withholding, delaying or conditioning its consent or approval shall be as this paragraph states. If this Lease does not require a party to act reasonably in approving or consenting to any matter or in determining whether any matter is satisfactory, then that party may approve or disapprove that matter for any reason or no reason, and may require payment as a condition to approval or consent. The parties acknowledge it would be reasonable for Landlord to withhold consent to comply with Landlord's obligations to any present or future Lender/Lessor.⁵⁵ Nothing in this paragraph gives Tenant any right or remedy it would not have had but for this paragraph.⁵⁶

36.3 *Execution.* This Lease and any Change or other document relating to this Lease may be executed in counterparts. Each is an original. All are the same document. Each party represents and warrants this Lease: (a) has been duly authorized, executed and delivered by all necessary action of that party; and (b) does not violate any other agreement of that party. Either party may in the ordinary course of business maintain its copy of this Lease as an electronic scanned or other image. Any such scanned copy or other image shall have the same force and effect as an original. The original may be destroyed. Its absence need not be explained.

36.4 *Failure to Enforce; No Waiver.* Either party's failure to enforce any agreement in this Lease shall not prevent that party from enforcing that agreement later or for a later violation of this Lease.

36.5 *Force Majeure.* If Landlord does not punctually perform any nonmonetary obligation because of Force Majeure, then that failure shall be excused and not deemed a breach. The time for Landlord to perform

55 Without the preceding sentence, the requirements of a Lender/Lessor—especially one brought to the table after Lease signing—probably cannot limit the definition of “reasonableness.”

56 This paragraph, though common in many leases, vitiates any obligation for Landlord to act reasonably. A strong Tenant may persuade Landlord to allow some limited remedy in that case, such as payment of damages or reimbursement of attorneys' fees, in each case up to some low cap. This paragraph will often be the last paragraph resolved in any lease.

that term, covenant or condition shall be extended by a period equal to the delay the Force Majeure caused.

36.6 *Limitation of Damages.* Neither party shall under any circumstances be liable for punitive, consequential or indirect damages, suffered or purportedly suffered by the other party from any acts or omissions of that party. Each party specifically waives and releases all such damages. Nothing in this paragraph limits Tenant's obligation to pay any damages expressly provided for in this Lease.

36.7 *Merger.* This Lease contains the entire agreement between the parties regarding the subject matter of this Lease, including any and all payments, allowances, equipment or services Landlord must provide. No separate understanding or agreement, oral or written, exists between Landlord and Tenant about those matters. Tenant has not relied on any statement, representation or promise not expressed in this Lease.

36.8 *No Binding Effect.* This Lease shall not be effective in any way until both parties have executed and delivered it. Landlord's delivery of a draft Lease to Tenant is not an offer to lease or a reservation of space, and shall not otherwise create any obligations of any kind (legal, equitable or otherwise) between the contemplated parties. Unless and until Landlord and Tenant execute and deliver a final Lease, each party may: (a) discontinue discussions for any reason or for no reason and (b) pursue other possible leasing opportunities, including any that would necessarily exclude entry into this Lease.

36.9 *Separability.* If any court of competent jurisdiction invalidates any provision of this Lease, then that invalidation shall not affect the validity of any other provision of this Lease.

36.10 *Successors and Assigns; No Third-Party Beneficiaries.* Except as this Lease expressly states: (a) "Landlord" and "Tenant" shall each include each party's permitted successors and assigns; (b) this Lease shall bind and benefit both parties' permitted successors and assigns; and (c) this Lease shall not benefit anyone else. This does not limit the Transfer restrictions in this Lease.

37. *Interpretation*

37.1 *Internal Inconsistencies.* The Basic Terms and the Supplemental Terms all contain significant obligations of Landlord and Tenant and should be read together as an integrated Lease. If the Basic Terms vary

from the Supplemental Terms, then: (a) if possible, that inconsistency shall be resolved by treating Tenant's obligations as cumulative and Landlord's rights as cumulative; (b) otherwise, if possible, the Supplemental Terms shall be interpreted as supplementing, clarifying, defining and otherwise explaining the Basic Terms; and (c) in all other cases, the Basic Terms shall supersede any inconsistent Supplemental Terms, to the extent of the inconsistency.

37.2 Multiple Parties as Tenant. If two or more Persons are Tenant, then: (a) each shall be jointly and severally obligated to pay and perform all obligations of Tenant and deemed to make all representations and warranties of Tenant; (b) Landlord may enforce this Lease against any or all such Person(s) with no need to join anyone else; (c) where this Lease defines any Event of Default based on an event or circumstance affecting Tenant (e.g., a Bankruptcy Event), that refers to any such event or circumstance affecting any one or more Person(s) constituting Tenant; and (d) if any such Person rejects this Lease through a Bankruptcy Event of such Person, that rejection shall be a breach of this Lease by all Persons constituting Tenant but shall not limit any other Person's liability as Tenant or as a Guarantor.

37.3 Generally. This Lease shall be construed under State law. To the extent this Lease defines any capitalized term, that definition applies throughout this Lease, including all exhibits. Terms defined in the plural have the same meanings in the singular, and vice versa, all in accordance with ordinary English grammar. If the Commencement Date predates the Signature Date, then Tenant's obligations under this Lease retroactively commenced as of the earlier Commencement Date. The first and last days of any Abatement Period shall accelerate accordingly. Where this Lease requires either party to perform an action or satisfy a condition, that party shall do so at its sole cost except as this Lease otherwise expressly states. This does not limit Landlord's right to collect any Additional Rent. The word "or" includes the word "and." This Lease does not identify particular obligation(s) of Tenant as "substantial obligations" of the tenancy. That shall not be considered in determining which obligations of Tenant are "substantial." Under some or all circumstances, any or all of Tenant's obligations are "substantial." Any reference to the "Premises," the "Building," or any other collective noun means "all or any part" of it, with an appropriate allocation to any matter affecting only part, except where, in Landlord's reasonable determination, the context requires otherwise. Wherever a party "may" take an action, such party has no obligation to do so. Wherever this Lease refers to anything being done at Tenant's

expense, Tenant shall pay for it as Additional Rent. This Lease incorporates by reference all its exhibits, as if the text of such exhibits appeared verbatim in the text of this Lease.

37.4 *Successor Statutes.* Wherever this Lease refers to any statute, that also includes the statute as amended from time to time, and any other or successor statute similar to the statute mentioned.

38. *Definitions*

In addition to any other definitions in this Lease, these definitions apply for all purposes of this Lease. If this Lease fails to use a term defined here, then its definition shall be disregarded.

“Additional Rent” means all payments that this Lease requires Tenant to make, whether to Landlord or a third party, except Base Rent, whether or not this Lease designates any payment as Additional Rent. Additional Rent includes Escalation Rent; payments of Security; reimbursement of Landlord’s costs where stated; and all other payments this Lease requires Tenant to make, except Base Rent.

“Additional Services” means: (a) Utilities, janitorial services, and other services Landlord provides from time to time beyond Basic Services; (b) electricity and/or water Tenant consumes for any dedicated or supplemental HVAC, computer power and telecommunications, or other special units or systems of Tenant; and (c) chilled, heated, condenser, or domestic water beyond that necessary for Basic Services.

“Administrative Fee” means, for any outlay by Landlord or reimbursement of Landlord or payment to Landlord by Tenant, a payment by Tenant to Landlord, in an amount equal to this percentage of that outlay, reimbursement, or payment: (a) 10%, if the outlay, reimbursement, or payment arose from a Default; and (b) 5% otherwise. The Administrative Fee constitutes a reasonable estimate of Landlord’s indirect costs of the matter in question. Those indirect costs are likely to be higher under the circumstances described in clause “a.”

“Adverse Amendment” means any amendment to, or additional document related to, this Lease that materially adversely affects a party or materially diminishes its rights or the other party’s obligations. Without limiting the preceding sentence, an amendment or other document shall be an “Adverse Amendment” if it changes the Rent, the location of the Premises, or the Term (but cure rights that could prevent Tenant from ter-

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minating this Lease when otherwise entitled to do so shall not be deemed to change the Term), except as this Lease otherwise expressly requires.

“Anticipated Delivery Date,” if not defined in the Basic Terms, means the date when Landlord reasonably estimates from time to time (with Notice to Tenant) that Landlord will Substantially Complete Landlord’s Initial Work.

“Approvals” means certificate of occupancy (temporary and permanent), building permit, alteration permit, demolition permit and all other governmental and quasi-governmental permits, licenses, certificates, approvals and consents for the Building or any part of it.

“Assignment” means any assignment of this Lease, including: (a) through a sale or other transfer of all or substantially all of Tenant’s assets; or (b) by operation of law.

“Bankruptcy Event” means, for any Person, that such Person becomes bankrupt or insolvent, or makes an assignment for the benefit of creditors, ceases to pay its debts as they become due or admits in writing that it is unable to pay its debts as they become due, or becomes a “debtor,” or is otherwise the subject of any similar proceeding; or a custodian, administrator, receiver, or trustee is appointed to take possession of, or an attachment, execution or other judicial seizure is made for, all or a substantial part of that Person’s assets or interest in this Lease.

“Bankruptcy Law” means the United States Bankruptcy Code (United States Code Title 11), and any other law providing for or governing any Bankruptcy Event or debtor protection.

“Bankruptcy Transfer” means any Transfer of this Lease to any Person under Bankruptcy Law or through a Bankruptcy Event.

“Basic Nonmonetary Cure Period” means 30 days after Notice from Landlord.

“Basic Services” means: (a) HVAC required in Landlord’s reasonable judgment for comfortable use and occupancy of the Premises for Permitted Use(s) in Business Hours; (b) unheated water from the local utility at supply point(s) Landlord provides for Tenant’s ordinary drinking and lavatory purposes and for restroom(s) and drinking fountain(s) in Common Areas; and (c) for Premises above the ground floor, nonexclusive passenger elevator service for general office pedestrian usage. To the extent (if

any) that this Lease requires Landlord to clean the Premises in accordance with Landlord's standard cleaning specifications, that cleaning also constitutes Basic Services.⁵⁷

“Bonding Threshold” means an amount equal to 25% of the then-current annual Base Rent.⁵⁸

“Building Rules” means such reasonable rules and regulations for the Land, the Premises, and the Building (including Common Areas) as Landlord reasonably promulgates or amends from time to time by Notice. [Building Rules as of the Signature Date are attached as **Exhibit __.**]

“Building Systems” means mechanical, gas, electrical, sanitary, heating, air conditioning, ventilating, elevator, plumbing, life-safety and other service systems of the Building.

“Business Day” means Monday through Friday except any day recognized as a holiday by the building services union in the City.

“Business Hours” means 8 a.m. to 5 p.m. on Business Days.

“Cabling” means all Communications Services, electrical, network and other conduits, cabling, interfaces, risers, boards, wiring, sleeves and similar installations installed by Tenant or specifically for Tenant's benefit, whether in Tenant's own Premises or in the Building's shared telecommunications closets or other Common Areas.

“Certificate Holders” means: (a) Landlord, (b) all Lenders/Lessors of which Tenant has received Notice; and (c) any other Person(s) Landlord designates from time to time.

“Change” means amend, consolidate, extend, increase, modify, recast, refinance, renew, replace, surrender, terminate or waive, or the act of doing any of the foregoing.

“City” means any municipality where the Building is located.

57 Electricity is not a “Basic Service.” This Lease assumes Tenant has direct metering. See Optional Provisions at the end of this Lease for appropriate language for other arrangements regarding electricity.

58 This threshold seems relatively low. Tenant will favor a higher threshold, especially if Tenant is credit-worthy.

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“Commercial Rent Control” means any Law, whether or not constitutional, that prohibits, precludes, or prevents Landlord from collecting, or excuses Tenant from paying, or otherwise controls, stabilizes, suspends, reduces, delays or defers any Rent this Lease establishes; requires any extension or renewal of this Lease beyond the Term (including Option Terms); grants Tenant any “right of first refusal” or similar extension right for the Premises; requires Landlord to participate in any so-called “rent arbitration” or similar proceeding, except as this Lease expressly requires; or otherwise directly or indirectly limits or restricts Landlord’s ability to collect the Rent this Lease establishes or to negotiate in a free market the rent for the Premises after the Expiration Date.

“Common Areas” means all areas within the boundaries of or adjacent to the Building not from time to time held for exclusive use by Landlord or by other Persons entitled to occupy space in the Building, including, to the extent, if any, existing in or serving the Building: parking areas and structures, driveways, entrances and exits, sidewalks and pedestrian passageways, truckways, atriums, courtyards, delivery passages, elevators and escalators, public stairways, lobbies, elevator lobbies, public corridors, loading docks, sidewalks, pedestrian and vehicular bridges within or providing access to the Building, ramps, open and enclosed courts and malls, landscaped and planted areas, exterior stairways, mechanical closets, drainage systems, bus stops, retaining walls, management offices, restrooms not located within the premises of any tenant and other areas and improvements Landlord provides for the common use of Landlord and tenants and their employees and invitees, and walls facing any of the foregoing. If any pedestrian or vehicular bridge provides access to and has a landing within the Building, then the entire bridge is a Common Area. Landlord may from time to time change the size, shape, location, number and extent of the Common Areas. No such change shall entitle Tenant to any Offset. Landlord may add improvements, including parking decks, anywhere in the Building or on the Land. To the extent Landlord uses the Building office to operate and manage the Building, Landlord may treat it as “Common Areas.”

“Communications Services” means all voice, data communications, Internet access and telecommunications services necessary or appropriate for the Premises and Tenant’s activities.

“Comparable Buildings” means prudently managed buildings similar to the Building in terms of location, overall quality of operations, tenant composition, nature of ownership and use, and the management, opera-

tional procedures and requirements in effect from time to time in such buildings, all as determined in Landlord's reasonable judgment.

“Condemnation” means taking by condemnation (or sale in lieu of condemnation) of all or any part of the Building or the Land, or in or as a result of any similar proceeding. That taking shall be deemed to have occurred upon the vesting of title.

“Contractor” means any contractor, subcontractor, laborer or materials supplier engaged by Tenant or any Tenant Party, and any other Person that has or may have the right to file a Lien if not paid for Work or related goods or services.

“Control” means the ability to determine management and decisions of a Person, whether by contract, by ownership of Equity Interests or otherwise.

“Default” means any act or omission of Tenant that violates this Lease; the material inaccuracy of any representation or warranty by Tenant in this Lease; or any event that, with the passage of time or the giving of notice, would constitute (or already constitutes) an Event of Default.

“Default Notice” means any Notice from Landlord to Tenant about a Default or alleged Default. Any such Notice may describe Tenant's Default in general terms. It need not specify the provisions of this Lease being violated or Tenant's cure period.

“Default Period” means any period when Landlord has given Tenant any Default Notice and continuing until no uncured Default exists.

“Department of Buildings” means the department(s) or agency(ies) of any Government with authority to issue permits for Work.

“Electricity Impairment” means any change, failure, interference, disruption, interruption or defect in the supply or character of electric energy furnished to the Premises or Building, regardless of duration, or if the quantity or character of electric energy supplied by Power Company is no longer available or suitable for Tenant's requirements.

“Enforcement Proceeding” means any: (a) foreclosure or delivery of a deed in lieu of foreclosure under any Mortgage; (b) eviction of Landlord under a Master Lease; (c) other exercise of a Lender/Lessor's remedies under any Landlord's Financing, divesting Landlord of title; or (d) termination or expiration of any Master Lease.

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“Environmental Law” means any Law on environmental conditions caused by any Tenant Party or arising from any Tenant Party’s use or occupancy of the Premises, or any Tenant Party’s use, generation, storage, transportation, or disposal of Hazardous Substances.

“Equity Interests” means, for any entity, its stock, partnership or membership interests, or other equity or ownership interests.

“Escalation Rent” means Operating Expenses Escalation Rent, Property Tax Escalation Rent, and any other amount(s) that this Lease identifies as Escalation Rent.

“Estoppel Certificate” means a certificate substantially in the form of **Exhibit** __, signed by Tenant and any Guarantor, with such other confirmations, if any, as Landlord or a Lender/Lessor reasonably requests.

“Exempt Transfer” means any of these Transfers, if made without consideration and in compliance with the “Conditions and Limitations to Landlord’s Consent” in this Lease: (a) if Tenant is an individual, a Transfer to an immediate family member of Tenant; (b) a Transfer to a trust for the benefit of anyone in clause “a”; and (c) a Transfer to an entity 100% of which is owned by Tenant or by the Persons who, at the Signature Date, were (and, at and after the Transfer remain) all beneficial owners of Tenant and the Transferee.

“Force Majeure” means any strike, lockout, labor dispute, terrorism, inability to obtain labor or materials or reasonable substitutes for such labor or materials, act of God, governmental restrictions, regulations or controls, enemy or hostile government action, civil commotion, riot, insurrection, fire, or other casualty or other events similar or dissimilar to those listed in this paragraph beyond Landlord’s reasonable control.

“Garbage” means all garbage, trash, debris, refuse, and other similar waste material of any kind, whether wet or dry.

“Good Funds” means certified or cashier’s check or wire transfer to an account Landlord designates.

“Government” means any local, county, City, State or federal governmental authority or agency, business improvement district, or other governmental or quasi-governmental authority or agency (including any taxing or assessing authority) having or claiming jurisdiction over the Land or the Building.

“Guarantor” means: (a) any guarantor of any of Tenant’s obligations under this Lease; (b) any unreleased assignor of this Lease; and (c) any other Person primarily or secondarily liable for Tenant’s obligations under this Lease.

“Hazardous Substance” means radon, formaldehyde, urea, or any flammable substance, explosive, radioactive material, asbestos, chemical known to cause cancer or reproductive toxicity, pollutant, contaminant, hazardous waste, medical waste, toxic substance or related material, petroleum or petroleum product, or other substance declared to be hazardous or toxic under Environmental Law, or toxic mold.

“Hazardous Substance Discharge” means any deposit, spill, discharge, spread, or other release of Hazardous Substances caused by any Tenant Party in the Term or that arises from Tenant’s use or occupancy of the Premises.

“HVAC” means heating, ventilating, and air conditioning services and equipment, including any humidification system, dehumidification system, air handler(s), chiller(s), air compressor(s), related electrical service, and other equipment or components for the HVAC.

“Include,” “including,” “such as,” and similar words shall be interpreted as if followed by the words “without limitation” except where the context necessarily implies otherwise.

“Indemnify,” “Indemnitor,” and “Indemnitee” shall be defined as follows. Wherever this Lease states that a party (the “Indemnitor”) shall “Indemnify” another party (the “Indemnitee”) for, against, or otherwise in connection with, any matter (the “Indemnified Risk”), Indemnitor shall defend, protect, indemnify, and hold harmless Indemnitee (which term shall also refer to the Indemnitee’s Related Parties and, where Landlord is Indemnitee, Landlord’s Lenders/Lessors) from and against any and all loss, cost, liability, Operating Expenses, claim, action, damages (except consequential and indirect damages), and fines (including any arising from loss of life, personal injury, and/or property damage), and Legal Costs, caused by or arising from or out of the Indemnified Risk, except to the extent caused by Indemnitee’s gross negligence or intentionally wrongful acts.

“Land” means the land underlying or surrounding or adjacent to the Building and owned (or leased under a Master Lease) by Landlord or its Related Parties.

EXHIBIT B-1: SUPPLEMENTAL TERMS

“Landlord-Restored Damage” means any damage caused by Casualty or Condemnation to the Building, including Landlord’s Initial Work, but not Tenant-Restored Damage.⁵⁹

“Landlord’s Financing” means, collectively, all Mortgages, all Master Leases, and all their terms and conditions.

“Landlord’s Interest” means Landlord’s entire right, title and interest (including leasehold interest, if applicable) in the Building and the Land, including Landlord’s rights to receive any rents, insurance proceeds, Condemnation proceeds and Property Tax refunds, to the extent any of those items were not already collected.

“Laws” or “Law” means all laws, regulations, ordinances, directives, codes, orders, insurance requirements, rules, guidelines, and other requirements (whether now existing or later enacted, whether or not foreseeable, and whether imposing any obligation on Landlord or on Tenant), including judicial rulings and other interpretations announced, enacted, established, promulgated or enforced by any Government, insurance carrier, board of fire underwriters or similar group and affecting the Premises, or the use, maintenance, physical condition, operation or occupancy of the Premises, or activities conducted in the Premises, or the abatement of any nuisance in, on or about the Premises or caused by activities in the Premises, or relating to matters substantially within the control of the occupant of the Premises, accommodation of disabled persons in the Premises, nondiscrimination, Landlord’s rights and remedies, this Lease or anything else affecting this Lease. “Law” includes all conditions or requirements within Tenant’s control the noncompliance with which could adversely affect Landlord’s eligibility or qualification for any benefit or dispensation from any Government, including any reduction, abatement or deferral of Property Taxes. For Utilities, “Law” includes all rules, requirements, tariffs and actions of any utility company.

“Lease Year” means initially the first 12 full calendar months starting on or after the Commencement Date. The next period of 12 full calendar months is another “Lease Year” and so on for each subsequent 12-month period in the Term.

59 It may make sense for Landlord to insure and restore everything. This would require adjusting—for the most part, simplifying—insurance and restoration language but is not hard to do. It would be somewhat off market.

“Legal Costs” of Landlord means all reasonable costs and expenses Landlord incurs in any legal proceeding (including any appellate proceedings), in obtaining legal advice and assistance relating to this Lease, Tenant, or this tenancy, in any exercise or attempted exercise of remedies under this Lease or with respect to this Lease under Law, in establishing the amount of or collecting any Legal Costs, as the result of or through any Bankruptcy Event affecting Tenant or Guarantor, or in connection with any other matter for which this Lease entitles Landlord to reimbursement of its Legal Costs. Legal Costs shall include reasonable attorneys’ fees, disbursements and other charges billed by Landlord’s attorneys, court costs and expenses, fees for bonds, and charges for the services of paralegals, law clerks, process servers, private investigators, and all other personnel whose services are charged to Landlord in connection with Landlord’s receipt of those legal services. To the extent Landlord uses its own staff attorneys and other personnel, “Legal Costs” shall include the value of their time based on the billing rates of Landlord’s outside counsel for persons with comparable experience, qualifications and seniority.

“Lender/Lessor” means any Mortgagee or Master Landlord.

“Lien” means any mechanic’s, material supplier’s, or other lien or encumbrance filed against the Premises, the Building, the Land, or any interest in any of them.

“Lien Waiver” means a Contractor’s unconditional waiver of any right to file a Lien, in form satisfactory to Landlord.

“Master Landlord” means the master landlord (ground lessor) under any Master Lease.

“Master Lease” means any master or ground lease of the Building or the Land, entered into or Changed from time to time (whether before or after the Signature Date) under which this Lease is or becomes a sublease.

“Minor Work” means any Work that is immaterial and of a decorative or minor nature, e.g., painting, decorating, wall covering and carpeting, provided it is not reasonably projected to cost more than the Bonding Threshold and does not require a building permit.

“Mortgage” means any mortgage(s) (as Changed from time to time) that Landlord or Master Landlord grants at any time encumbering the Building, the Land or any estate or interest in either of them.

EXHIBIT B-1: SUPPLEMENTAL TERMS

“Mortgagee” means any holder of a Mortgage.

“Notice” means any notice, request or other communication, including a notice of Default or of termination. Notices shall be given and shall become effective in accordance with the provisions of this Lease on Notices.

“Notify” means give any Notice.

“Operating Expenses” means all costs and expenses of every kind, whether now or later classified as operating expenses or expenditures under generally accepted accounting principles on an accrual basis, that Landlord incurs to manage, operate, maintain, repair, and protect the Building (whether or not this Lease obligates Landlord to incur them), or to provide Basic Services, including costs and expenses of: (a) salaries, wages, bonuses, and other compensation (including hospitalization, medical, surgical, retirement plan, pension plan, union dues, life insurance (including group life insurance), welfare and other fringe benefits, and vacation, holidays and other paid absence benefits) for employees (including off-site senior property management personnel) of Landlord or its agents engaged in the operation, repair, or maintenance of the Building; (b) payroll, social security, workers’ compensation, unemployment and similar taxes for those employees of Landlord or its agents, and disability or other benefits imposed by law or otherwise, for those employees; (c) uniforms (including cleaning, replacement and pressing) for those employees; (d) premiums and other charges for fire, other casualty, rent and liability insurance and any other insurance as Landlord reasonably deems necessary or advisable, and repair of any insured casualty to the extent of the deductible amount under the applicable insurance policy; (e) water charges and sewer rents or fees; (f) license, permit and inspection fees; (g) sales, use and excise taxes on goods and services the cost of which constitutes “Operating Expenses”; (h) telephone, fax, cellular phone, two-way radio, postage, stationery supplies and other operating expenses incurred in connection with the operation, maintenance, or repair of the Building; (i) administrative and management fees, including accounting, data processing, and Legal Costs (except for negotiations and disputes with specific tenants not affecting other parties); (j) repair to and maintenance of the Building (including parking and circulation areas and facilities serving the Building), including Building Systems and appurtenances and repair and replacement of worn-out equipment, facilities and installations; (k) janitorial, window cleaning, guard, pest control and extermination, water treatment, Garbage removal and disposal, plumbing and other services and inspection or service contracts for elevator, electri-

cal, mechanical, HVAC, fire prevention, warning and security systems and other building equipment and systems or as may otherwise be necessary or proper for the operation, repair, or maintenance of the Building and the Common Areas and any costs of monitoring, improving, and remedying indoor air quality within the Building, whether to comply with Law or to improve indoor environmental quality; (l) supplies, tools, materials, and equipment used in connection with the operation, maintenance or repair of the Building; (m) architectural, engineering, and other professional fees and expenses; (n) painting the Building exterior or Common Areas; (o) maintaining landscaping, gardening, and plants, and replacement of interior and exterior plants and maintaining the Common Areas; (p) Utilities for operation, maintenance and repair of the Building and its Common Areas; (q) reasonable amortization (with interest at the Prime Rate) of capital improvements Landlord makes (or capital assets Landlord acquires) after the Base Year for the Building to comply with any Law or change in Law⁶⁰ or to seek to reduce other operating expenses; (r) building office rent or rental value; (s) surcharges and license and permit fees required by Law for parking and transportation facilities, including traffic management fees and charges; (t) furniture, wall, floor and window coverings, interior plants and planters and other customary and ordinary items of personal property (excluding paintings, sculptures and other works of art) for use in Common Areas; (u) purchasing, installing and removing seasonal and other temporary decorations for the Building or Common Areas; (v) acquisition, maintenance, repair and replacement of elevators, escalators, moving sidewalks, stairways, fire escapes, flagpoles, fountains, satellite dishes, signage (including parking, traffic, and directional signage and markers, whether temporary or permanent), tenant directories and other equipment and machinery for use in the public or common areas of the Building, including any personal property taxes thereon; (w) computers, data communications, two-way radios, personal digital assistants and other technology used in the Common Areas; (x) maintaining, cleaning, re-striping, repairing, replacing, repaving and resurfacing of parking lots or facilities; (y) substitution of work, labor, material or services in lieu of any of the above itemized items, or for any additional work, labor, services, fees or material resulting from compliance with any Law that affects the Building; (z) actual or reasonably allocable interest expense on funds Landlord borrows to pay Operating Expenses not yet reimbursed; and (aa) all costs related to the foregoing.

60 If a Lease does not provide for Operating Expenses Escalation Rent, then Landlord may want to treat this cost as Property Taxes. In any case, Landlord may prefer to pass it through separately rather than as an escalation above a base.

EXHIBIT B-1: SUPPLEMENTAL TERMS

Operating Expenses shall exclude these costs: (a) depreciation of the Building (or its capital improvements, equipment, or systems); (b) interest, amortization, or other financing costs except as expressly included in Operating Expenses; (c) Master Lease ground rent; (d) Property Taxes; (e) Additional Services furnished directly to any tenant and separately reimbursable; (f) attorneys' fees and expenses for lease negotiations; (g) decorating, improving for tenant occupancy, and painting or redecorating any leasable space; (h) executive salaries; (i) leasing commissions; (j) transfer taxes from any transaction of Landlord; and (j) at Landlord's option, any category of Operating Expenses that would otherwise constitute Operating Expenses, provided the exclusion applies both for Base Operating Expenses and for all Operating Years.

"Operating Expenses Escalation Rent" means, for each Operating Year, Operating Expenses Share times the excess, if any, of: (a) Operating Expenses for that Operating Year; over (b) Base Operating Expenses.

"Operating Year" means the fiscal year Landlord establishes from time to time. Landlord's Operating Year is now the calendar year.

"Person" means any corporation, estate, Government, limited liability company, natural person, partnership, trust or other entity of any kind.

"Power Company" means the company that supplies electricity to the Building and any replacement electricity provider Landlord designates.

"Prime Rate" means the "prime," "base," "reference," or equivalent rate announced from time to time by Citibank, N.A. or another bank in the City Landlord selects, or, at Landlord's option, published in The Wall Street Journal or a similar authoritative source.

"Prohibited Use" means these uses of the Premises, unless the Basic Terms expressly permit them: (a) department store, drugstore, pharmacy, dry cleaner, clothing store, supermarket, produce store, liquor store, restaurant, or delicatessen (but Tenant may install a microwave oven or other food heating equipment for use by Tenant's employees and business visitors); (b) sale or rental of video tapes or equipment; (c) sale of lottery or similar tickets of any kind; (d) barber shop or haircutting or beauty salon; (e) film developing or printing services; (f) sale of alcoholic beverages, marijuana or other recreational drugs, whether or not legal; (g) operation of a check-cashing or money transmission service; (h) operation of any church or other religious organization of any kind; (i) use or occupancy by any Government; (j) manufacturing or light manufacturing of

any kind (including the use of any equipment or process that in Landlord's reasonable determination is neither (i) typically used in generic office space; nor (ii) reasonably necessary or appropriate for use of the Premises as the Basic Terms expressly permit); (k) any obscene, nude, or semi-nude live or recorded performances, or nude modeling, rap sessions, or as a so-called "rubber goods"⁶¹ shop, or as a sex club of any kind; (l) to conduct any auction, bankruptcy, or "going out of business" sale; (m) residential, living, dwelling or sleeping purposes; (n) operation of any cabaret, club, disco, dance floor or eating or drinking establishment or live music or other live entertainment; (o) sale or display of nude photographs, sexual devices, objects, or publications depicting genitalia, obscene material, pornographic material (i.e., any written or pictorial matter with prurient appeal or any objects or instruments primarily concerned with lewd or prurient sexual activity, all as Landlord determines), or any other items commonly associated with peep show, massage parlor, adult book, "head shop," or similar stores; (p) possession of any animal or pet of any kind (except service animals for the disabled); (q) any clinic, medical, healing, chiropractor's office, doctors' office, spa, or similar use; (r) any other use of the Premises that Law or this Lease prohibits; (s) any unlawful or hazardous use; (t) to sell or display drug paraphernalia or drug-related merchandise, including any merchandise that Landlord reasonably determines is of a type used primarily in or identified primarily with the preparation, consumption, storage, or use of illegal drugs or other controlled substances; (u) any auction, fire, inventory close-out, bankruptcy, "going out of business," liquidation (whether of merchandise only or of Tenant's entire business), or similar sale; and (t) a club of any kind, including a so-called "night club" or "private club." [The "Prohibited Uses" shall also include operation of any retail business or the sale of any goods or services at retail.]

"Property Tax Escalation Rent" means Tax Share times the excess, if any, of the Building's: (a) Property Taxes in each Property Tax Year over (b) Base Property Taxes.

"Property Tax Year" means the City's fiscal year, now July 1 to June 30. If the City changes its fiscal year, then the definition of Property Tax Year shall change accordingly.

"Property Taxes" means all taxes, assessments (including "betterment" assessments), business improvement district charges, vault taxes (except

61 This prohibition often appears. "Rubber goods" are actually just contraceptives. Look it up. Consider deleting the prohibition, at least for certain types of retail stores.

EXHIBIT B-1: SUPPLEMENTAL TERMS

those paid by particular tenants), and other governmental charges, special or otherwise, actually assessed or levied (and in either case payable) from time to time upon or with respect to the ownership of and/or all other taxable interests in the Building, and/or the Land, including the sidewalks, plazas, or streets adjacent to the Land (as any of the foregoing may be improved, renovated, expanded or otherwise changed from time to time), imposed by any Government for any Property Tax Year. Property Taxes shall be measured based on the period to which they apply under Law, regardless of when Landlord actually pays them. If Landlord subdivides the Building into multiple tax lots (e.g., multiple condominium units), then Property Taxes shall continue to be measured for the Building as a whole based on the sum of Property Taxes for all individual tax lots. Property Taxes shall include so-called “payments in lieu of taxes” and any similar payments to any Government or otherwise in lieu of real estate taxes. Property Taxes shall not diminish by any discount for early payment. Property Taxes shall include assessments for public improvements or benefits assessed against the Building or Land, including any interest component. If because of any change in taxation of real estate any other tax or assessment (including any franchise, income, profit, sales, use, occupancy, gross receipts or rent tax, or any special assessment, levy or fee of any kind) is imposed upon Landlord, the Building, the Land, or the occupancy, rents or income of any of them, in substitution for any of the foregoing element(s) of Property Taxes, then that other tax or assessment shall at Landlord’s option be deemed part of Property Taxes. Except as the preceding sentence states, “Property Taxes” shall disregard: (a) Landlord’s income, intangible, franchise, capital stock, estate, inheritance, mortgage recording or transfer taxes; (b) water and sewer frontage charges; (c) penalties and interest for late payment; and (d) any partial or total abatement, deferral, or other tax benefit, exemption or rescheduling actually awarded or otherwise in place for the Building or Land (or any tax lot(s) within either), including any arising from the identity, investment(s) or business activities of any particular tenant(s) of the Building.⁶² If Tenant is tax-exempt, this does not limit the definition of Property Taxes or Tenant’s obligations and rights on Property Tax Escalation Rent.

62 Preceding sentence will not always work. As another approach, consider this:

Property Taxes shall fully take into account (and shall be measured after any reduction resulting from) the effect of any partial or total abatement, deferral, or other tax benefit, exemption, or rescheduling actually awarded or otherwise in place for the Building or Land, except as follows. To the extent that any such benefit, exemption, or rescheduling arises from the identity, investment(s), or business activities of any particular tenant(s) of the Building and Landlord must pass it through to such tenant(s), then Property Taxes shall be measured as if such benefit, exemption, or rescheduling did not exist and had not occurred.

“Related Party” of a Person means any: (a) agent, director, employee, family member (spouse, sibling, parent, or child), managing agent, member, officer, parent company, principal, partner, shareholder or subsidiary of that Person; or (b) Person Controlled by or Controlling that Person or under common Control with that Person.

“Rent” means: (a) Base Rent and Additional Rent, as adjusted from time to time under this Lease; and (b) all other payments or deposits this Lease requires Tenant to make.

“SNDA” means a nondisturbance agreement between Tenant and a Lender/Lessor, as the Lender/Lessor approves or requires.

“State” means the state where the Building is located.

“Structure” means only these elements of the Building, excluding anything Tenant installed: structural steel or other structural support system; elevators; escalators; systems serving the Building as a whole rather than individual tenant(s); roof; floors; ceilings; foundations and pilings; exterior walls (including windows and mullions, unless the Premises consists of ground floor space or this Lease otherwise provides); masonry; concrete work; load-bearing walls; and vertical and horizontal support beams and other support structures for the Building.

“Substantially Complete” means Landlord: (a) has completed Landlord’s Initial Work to the extent that Tenant can reasonably start Tenant’s Initial Work without material interference from Landlord’s final completion of Landlord’s Initial Work; and (b) is otherwise prepared to deliver the Premises to Tenant.

“Successor Landlord” means any Person that acquires or terminates Landlord’s estate in the Land and the Building through an Enforcement Proceeding, including the Master Landlord under any terminated Master Lease and any designee, nominee or assignee of any Landlord’s Lender/Lessor in an Enforcement Proceeding.

“Tenant Party” means each and all of: (a) Tenant and its successors and assigns; (b) anyone claiming through or under Tenant, including the transferee under any Transfer; (c) any Related Party of Tenant; and (d) any agent, Contractor, customer, employee, franchisee, franchisor, independent contractor, invitee, licensee, supplier, or vendor of Tenant. Nothing in this definition limits any Transfer restriction or prohibition.

EXHIBIT B-1: SUPPLEMENTAL TERMS

“Tenant’s Initial Work” means all Work necessary or appropriate for Tenant to operate the Permitted Use(s) in the entire Premises in compliance with this Lease.

“Tenant-Restored Damage” means any damage caused by a Casualty or Condemnation and affecting any Tenant’s Initial Work or other Work Tenant performed.

“Term” means a period that starts on the Commencement Date and ends on the Expiration Date.

“Transfer” means any of these affecting this Lease or the Premises: (a) Assignment; (b) subletting or grant of concession, license or other rights of occupancy; (c) Change or surrender of the foregoing; (d) use, operation or occupancy, by any Person or business except Tenant, for any purpose; (e) sale, mortgage, pledge or other transfer, assignment or succession, whether by operation of law or otherwise; and (f) any of the foregoing that affects any sublease or subtenant or any other estate or interest, or the holder of an estate or interest, whose creation was a Transfer. “Transfer” also includes: (x) any other transaction in substance equivalent to any of the foregoing; and (y) as this Lease provides, certain transactions affecting Equity Interests.

“Utilities” means all utilities and services necessary or appropriate for the Premises, including electricity, gas, water, HVAC, fuel, steam, sewer, Garbage removal, and all other utilities and other services of any kind except Communications Services.

“Waiver of Subrogation” means a provision in, or endorsement to, any policy⁶³ of insurance, by which the carrier agrees to waive rights of recovery by subrogation against either party to this Lease (and, in the case of Tenant’s carriers, against Landlord’s Lender/Lessor(s)) for any loss that policy covers.

“Work” means any addition, alteration, construction, demolition, reconstruction, renovation or other work of any magnitude of any kind in, at or serving (or materials fabricated off-site for) the Premises or the Building, including Tenant’s Initial Work and installations of any systems or services benefiting the Premises.

63 It is sometimes thought that Waivers of Subrogation: (a) apply only to Property Insurance; and (b) are now baked into standard insurance policy forms. Neither statement is true, according to the author’s reliable sources.

EXHIBIT B-2: STATE-SPECIFIC TERMS

These additional Supplemental Terms (also part of the “Supplemental Terms”) constitute part of the Lease to which attached. All statutory references relate to New York law.

[New York State-Specific terms can be found in a separate chapter of this work. They should be added here, as appropriate.]

EXHIBIT B-3: SUPPLEMENTAL TERMS (RETAIL)

These additional Supplemental Terms (also part of the “Supplemental Terms”) are part of the Lease to which attached. Terms defined in this **Exhibit B-3** are listed in the Index of Defined Terms after the Basic Terms, in each case with a page reference. The table of contents for **Exhibit B-1** also covers this **Exhibit B-3**.⁶⁴

39. Percentage Rent

39.1 Tenant’s Obligation. For every Lease Year or partial Lease Year, except in any Abatement Period, Tenant shall pay Landlord an amount (“Percentage Rent”) equal to the excess, if any, in that period, of (a) Landlord’s Percentage times Gross Sales over (b) Base Rent. If in any period “a” is less than “b,” then Percentage Rent for that period shall be zero, no other Rent shall be affected and Tenant shall have no Offset. Within 30 days after the last day of each calendar month, except any calendar month entirely in an Abatement Period, Tenant shall pay Landlord Percentage Rent for that calendar month. Within 90 days after each Lease Year, the parties shall make adjusting payments so Tenant’s total payments of Percentage Rent for that Lease Year equal actual Percentage Rent.

39.2 Definition: “Gross Sales.” The “Gross Sales” means the entire amount charged, whether wholly or partly for cash, on credit or otherwise, for all merchandise sold, and all charges made for services performed or for the extension of credit in, at or from the Premises, or through the substantial use of the Premises, including the amount allowed upon any “trade-in,” the retail price of any merchandise delivered on redemption of trading stamps, all deposits not refunded to purchasers, all catalog sales at or from the Premises, all direct mail sales made from any location based on a list of Tenant’s customers at the Premises, all receipts from electronic or other video games and from advertising conducted at the Premises by Tenant for others and all orders taken in or from the Premises or that Tenant would in the normal course of its operations credit or attribute to its business in the Premises, even if those orders are filled from another location. If Tenant sells stamps or tickets at the Premises and receives only a service fee, royalty or commission from those sales, then Gross Sales shall include only the net amount payable to Tenant. Gross Sales shall not be reduced for uncollected or uncollectible credit accounts.

⁶⁴ Tenant will also want to cover at a minimum signage; parking; co-tenancy (for opening and for continued operations); and restrictions on activities and objects in common areas near premises.

EXHIBIT B-3: SUPPLEMENTAL TERMS (RETAIL)

“Gross Sales” shall include gross receipts from all mechanical, electronic and other vending devices placed in the Premises by Tenant or under authority from Tenant, except any installed (in parts of the Premises not open to the public) for convenience of Tenant’s employees; mail or phone order sales solicited from the Premises; and mail order or telephone order sales from the Premises in response to advertisements using the Premises address or telephone number. “Gross Sales” shall include all sales made by mail, catalog, telephone, Internet, electronic, video, computer or other technology whether now or later existing (all, collectively, “Electronic Sales”) if received, placed, filled or shipped from the Premises,⁶⁵ including sales made from any computer in or accessed from the Premises. Tenant shall install no such computer unless Tenant demonstrates to Landlord’s reasonable satisfaction that Tenant’s sales reporting system for Gross Sales will include all sales made from that computer. Gross Sales include receipts from sales made and orders taken in the Premises even if: (a) the account is transferred elsewhere for collection; or (b) merchandise or services sold from the Premises are delivered elsewhere. Every credit sale shall be treated as a sale for the full price in cash when the transaction occurs, whether or not the customer pays or title passes. Tenant’s Gross Sales shall include the Gross Sales of every sublessee, licensee, concessionaire or other person using or occupying any Premises under authority from Tenant (“Additional Retailers”), but shall exclude payments Additional Retailers pay Tenant in consideration for use and occupancy.⁶⁶

39.3 *Exclusions from Gross Sales.* Tenant’s “Gross Sales” shall not include (or, if included, there shall be deducted to the extent of that inclusion) the amount of any: (a) cash or credit refund that Tenant actually makes for merchandise sold in, at, or from the Premises; (b) exchanges and transfers of merchandise between Tenant’s multiple locations, if made only for convenient operation of Tenant’s business and not with the purpose or effect of consummating elsewhere a sale (that would have been) made at the Premises; (c) returns to shippers or manufacturers; (d) sales of fixtures or equipment after their substantial use in the conduct of Tenant’s business in the Premises; and (e) sales, luxury or excise taxes on sales from the Premises, where Tenant (but not any vendor to Tenant) adds those taxes to (or absorbs them in) the selling price and pays them to the taxing authority. Tenant may not deduct from Gross Sales any cash or

65 Landlord may wish to include Internet orders shipped from anywhere to any address within the marketing area of this particular location (even if the order never passed through this particular location in any way), under the theory—probably dubious—that those orders represent sales that this particular location would otherwise have made.

66 “Gross Sales” may require tailoring for particular businesses.

credit refund for merchandise sold via Electronic Sales unless Gross Sales included the sales price of that merchandise.

39.4 *Recordkeeping.* Tenant shall keep and shall require Additional Retailers to keep at the Premises (or at another location approved by Landlord in writing) complete and accurate books of account and records that include all purchases and receipts of merchandise, inventories and all sales and other transactions from which Tenant's Gross Sales can be determined. Tenant shall record all sales, when made, whether for cash or on credit, in a cash register(s) containing locked-in cumulative tapes with cumulation capacity satisfactory to Landlord or a point of sale computer recording system, in either case with the capacity to identify individual sales by method of payment (cash, check or credit card). Tenant shall keep all pertinent original sales records, which records shall include, as applicable, these items or their electronic equivalents: (a) daily dated register tapes; (b) serially numbered sales slips; (c) mail and catalog orders; (d) telephone orders; (e) settlement report sheets of transactions with Additional Retailers; (f) records showing that merchandise returned by customers was purchased by them at or from the Premises; (g) receipts or other records of merchandise leased, licensed or taken out on approval; (h) duplicate bank deposit slips and bank statements; (i) such other records as would normally be required to be kept and examined by an independent accountant in accordance with accepted auditing practices in performing an audit of Tenant's Gross Sales; and (j) all income, sales and occupation tax returns. In addition to Landlord's audit rights under this Lease, Landlord may periodically inspect or monitor the Premises to confirm Tenant is complying with the operating procedures this paragraph requires. If Tenant is not in substantial compliance with those requirements, then Tenant shall reimburse Landlord's cost of that inspection and monitoring. Tenant shall on request give Landlord copies of Tenant's sales reports for the Premises (as electronic data, if Landlord requests) that were or are delivered to Tenant's headquarters.

39.5 *Reporting.* Tenant shall submit to Landlord, in each case in reasonable detail: (a) within 30 days after the last day of each calendar month, a written statement of Gross Sales for that calendar month; and (b) within 90 days after the last day of each Lease Year, a written statement certified by Tenant's chief financial officer of Gross Sales for that Lease Year. Each such statement, and its certification, shall be in form and scope (and subject only to qualifications) reasonably satisfactory to Landlord. Landlord's acceptance of Percentage Rent shall not limit Landlord's right to examine Tenant's records to verify Tenant's Gross Sales. If Tenant fails

EXHIBIT B-3: SUPPLEMENTAL TERMS (RETAIL)

to timely report Tenant's Gross Sales as this Lease requires, then without limiting Landlord's other rights or remedies: (a) Tenant shall pay Landlord a fee of \$50 per day for each day of lateness in Tenant's delivery of that report; and (b) Landlord may estimate Tenant's Gross Sales. Tenant shall pay Percentage Rent accordingly unless and until Tenant affirmatively demonstrates that Landlord's estimate is incorrect.⁶⁷

39.6 *Audits.* At any reasonable time, upon five days prior Notice to Tenant, Landlord or its designee may, at Landlord's expense (except as this Lease otherwise provides) audit Tenant's records of Gross Sales for any Lease Year. Any such audit performed by a certified public accountant or other auditor selected by Landlord shall bind the parties. If that audit discloses any deficiency in payment of Percentage Rent, then Tenant shall immediately pay Landlord that deficiency, with interest at the rate that applies to late payments of Rent from the dates when this Lease first required Tenant to make each such payment. Only if the deficiency exceeds 2% of the Percentage Rent as Tenant computed and paid it for the period the audit covered, Tenant shall pay for the audit, including reasonable travel, meal and lodging Operating Expenses of Landlord's auditor(s).

40. *Noncompete Zone*

40.1 *Tenant's Covenant.* Neither Tenant nor any Related Party of Tenant shall, directly or indirectly, operate, manage, franchise, license, have any interest in or allow or authorize any other Person to operate any store or other retail facility of any kind (including any concession, outlet store, discount store, seasonal store, temporary store or selling program, subleased or licensed department or other facility of any kind selling to the public, even if its prices vary from those in the Premises) that: (a) is located in the Noncompete Zone; (b) uses Tenant's Trade Name or a similar or variant trade name (owned or controlled by Tenant or Tenant's Related Party) or otherwise competes with or overlaps to any material degree Tenant's business in the Premises; and (c) is not in operation⁶⁸ on the Signature Date (a "Prohibited Store"). The parties acknowledge that the Noncompete Zone reasonably approximates the geographic area of Tenant's anticipated clientele and this restriction is reasonable given

67 Even if Tenant does not pay Percentage Rent, Landlord may desire periodic reports on Gross Sales simply to assess how well Tenant is doing and Tenant's long-term prospects. Lenders like this information, too.

68 Landlord may wish to memorialize exactly which existing operations of Tenant will be "grandfathered."

Tenant's ability to draw clientele from significant distances because of Tenant's favorable reputation.

40.2 *Remedies.* If any Prohibited Store(s) operate in the Noncompete Zone, then Landlord may: (x) treat such Prohibited Store(s) as a Default; (y) obtain injunctive relief to require Tenant to close the Prohibited Store(s); and/or (z) include all sales from the Prohibited Store(s) in Gross Sales.

40.3 *Radius.* If the Noncompete Zone is defined as any points within a stated distance from any point(s) or location(s), then that stated distance shall be measured on a straight line ("as the crow flies"). If the Noncompete Zone includes any part of any shopping center, mall or other retail (or mixed use) development project, then the Noncompete Zone shall include the entirety of that shopping center, mall or development project, as expanded from time to time.

41. *Common Areas*

41.1 *Parking.* Tenant and its employees shall park their vehicles only in parking areas as Landlord from time to time designates. Landlord may change that designation at any time. Tenant shall give Landlord a list of its and its employees' vehicle license numbers within 15 days after the Commencement Date. Tenant shall Notify Landlord of any change in that list within five days after it occurs. Tenant shall cause its employees to comply with the parking restrictions in this Lease. If Tenant or its employees violate Landlord's parking regulations, Landlord may charge Tenant \$50 per day or partial day of that violation and may tow away or attach violation notice(s) or boot(s) to the affected vehicle(s). Tenant shall pay all towing costs as a condition to release of the affected vehicle(s).

41.2 *Additional Operating Expenses.* In addition to any items this Lease otherwise includes in Operating Expenses, Landlord's "Operating Expenses" shall also include all these expenses of Landlord.

41.2.1 *Amenities.* Maintenance and operation of special amenities, e.g., meeting rooms, amusements, a concierge desk and police and security facilities.

41.2.2 *Decorations; Shopper Amenities.* Providing customer services determined by Landlord to be advantageous to attract patrons or to help them shop at the Building, e.g., costs of leasing or operating shuttle buses and other transportation systems, public or private, and the costs of pro-

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viding shopping bags, strollers, wheelchairs, gift certificates, valet parking and entertainment.

41.2.3 *Audio/Video*. Installing and operating loudspeaker systems, music program services and other audio or video transmission systems, including licensing fees, and all security systems for the Building.

41.2.4 *Promotion*. Promotion of visits to the Building, including advertisements, promotional literature and incentives for travel agents, public and charter transportation carriers and others engaged in the tourism industry, and advertising generally.

42. *Exclusive Use(s)*

42.1 *Tenant's Right*. So long as no Default exists, Tenant shall have the sole and exclusive right (as against Landlord and anyone claiming through Landlord), within the Exclusivity Zone, to operate a store whose business consists of (or includes as its primary component) the Exclusive Use. Nothing in the preceding sentence prohibits operation of any Exclusive Use(s) by anyone within the Exclusivity Zone if such Exclusive Use(s) either (a) are already permitted⁶⁹ under leases entered into before the Signature Date; (b) constitute one line (but not the single primary line) of goods or services among other lines sold, leased or licensed by a multi-department store, e.g., a supermarket, drugstore, department store or the like, whenever that store's lease was signed; or (c) constitute an incidental and minor line (but not the single primary line) of goods or services sold, leased or licensed by a store the primary business of which is not Tenant's Exclusive Use. For example, if Tenant's Exclusive Use consists of selling recorded music, then a coffee store selling music CD's as an incidental business would not violate Tenant's Exclusive Use.

42.2 *Operation of Exclusive Use(s)*. Tenant shall operate all Exclusive Uses throughout the Term, except when this Lease allows Tenant to close. Any Exclusive Use shall cease to be an Exclusive Use if Tenant ceases to operate it and: (a) Tenant does not recommence its operation within 15 days after Notice from Landlord or (b) Landlord has already given Tenant one Notice under clause "a" in the preceding 36 months. That use shall then, for the remaining Term and any Option Term(s), constitute a Permitted Use but never again an Exclusive Use.

⁶⁹ These grandfathered leases should probably be listed.

42.3 *Landlord's Covenant.* Landlord agrees that every future lease of retail space Landlord enters into in the Exclusivity Zone shall prohibit the tenant from using its demised premises for any Exclusive Use, if that tenant's operation of that use would violate this Lease, but only so long as: (a) no Default exists and (b) Tenant's exclusivity rights have not terminated.

42.4 *Remedies for Other Tenant's Breach.* If any retail tenant within the Exclusivity Zone, except Tenant, breaches its covenant not to use its demised premises for an Exclusive Use under this Lease, then at Tenant's request (as Tenant's sole and exclusive remedy) Landlord shall, provided no Default exists, at Landlord's election and at Tenant's expense (including Legal Costs), either: (a) exercise reasonable efforts to enforce that other tenant's lease, short of eviction; or (b) assign to Tenant, without recourse, or allow Tenant to exercise as a third-party beneficiary, Landlord's right (if any) to obtain injunctive relief compelling that other tenant to cease that use, but no other rights or remedies of Landlord against that other tenant. Landlord shall make the arrangements with Tenant described in clause "b" under documents satisfactory to Landlord.

42.5 *Unenforceability.* Any Exclusive Use(s) were granted at Tenant's request as part of negotiating this Lease. Notwithstanding anything to the contrary in this Lease, if it is determined that any Exclusive Use violates antitrust or any other Law, then: (a) that Exclusive Use shall be forever null and void and of no force or effect whatsoever; and (b) the remainder of this Lease shall continue in full force and effect without change. Landlord shall have no obligation to contest or defend any proceeding or other action that would or could have the effect described in this paragraph. Tenant shall Indemnify Landlord on any such proceeding or other action and its outcome.

42.6 *Interpretation.* Tenant's Exclusive Use, if any, shall be limited to its express terms, which shall be strictly construed. Nothing in this Lease (including the scope of Tenant's Permitted Use(s)) shall be deemed to give Tenant any Exclusive Use other than, in addition to or otherwise extending beyond the Exclusive Use and Exclusivity Zone, if any, that this Lease expressly contemplates.

43. *Odors and Exhaust*

Tenant acknowledges that Landlord would not enter into this Lease unless Tenant assured Landlord that under no circumstances will any other occupants of the Building be subjected to odors or fumes, whether

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or not noxious, and Landlord's Building will not be damaged by any exhaust, from Tenant's operations. Landlord and Tenant therefore agree as follows:⁷⁰

43.1 *Prohibition.* Tenant shall not cause or permit (or conduct any activities that would cause) any release of any odors or fumes of any kind from the Premises.

43.2 *Venting Requirements.* If the Building has a ventilation system that in Landlord's judgment is adequate, suitable and appropriate to vent the Premises, Tenant shall vent the Premises through that system. If Landlord at any time determines that no such ventilation system exists, Tenant shall in compliance with Law vent all fumes and odors from the Premises as Landlord requires. The placement and configuration of all ventilation exhaust pipes, louvers and other equipment shall be subject to Landlord's approval.

43.3 *Abatement.* Tenant shall, at Tenant's sole cost and expense, provide odor eliminators and other devices (e.g., filters, air cleaners, grease guards, scrubbers and whatever other equipment may in Landlord's judgment be necessary or appropriate from time to time) to completely remove, eliminate and abate any odors, fumes, grease, or other substances in Tenant's exhaust stream that, in Landlord's judgment, emanate from Tenant's Premises.

43.4 *Odor Problems in Term.* Tenant's responsibility to remove, eliminate and abate odors, fumes and exhaust shall continue throughout the Term. Landlord's approval of Tenant's Initial Work shall not preclude Landlord from requiring additional measures to eliminate odors, fumes and other adverse impacts of Tenant's exhaust stream, as Landlord may designate in Landlord's discretion. Tenant shall install additional equipment as Landlord requires from time to time under the preceding sentence.

43.5 *Failure to Install.* If Tenant fails to install satisfactory odor control equipment within 10 Business Days after Landlord's demand made at any time, then Landlord may, without limiting Landlord's other rights and remedies, require Tenant to cease and suspend any operations in the Premises that, in Landlord's determination, cause odors, fumes or exhaust. For example, if Landlord determines that Tenant's production of

⁷⁰ These provisions do not cover all the ground a Landlord would want to cover for a restaurant lease.

a certain type of food causes odors, fumes or exhaust and Tenant does not install satisfactory odor control equipment within 10 Business Days after Landlord's request, then Landlord may require Tenant to stop producing that type of food in the Premises unless and until Tenant has installed odor control equipment satisfactory to Landlord.

44. *Tenant's Initial Work and Opening*

44.1 *Pre-Opening Signage.* Promptly after the Signature Date, unless Landlord directs otherwise, Tenant shall give Landlord and Landlord shall install at Tenant's expense, or at Landlord's option Tenant shall install, in the windows of the Premises (or otherwise on the exterior of the Premises at locations satisfactory to Landlord), temporary professionally painted signage, in appearance and wording satisfactory to Landlord, including Tenant's and/or Landlord's name and logo, if Landlord requests, announcing the opening of Tenant's business. Installation of temporary signage shall not constitute Tenant's taking occupancy of the Premises or require payment of Base Rent. If temporary signage is damaged during Work, Tenant shall at Landlord's request promptly provide replacement signage.

44.2 *Obligation to Open.* The "Opening Deadline" means the date 90 days after the Commencement Date, unless the Basic Terms state some other Opening Deadline. By the Opening Deadline, Tenant shall complete Tenant's Initial Work, in compliance with this Lease; fully stock the Premises; and hire and assign to the Premises suitable staff for, and open the entire Premises to the public for, active and continuous operation of Tenant's business in accordance with this Lease.

44.3 *Liquidated Damages for Late Opening.* Tenant recognizes and acknowledges that if Tenant fails to open by the Opening Deadline in accordance with this Lease, then Landlord and Landlord's other tenants will suffer injury whose scope and nature cannot readily be ascertained or determined. In that case, beginning on the 15th day after the Opening Deadline, Tenant shall pay Landlord, as liquidated damages and not as a penalty, for each day (except the first 14 days) after the Opening Deadline on which Tenant has not yet opened for business as this Lease requires, an amount equal to 1/30 of Tenant's monthly Base Rent (determined as if any Abatement Period or "free rent" or other rent abatement under this Lease had expired and terminated). Tenant shall pay that amount in addition to any and all other sums, including Base Rent, that this Lease requires Tenant to pay. That payment shall not limit any other rights or remedies of Landlord.

45. *Retail Operations*

45.1 *Trade Name.* Tenant shall conduct business at the Premises only under Tenant's Trade Name. In conducting business at the Premises Tenant shall not use any trademark, service mark or other trade name except Tenant's Trade Name to identify or refer to Tenant's business. Tenant shall not change Tenant's Trade Name without Landlord's prior reasonable consent. Tenant's Trade Name shall not include the name of the Building or of Landlord or its Related Party, or otherwise suggest any connection or affiliation between Landlord and Tenant, without Landlord's consent.

45.2 *Façade.* Unless Landlord elects otherwise, Tenant shall perform and discharge, for the Façade, all obligations that this Lease requires Tenant to perform for the Premises, including maintenance, repairs and compliance with Work procedures. The "Façade" means signage (temporary and permanent) and non-structural customary tenant installations to the storefront (i.e. anodized aluminum, windows and other glass, mirrors, exterior finishes and window treatment, doors, door frames, rolldown doors, awnings, and similar storefront installations) for the Premises. If Landlord permits Tenant to install rolldown doors, then they shall be open-face (i.e., see-through rather than solid) and located inside Tenant's glass. Tenant shall install no exterior rolldown doors. The design and specifications of rolldown doors shall be subject to Landlord's prior written approval.

45.3 *Coordinated Façade.* Tenant shall comply with any requirements and limitations Landlord imposes (provided they do not unreasonably discriminate against Tenant and preserve reasonable visibility of Tenant's business) on coordination and design of Tenant's Façade and the overall Façade of the Building. Tenant shall install signage only on Landlord's designated signage panels. Tenant's Façade shall at all times comply with Landlord's signage and storefront program and criteria (the "Façade Requirements"). [Exhibit __ consists of the Façade Requirements at the Signature Date.] Landlord shall give Tenant further specifications, if any, for the Façade Requirements on Tenant's written request. Landlord may modify or add to the Façade Requirements from time to time with Notice to Tenant.

45.4 *Façade Construction.* Tenant's Façade, and any changes to Tenant's Façade, are subject to Landlord's prior approval, not to be unreasonably withheld provided Tenant's Façade at all times fully complies with the Façade Requirements. Any construction or alteration of Tenant's

Facade shall constitute Work, except that if Tenant proposes to perform Façade Work, then Landlord shall have the right to perform it at Tenant's reasonable expense with no Administrative Fee or any other fee beyond reimbursement of cost. If Tenant's Façade is wholly or partially damaged or destroyed, Tenant shall repair it within three Business Days after receipt of Notice from Landlord, in accordance with Tenant's repair and maintenance obligations, and its obligations in the event of casualty, under this Lease. Notwithstanding the previous sentence, Tenant shall have no obligation to repair items this Lease requires Landlord to repair or rebuild. If Landlord decides to improve or replace Tenant's Façade, Tenant shall cooperate with Landlord and make the Premises available to Landlord at reasonable times and not cause or permit any obstruction or delays to Landlord's Work. That Landlord Work shall be subject to the provisions on Landlord's Work under this Lease.

45.5 *Continuous Operation.* From and after the Opening Deadline (or, if earlier, substantial completion of Tenant's Initial Work), except in reasonable periods for remodeling and bona fide periodic taking of inventory, Tenant shall actively operate a retail business (constituting a Permitted Use) in the entire Premises and keep the entire Premises (except up to 10% of the Premises for office, storage and warehouse area) open to the public, fully stocked with inventory, including seasonal items as appropriate for the Permitted Use, for the active and continuous conduct of Tenant's retail business in Minimum Hours and for additional operating hours as Tenant deems appropriate. Tenant shall not use the Premises for storage or warehouse purposes, except as this Section allows and then only as reasonably necessary to operate Tenant's business at the Premises for Permitted Uses. Tenant shall keep Tenant's exterior signage fully lighted at least until 10 p.m. every night.

45.6 *Going Dark.* If Landlord determines that Tenant has not substantially complied with the preceding Section entitled Continuous Operation, then Landlord may so Notify Tenant (a "Dark Fee Warning Notice"). Any Dark Fee Warning Notice shall refer to this paragraph and the Dark Fee. Any Dark Fee Warning Notice shall lapse if, for 24 months, Landlord has assessed no Dark Fee. After Landlord has given Tenant any Dark Fee Warning Notice, so long as that Dark Fee Warning Notice has not lapsed, for each hour that Tenant is closed during Minimum Hours (a "Dark Period"), Tenant shall pay Landlord a fee equal to this percentage of Tenant's then-current monthly Base Rent (the "Dark Fee"): (a) no Dark Fee for the first five hours of Dark Period in any calendar year; (b) thereafter, one half of one percent until the total Dark Fees in any one calendar

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year equal one month's Base Rent; and (c) thereafter (and continuing until Landlord's Dark Fee Warning Notice has lapsed, superseding "a" and "b"), 1%. The Dark Fees are intended to compensate Landlord for the detriment that Landlord would suffer from any Dark Period, e.g., diminished desirability of the Building, reduction of pedestrian traffic, complaints from other tenants, reduced percentage rent from other tenants and interference with Landlord's goal to produce an attractive environment in and near the Building. The parties acknowledge that the detriment to Landlord cannot be readily quantified or measured. They have therefore agreed on the Dark Fee as a reasonable estimate of that detriment. Tenant confirms to Landlord that the Dark Fee is fully enforceable.

45.7 *Standards.* Tenant shall fixturate (including replacements and additions to Tenant's initial fixtures), maintain and operate (including maintenance of inventory levels, introduction of new products, staffing, promotional activities and all other business activities) Tenant's retail store in the Premises in an attractive and first class manner, consistent with the highest standards for retail stores in the City selling goods or services of the type Tenant sells, in accordance with a standard of operations at least equivalent to the higher of (a) Tenant's competitors; or (b) Tenant's other locations. Tenant shall operate the entire Premises as a single retail unit entirely under Tenant's direct management and control. Tenant shall promptly replace with equivalent new glass all broken glass in Tenant's trade fixtures. Tenant shall always maintain adequate staffing to actively and continuously operate Tenant's business in compliance with this Lease. Tenant shall keep its display windows fully stocked and well-lit in Minimum Hours. Landlord, in its reasonable judgment, shall determine Tenant's compliance with this paragraph.

45.8 *Windows.* The portion of Tenant's Facade extending from ground level to a level equal to the lowest point on the ceiling of the Premises shall be primarily transparent glass. Tenant shall not: (a) replace any windows with brick, aluminum, metal or any other construction material except transparent glass; or (b) otherwise materially obstruct the visibility of the interior of the Premises from the street. Tenant shall not be deemed in violation of clause "b" if Tenant posts in Tenant's window professionally printed or professionally painted signs consistent (in style, quality, number and size) with those, in Landlord's reasonable judgment, customarily used by first-class operators of businesses like Tenant's in Comparable Buildings. Tenant shall post no other signs in the windows of the Premises except as this Lease permits.

45.9 *Operating Standards.* Tenant shall not conduct business through window counters, chutes or other openings of any kind in any exterior wall or storefront of the Premises. Tenant shall conduct business in a way consistent with high quality operation of the Permitted Use(s) in Comparable Buildings. Tenant shall create no nuisance or disturbance in or near the Premises. Any Work (temporary or permanent) and lighting within Tenant's Premises visible from outside the Premises requires Landlord's approval. Tenant shall install no Vending Equipment. All doors in Tenant's Facade shall be open and unlocked, providing access to Tenant's store, in Minimum Hours, except bona fide service entrances, identified as such on Tenant's plans approved by Landlord, constructed substantially entirely of metal and not glass. Tenant shall not use padlocks, chains or other portable locking devices. Tenant shall conduct Tenant's business entirely within the Premises, except as the Basic Terms otherwise expressly allow. Tenant shall place no signs or other objects in any Common Areas or at any other location outside the Premises at, in on or near the Building without Landlord's consent, except as Law requires or this Lease expressly permits. Tenant shall not cause or permit Tenant Parties to gather, wait, or await assignments anywhere outside the Premises, including in Common Areas. Tenant shall not suffer or permit individuals having no apparent business in the Premises to loiter in the Premises. Tenant shall not install loudspeakers or other sound systems in, on or about the Premises, or operate any musical instruments, that (in the case of any of the foregoing) are audible outside the Premises. Tenant shall not use or permit use of any flashing, moving and/or rotating lights audible or visible outside the Premises.

49.10 *Franchise Requirements.* If Tenant operates the Premises under a license or franchise issued by any franchisor, Tenant shall comply with that license or franchise and not cause or permit it to be terminated or cancelled without Landlord's consent, not to be unreasonably withheld.⁷¹

45.11 *Additional Restrictions.* Tenant shall not install or operate, or allow to be installed or operated, any video game, pinball machine, pay telephone, vending machine (whether for sale of beverages, foods, candy, cigarettes, or other goods or products, or otherwise), Internet kiosk, can redemption machine, pay locker, pay toilet, kiddie ride, scales, amuse-

71 If Landlord regards Tenant's franchise arrangements as fundamentally important, Landlord may want other covenants and protections, similar to those a hospitality lender might obtain when financing a franchised hotel. In these cases, Landlord will often sign the Lease with the franchisor, who will then sublease to the franchisee and seek comfort that if one franchisee fails the franchisor can install another one.

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ment devices, automatic teller machine, or other coin-operated (or card-operated) equipment or machine of any kind in the Premises, or any other equipment or machine providing goods or services directly to Tenant's customers in exchange for payment of consideration in any other form, except machines dispensing gumballs and candy (all the foregoing, subject to that exception, collectively, "Vending Equipment").

45.12 *Ground Floor Maintenance.* If the Premises is located at ground level, then Tenant shall sweep and remove any snow, ice, clutter, refuse and litter from the sidewalk, driveway, parking area, yard, delivery doorway(s), and entrances serving the Premises, and keep them clean.

46. Miscellaneous

46.1 *Security Interest.* Tenant grants Landlord a security interest in all goods, inventory, equipment, trade fixtures and all other personal property of any kind or nature belonging to Tenant located in, on, or at the Premises in the Term, and all proceeds of the foregoing. That security interest shall secure Tenant's payment of all Rent, including damages upon an Event of Default, and all other indebtedness of Tenant to Landlord arising from or relating to this Lease or Landlord's exercise of rights and remedies under this Lease. This Lease constitutes a security agreement for that security interest. Landlord's security interest shall, however, survive any termination of this Lease and remain in full force and effect until Tenant has paid and performed all secured obligations. Tenant shall execute any further document(s) Landlord requests to effect, implement, evidence, or confirm Landlord's security interest. Tenant authorizes Landlord to file on Tenant's behalf any financing statement necessary or appropriate for that security interest.⁷² Landlord may exercise all rights and remedies available under the State's Uniform Commercial Code and other Law, but that does not limit Landlord's other rights and remedies. The lien granted under this paragraph shall be in addition to any Landlord's lien or distraint rights that Law may give Landlord at or after the Commencement Date.⁷³

46.2 *Nature of Lease.* If (a) the Building (with any adjacent or nearby buildings under ownership, operation or management by Landlord

72 If Landlord cares about its security interest, Landlord should file a financing statement; otherwise the security interest is generally unperfected. New York law does not give Landlord any automatic security interest.

73 Major tenants will typically require Landlord and its mortgagee(s) to waive or subordinate any such security interest to facilitate Tenant's asset-based financing.

and its Related Parties) contains or was designed to contain four or more retail occupancies; (b) this Lease requires Tenant to operate a retail business in the Premises; and (c) this Lease establishes Prohibited Use(s) that Law would otherwise allow, then this Lease is a lease of real property in a shopping center, within the meaning of 11 U.S.C. § 365(b)(3).⁷⁴

OPTIONAL PROVISIONS⁷⁵

47. *Adjustment of Size*

If the actual rentable square footage (as reasonably measured and calculated by Landlord in accordance with leasing practices in the City) varies by more than 2% from the square footage stated in this Lease, then the Base Rent, Tenant's Proportionate Share, any Security and any other obligations of the parties that in Landlord's reasonable judgment directly correlate to the rentable square footage of the Premises shall be adjusted in proportion to that variation, in a way reasonably satisfactory to Landlord.⁷⁶

48. *Inability to Deliver*

If Landlord reasonably determines that, because of circumstances beyond Landlord's reasonable control, Landlord cannot deliver the Premises before Delivery Deadline and may not be able to deliver the Premises within any reasonable period after Delivery Deadline, then Landlord shall so Notify Tenant and this Lease shall automatically terminate. If Landlord so terminates this Lease, Landlord shall within a reasonable time refund the Security to Tenant. At the same time, the parties shall enter into a termination of this Lease in mutually satisfactory form. That termination and refund shall be Tenant's sole remedy for Landlord's failure to deliver. Tenant shall have no other rights or remedies against Landlord on account of this Lease.⁷⁷

49. *Rent Increase/CPI Adjustment*

74 The statute does not define a shopping center. This paragraph seeks to establish a reasonable definition. Will a bankruptcy court accept it?

75 The following optional provisions may be used in **Exhibits B-1** through **B-3** as desired.

76 This paragraph would apply to a new Building rather than an existing one. Tenant might well push back with a request to have the right to remeasure downward. The entire discussion is usually counterproductive for both parties.

77 A Tenant will regard this provision as unreasonable.

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49.1 *Annual Percentage Increase.* On the first day of each Lease Year after the first Lease Year, Base Rent shall increase by an amount equal to ___% of the annual Base Rent that was in effect (after previous adjustments, if any) in the immediately preceding Lease Year.

49.2 *Annual CPI Increase.* On the first day of each Lease Year after the first Lease Year, annual Base Rent shall increase by an amount equal to (a) annual Base Rent (as previously adjusted under this sentence) in the previous Lease Year times (b) the CPI Increase for the previous Lease Year.

49.3 *CPI Increase Mechanism.* If a CPI Increase entitles Landlord to a change in Base Rent, then Landlord shall Notify Tenant. Tenant's equal monthly payments of Base Rent in the affected Lease shall reflect that change. If Landlord gives that Notice after a Lease Year begins, then Tenant shall remit to Landlord, without interest, an amount equal to the additional Base Rent would have been required to pay had Landlord Notified Tenant before that Lease Year.

49.4 *Porter's Wage Escalation.* Tenant shall pay Porter's Wage Escalation, in equal monthly installments in each Lease Year.

49.5 *Definitions.* These terms shall have these meanings:

“CPI” means the United States Department of Labor, Bureau of Labor Statistics “Consumer Price Index” for All Urban Consumers (CPI-U) published for New York - Northern New Jersey - Long Island, NY-NJ-CT,⁷⁸ with a base of 1982-1984 = 100. If that index is no longer published, or is modified from time to time, Landlord shall reasonably designate an appropriate successor or substitute index using, if available, such conversion factor, formula or table for conversion as published by the Bureau of Labor Statistics or by a nationally recognized publisher of similar statistical information.

“CPI Increase” means for any period a fraction: (a) whose numerator is the excess, if any, of the CPI last published before the last day of that period over the CPI last published before the first day of that period or, if no such excess exists, zero; and (b) whose denominator is the CPI last published before the first day of that period.

78 Some Landlords prefer to use a specific CPI index other than this one. Many options exist.

“Porter” means the classification of nonsupervisory employees employed in and about a Class A office building who devote a major portion of their time to general cleaning, maintenance, and miscellaneous services essentially of a nontechnical and nonmechanical nature and are the type of employees who have been historically included in the Classification of “Class A-Others” in the agreement between the Realty Advisory Board and the Union.

“Porter’s Wage” means the average hourly rate of wages, plus the allocable cost of all bonuses, fringe benefits, payroll and FICA taxes, unemployment, compensation taxes, disability benefit premiums, hospitalization, medical, surgical and general welfare benefits (including group life insurance), costs of any pension, retirement profit sharing or life insurance plan, uniform costs, and costs of other benefits or similar Operating Expenses relating to Porters in effect from time to time, whether or not actually paid by Landlord or any contractor employed by Landlord, computed as required to be paid over a standard working week to Porters in Class A office buildings under an agreement between Realty Advisory Board on Labor Relations, Incorporated, or any successor (the “Realty Advisory Board”), and Local 32B of the Building Service Employees International Union, AFL-CIO, or any successor (the “Union”), or under the wage agreement on Porters. If no such agreement prescribes a wage rate for Porters in the City, or if the “Porter” job classification is terminated, then Landlord shall reasonably calculate or estimate “Porter’s Wage” based on average hourly wage rate and allocated cost of all fringe benefits and all other costs actually payable to Porters over a 40 hour week at the time in Class A office buildings in the City. Landlord shall make all calculations and estimates of Porter’s Wage with Notice to Tenant.

“Porter’s Wage Escalation” means in each Lease Year after the first Lease Year the product of (a) _____⁷⁹ times (b) [100%] of the excess, if any, of (i) Porter’s Wage on the first day of that Lease Year over (ii) Porter’s Wage on the Signature Date.

50. *Substitute Premises*

50.1 *Before Commencement Date.* Landlord may, by Notice to Tenant before the Commencement Date, relocate the Premises to any other substantially similar space within the Building (the “Substitute Premises”). If Landlord exercises its rights under this paragraph, Landlord

⁷⁹ Fill in square footage of Premises.

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shall reimburse Tenant for Tenant's actual reasonable out-of-pocket costs for redesign or otherwise on account of the Substitute Premises. The Commencement Date and Opening Deadline shall be deferred to the extent reasonably appropriate and necessary.

50.2 *After Commencement Date.* Landlord may, upon six months' prior Notice at any time after the Commencement Date, deliver to Tenant Substitute Premises in place of the Premises, provided Landlord reasonably determines that: (a) the substitution is reasonably necessary to combine the Premises with adjacent vacant (or soon to be vacant) space to meet the needs of an actual or prospective tenant and (b) no other suitable vacant space exists in the Building. If Landlord designates Substitute Premises, then: (a) Landlord shall construct in the Substitute Premises, at Landlord's expense, tenant improvements substantially equivalent to those in the Premises on the date of Landlord's Notice; (b) Landlord shall pay all reasonable moving costs and other out-of-pocket costs Tenant reasonably incurs in relocating to the Substitute Premises or at Landlord's option Landlord shall arrange relocation at Landlord's expense; (c) Tenant shall be excused from any obligation to pay Rent under this Lease for ___ months beginning ___ days after Tenant moves into the Substitute Premises (provided Landlord has then in fact Substantially Completed Landlord's Initial Work in the Substitute Premises); and (d) the parties, acting reasonably, shall cooperate to minimize disruption to Tenant's business and to facilitate Tenant's relocation.

50.3 *Requirements for Substitute Premises.* Landlord may not designate any Substitute Premises unless it has at least as much sidewalk frontage (including as much avenue frontage) as the Premises (if the Premises is on the ground floor), has substantially the same size and visibility as the original Premises, is not on a lower floor than the original Premises and is configured in a way reasonably appropriate for Tenant's business.

50.4 *Effect of Substitution.* If Landlord designates Substitute Premises in place of the Premises, then after Tenant relocates to such Substitute Premises, every reference to the "Premises" shall refer instead to the Substitute Premises.

51. *Demolition*

51.1 *Landlord's Rights.* If Landlord intends, in Landlord's sole and absolute discretion, to demolish or to substantially reconstruct the Building, e.g., by stripping the Building down to its structural steel and then

rebuilding it or otherwise changing the overall Building in a manner that it temporarily cannot reasonably be occupied (any of those, “Demolition”) (or has entered into or intends to enter into a contract to sell the Building to a purchaser that intends to accomplish a Demolition),⁸⁰ then Landlord may so Notify Tenant (the “Demolition Notice”). In any Demolition Notice, Landlord shall certify that: (x) Demolition is expected to commence (or the sale to a purchaser that intends to commence Demolition is expected to close) within [one year] after the Demolition Notice; (y) Landlord does not intend to relet the Premises as it exists; and (z) Landlord has given, or is substantially simultaneously giving, similar Notices to all other tenants of the Building whose leases entitle Landlord to do so, except any tenants with whom Landlord has entered into other agreements for Demolition.⁸¹

51.2 *Effect of Demolition Notice.* Notwithstanding anything to the contrary in this Lease, if Landlord gives Tenant a Demolition Notice, then:

51.2.1 *End of Term.* The Term shall unconditionally terminate and expire, and the Expiration Date shall occur, on the date the Demolition Notice specifies, provided it is at least [six months] after the Demolition Notice.

51.2.2 *Tenant’s Obligations.* Until the Expiration Date, Tenant’s obligations under this Lease shall continue in full force and effect, but Tenant may obtain a partial refund of Rent after the Expiration Date by satisfying the conditions described below.

51.2.3 *Removal of Tenant Property.* Tenant may remove any or all of Tenant’s improvements and equipment, and may vacate the Premises, at any time before the Expiration Date.

51.2.4 *Duty to Vacate; Condition of Premises.* At the Expiration Date, Tenant shall vacate and surrender the Premises in its then-current condition, and deliver to Landlord an instrument (in form and substance reasonably satisfactory to Landlord) unconditionally surrendering and

80 Any such purchaser will often want Landlord to deliver the Building vacant at closing, or will at least pay more for vacant delivery. The purchaser will regard this as far superior to merely having a right to give a Demolition Notice after buying the Building. Thus, Landlord wants to be able to give Demolition Notices in preparation for a sale.

81 If Landlord might demolish only “part” of the Building or might want to leave some favored tenants in place as long as possible, delete clause “z.”

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terminating Tenant's estate under this Lease, with no obligation to restore the Premises or to repair any damage caused by Tenant's removal of Tenant's improvements and equipment, notwithstanding any restoration or repair obligations that would otherwise apply under this Lease.⁸² If Tenant fails to vacate and surrender the Premises by the Expiration Date, then in addition to any other rights and remedies available to Landlord under applicable law or this Lease, Landlord shall be entitled to recover all damages, direct and indirect, including consequential damages, as a result of Tenant's failure to vacate and surrender when required.

51.2.5 *Documents and Deliveries.* Tenant shall within ___ days after Landlord's request: (a) execute such documentation as Landlord requires to evidence, confirm and implement the absolute and unconditional termination and cancellation of this Lease effective at the Expiration Date, including at Landlord's option a stipulated judgment of eviction in form and substance reasonably satisfactory to Landlord;⁸³ and (b) deposit with Landlord additional Security equal to _____ times the then-current monthly Base Rent.

51.3 *Demolition Payment.* If and only if Landlord delivers a Demolition Notice and Tenant actually vacates and surrenders the Premises by the Expiration Date in the Demolition Notice, and otherwise performs all Tenant's obligations arising from that Demolition Notice, all in strict compliance with this Lease with time being of the essence, then at substantially the same time all Tenant Parties vacate the Premises and Tenant releases in writing any and all rights in or to the Premises and on account of this Lease: (a) the Expiration Date shall occur, even if earlier than the Expiration Date specified in the Demolition Notice;⁸⁴ and (b) Landlord shall, provided no Event of Default exists, refund to Tenant the entire remaining Security plus all Base Rent and Escalation Rent Tenant paid Landlord in the ___ months before the Expiration Date in the Demolition Notice.⁸⁵

82 If Tenant has Specialty Work such as vaults, Landlord may still want Tenant to remove them.

83 A stipulated judgment of eviction may be rather extreme. It does, however, represent a common element of any lease buyout transaction in New York, where the courts are extraordinarily friendly to tenants.

84 Consider deleting clause "a" although it does give Tenant a good incentive to move out early.

85 Landlords often agree to make a demolition payment (in the form of a Rent refund or waiver for a certain period—typically six months—at the end of the truncated Term), but many Landlords do not agree to do that.

52. *Utilities and Services.*⁸⁶

Tenant shall arrange and promptly pay when due for all Utilities, including distribution lines, necessary or appropriate for the Premises, except to the extent this Lease expressly states otherwise, including Landlord's Initial Work. Landlord grants Tenant a license, irrevocable in the Term so long as no Default exists, to use those Utility hookups and outlets within the Building as Landlord designates to serve the Premises, all in compliance with this Lease. Tenant shall pay for all Utilities consumed in or at the Premises. Tenant consents to any temporary interruption of any Utility service during installation of (sub)meters. The parties agree as follows regarding Utilities and certain other Building services.

52.1 *Restrooms.* Landlord shall at no separate charge provide hot and cold water to any existing restrooms serving the Premises, for normal lavatory purposes. Tenant shall (and Landlord shall have no obligation to) maintain and clean those restrooms.⁸⁷

52.2 *Water and Sewage; Building-Wide Charges.* If any Utility is metered or charged to the Building as a whole [(except water or sewage)], Tenant shall reimburse Landlord for the Operating Expenses Share of the cost of that Utility, or as Landlord otherwise reasonably allocates it. Landlord may require Tenant to make reimbursement in the form of estimated monthly payments before payment is otherwise due. [So long as Tenant's usage of water and sewage is consistent with ordinary usage for the Permitted Use(s), Landlord shall pay for water and sewage usage as Operating Expenses.] If Tenant's usage exceeds ordinary usage for the Permitted Use(s), Tenant shall reimburse Landlord for Landlord's reasonable estimate of the incremental cost of Tenant's excessive usage.

53. *Electricity Definitions*

These terms shall be defined as follows:

“Base Electric Rate” means the Electric Rate as of the Signature Date.

“Electric Rate” means the rates in effect under Power Company's service classification for the Building at the time particular energy is consumed, plus taxes, or any successor or replacement rate that applies from time to time to consumption of electricity in the Building, including all

⁸⁶ These provisions supplement and vary from those in the Basic Terms.

⁸⁷ For a partial floor, Landlord will assume this responsibility.

EXHIBIT B-3: SUPPLEMENTAL TERMS (RETAIL)

applicable surcharges, demand charges, rate adjustment charges, energy charges, fuel adjustment charges, volume charges, volume discounts, time of day charges and other sums payable to Power Company. The Electric Rate shall disregard any rebate(s) arising from installation of electrical equipment.

54. *Submetering*

54.1 *Electricity Additional Rent.*⁸⁸ Landlord shall furnish electricity to the Premises. Tenant shall pay Landlord an amount (the “Electricity Additional Rent”) equal to the Electric Rate times Tenant’s actual consumption in kilowatt hours and demand in kilowatts, respectively (and/or any other method of quantifying Tenant’s use of or demand under Power Company tariff) as registered on (sub)meter(s) (installed by Landlord at Landlord’s⁸⁹ sole cost and expense) to measure that demand, consumption or other method of quantifying Tenant’s use of or demand for electricity. The (sub)meter(s) shall measure demand and consumption, and off-peak and on-peak use, in either case to the extent they affect determination of Electricity Additional Rent.

54.2 *Totalization.*⁹⁰ Where more than one (sub)meter measures electricity supplied to the Premises, the electricity rendered through all those (sub)meters shall be measured, consolidated and totalized as if all service were rendered through a single meter.

55. *Electricity Rent Inclusion*

55.1 *Provision of Service.* Landlord shall furnish electric current to the Premises for Tenant’s lighting fixtures and equipment this Lease allows on a “rent inclusion” basis. There shall be no separate charge to Tenant for electric current by way of measuring it on any meter. In addition to any other Rent, Tenant shall pay Landlord an annual charge (in equal monthly installments) for electricity service equal to the Electricity Rent Inclusion Charge⁹¹ (as increased or decreased from time to time in

88 Either “Submetering” or “Electricity Rent Inclusion” (but not both) may replace the provisions on Tenant’s direct relationship with Power Company. In that case, some defined terms may not apply and this Lease should be modified appropriately.

89 Tenant may need to pay. This is negotiable.

90 This paragraph will reduce Tenant’s electricity costs. Landlord may prefer to omit.

91 Specify the “Electricity Rent Inclusion Charge” in the Basic Terms, typically around \$2.50 to \$3.00 per square foot for office space as of 2015. If the Lease does not indicate square footage, adjust the charge and Lease language accordingly.

accordance with this Lease) times the rentable square footage of the Premises. Although Additional Rent includes the charge for furnishing electrical energy on a so-called “rent inclusion” basis, it may not fully reflect the value to Tenant of that service. Landlord may from time to time cause a reputable and independent electrical engineer or electrical consulting firm (the “Independent Engineer”), to make a determination, after Tenant has commenced normal business activities in the Premises, of the Full Value of that service. The “Full Value” means the product of (a) the demand and consumption of electric energy at the Premises times (b) the Electric Rate. The Independent Engineer shall certify its determination in writing to Landlord and Tenant. If the then Full Value exceeds the then Electricity Rent Inclusion Charge, then the Electricity Rent Inclusion Charge (and corresponding Additional Rent) shall proportionately increase, and vice versa. If in the Term the Electric Rate increases or decreases as against the Base Electric Rate, the Electricity Rent Inclusion Charge shall be proportionately increased or decreased.⁹²

55.2 *Electricity Statements.* Landlord shall promptly give Tenant a written statement (an “Electricity Statement”) with Landlord’s determination of any increase or decrease that has occurred in the Full Value and the Electricity Rent Inclusion Charge. Any such increase or decrease in the Electricity Rent Inclusion Charge for the Premises shall be effective as of the date of the increase or decrease in the Electric Rate or the date of the survey and shall be retroactive if necessary.

55.3 *Tenant’s Right to Object.* Each Electricity Statement shall bind Tenant unless within ___ days after receiving it, Tenant notifies Landlord that it disputes the correctness of the Electricity Statement. If that dispute is based on Tenant’s demand and consumption of electric current, Tenant shall submit a survey and determination of that adjustment, made at its sole cost and expense, by a reputable independent electrical engineer or electrical consulting firm (“Tenant’s Engineer”), within 60 days after receipt of that Electricity Statement. If Landlord and Tenant cannot resolve their differences within ___ days after Landlord receives a copy of the determination of Tenant’s Engineer, then a third reputable independent electrical engineer or electrical consulting firm (the “Third Engineer”) shall decide the dispute. If the parties do not agree on the Third Engineer within ___ days after Landlord receives the determination of Tenant’s Engineer, then either party may apply to the AAA to designate the Third Engineer. The Third Engineer shall conduct such hearings as it

92 Landlords sometimes just charge for increases in electrical cost and ignore decreases, another nuisance profit center from Tenants’ perspective.

deems appropriate. Within ___ days after designation, the Third Engineer shall select the determination of either the Independent Engineer or Tenant's Engineer. That determination shall be conclusive and bind the parties. The parties shall pay equally the costs of that arbitration, except that (i) each party shall pay its own counsel fees and expenses; and (ii) the loser in the arbitration shall pay the Third Engineer's fees. Pending resolution of the dispute by agreement or arbitration, Tenant shall pay the increase in the Electricity Rent Inclusion Charge in accordance with the Electricity Statement. If Tenant wins the dispute, Landlord shall promptly refund any overpayments, without interest.

55.4 *No Waiver.* Landlord's failure in the Term to prepare and deliver any Electricity Statement, or bill, or Landlord's failure to make a demand, under this Article or any other provisions of this Lease, shall not waive, or cause Landlord to forfeit or surrender, its rights to collect any increase in the Electricity Rent Inclusion Charge that may become due in the Term. Tenant's liability for the amounts due from Tenant, and Landlord's obligation to make any refund, under this Article shall survive the expiration or sooner termination of this Lease.

56. *Discontinuance of Electricity*

If Landlord is required to discontinue furnishing electricity to Tenant on any basis under this Lease, then this Lease shall continue in full force and effect and shall be unaffected, except that from and after the effective date of that discontinuance, Landlord need not furnish electricity to Tenant and Tenant need not pay any Electricity Additional Rent or Electricity Rent Inclusion Charge. If Landlord so discontinues furnishing electricity to Tenant, Tenant shall use diligent efforts to obtain electric energy directly from Power Company. Tenant shall pay the costs of that service directly to Power Company. That electricity may be furnished to Tenant by means of the existing electrical and related facilities serving the Premises, at no charge, to the extent they are available, suitable and safe for that purpose as Landlord reasonably determines based on the advice of Landlord's engineers. Landlord shall install all necessary or appropriate meters, panel boards, feeders, risers, wiring and other conductors and equipment at Tenant's expense, plus an Administrative Fee.⁹³

57. *Removal of Signage*

93 This appears in every Lease. The author has never heard of any circumstance in which it has ever become relevant or even possibly relevant. If any reader is aware of any such circumstance, or the historical reason for this paragraph, please notify the author.

On Notice from Landlord, Tenant shall immediately remove any sign(s) that Tenant installed in violation of this Lease. If Tenant fails to do so within two Business Days after Landlord's Notice, then Landlord may remove any such sign(s), without further Notice, at Tenant's expense plus an Administrative Fee. If Landlord determines it is necessary to remove Tenant's sign(s) to paint, repair, alter or improve the Building, then Landlord may do so, on two Business Days' Notice, provided that Landlord: (a) reasonably promptly restores the removed sign(s), except any violating this Lease; (b) pays for removal and restoration; and (c) allows Tenant to install reasonable temporary signage as reasonably feasible under the circumstances. In an emergency no prior notice shall be required. Landlord shall provide prompt notice after the emergency.

58. *Mitigation of Damages*

If it is determined that Landlord must seek to mitigate damages from a Default, then none of these would constitute failure to mitigate: (a) failure to enter into a lease for only part of the Premises or with a replacement tenant that Landlord disapproves; (b) failure to enter into a Lease for a term substantially shorter or longer, or providing for a net effective rental rate (taking into account leasing commissions, tenant improvement costs and other costs) significantly lower than current market rent; (c) encouraging prospective tenants to lease other space that Landlord or any Related Party owns or controls, and not the Premises; or (d) taking or not taking any other action, if Landlord's course of action conforms to what a reasonable landlord would do to protect its interests in comparable circumstances.

59. *Discussions or Negotiations*

Notwithstanding anything to the contrary in this Lease, if Landlord gives Tenant a Default Notice, Tenant's cure period (if any) for that Default shall continue to run, and not be tolled or suspended, notwithstanding any discussions between Landlord and Tenant about possible resolution of the Default. Tenant shall rely on no such discussions as the basis to fail to cure or delay curing a Default. Those discussions constitute settlement discussions and shall be inadmissible as evidence. All cure periods shall continue to run during any such discussions, unless and until Landlord and Tenant, in their sole and absolute discretion, fully agree upon, execute and exchange legally binding documentation by which Landlord withdraws any Default Notice(s), tolls any cure period(s) or waives any Default(s). Email messages do not meet that standard, except to the extent that they attach scanned images of ink-signed documents.

60. Designation of Tenant's Agent

60.1 *Initial Designation.* Tenant irrevocably designates _____ as Tenant's agent ("Tenant's Agent") for service of process, including all notices required to institute any proceeding in any court or in any way required to confer personal jurisdiction over Tenant in any court, and for receipt of any Notices under this Lease, including personal demands for Rent. Service or demand on Tenant's Agent shall be good and sufficient service and demand on Tenant for all purposes, including obtaining personal jurisdiction for any legal action or proceeding, including a summary dispossession, unlawful detainer or eviction proceeding.⁹⁴

60.2 *Preservation and Replacement of Tenant's Agent.* Tenant shall maintain Tenant's Agent's designation in full force and effect throughout the Term. If Tenant's Agent cannot act as such for any reason, then Tenant shall forthwith irrevocably designate a replacement Tenant's Agent. By Notice to Landlord, up to once every six months, Tenant may substitute in place of Tenant's Agent a new Tenant's Agent, provided it is: (a) an attorney admitted to practice in the courts of the State and having full-time business offices in the City (or, in the alternative, admitted to practice and having full-time business offices in the state within the United States where Tenant maintains its single bona fide headquarters office); or (b) a corporate service company in the business of acting as agent for service.

60.3 *Notice to Tenant's Agent.* Delivery of any Notice to Tenant's Agent, or any service of process on Tenant's Agent, in accordance with the notice requirements of this Lease, constitutes valid and effective personal service on Tenant. Tenant's Agent's failure to give Tenant a copy of that service of process shall not impair or affect its validity or any judgment rendered in any Proceeding based thereon.

61. *More Provisions on Commercial Rent Control*⁹⁵

Tenant acknowledges that the Term of this Lease is satisfactory to Tenant, giving Tenant a reasonable opportunity to conduct Tenant's business for a period satisfactory to Tenant even if Landlord does not extend the Term. Tenant assumes the risk that Landlord will not extend the Term. Tenant does not desire any Government to give Tenant any extended Term

94 Landlord should also obtain from Agent its acceptance of such appointment.

95 These provisions supplement Basic Terms on Commercial Rent Control. They are relegated to Optional Provisions because any Government that enacts Commercial Rent Control will also probably be smart enough to invalidate provisions like these.

not expressly provided for in this Lease, and waives any such extended Term. If Commercial Rent Control is enacted but this paragraph is not fully enforceable, then any or all of these (as Landlord designates from time to time during Commercial Rent Control or at any later time before Landlord has received all payments this paragraph requires) shall apply, notwithstanding anything to the contrary in this Lease, including the Basic Terms: (a) Landlord may suspend all services to the Premises that this Lease otherwise requires Landlord to provide and shall have no obligation to perform any actions this Lease otherwise requires; (b) to the extent this Lease grants Tenant any options or exclusive uses, they shall be permanently and irrevocably terminated, canceled, and of no force or effect; (c) no Transfer may be made, and any provisions of this Lease (including any Basic Terms) permitting any Transfer shall be of no force or effect; and (d) Landlord may terminate this Lease, or require Tenant to assign this Lease to an assignee Landlord procures, upon Landlord's payment to Tenant of an amount equal to the actual cost of Tenant's Initial Work, less amortization on a five-year straight-line schedule. If this paragraph conflicts with any other terms and conditions of this Lease, then this paragraph governs.

62. *Miscellaneous*

62.1 *Failure to Allow Cure Period.* Wherever this Lease requires Landlord to deliver a Default Notice for any Default (an "Unmatured Default") to commence the cure period after which an Event of Default occurs (the "Cure Period"), if Landlord fails to give a required Default Notice or to permit a full Cure Period, then: (a) that failure shall not invalidate, nullify, or constitute a defense in any eviction or other proceedings against Tenant otherwise properly commenced for Tenant's Unmatured Default; (b) if, within the Cure Period, as measured from Landlord's commencement of proceedings (or the date of Landlord's Default Notice, if earlier), Tenant cures the Unmatured Default, then Landlord shall discontinue such proceedings; and (c) that discontinuance shall constitute a complete and adequate substitute for, and Tenant's sole remedy for Landlord's failure to have given, the Default Notice.

62.2 *Landlord's Unrecovered Leasing Investment.* If Landlord terminates this Lease because of an Event of Default, then, at Landlord's option, in addition to any other Landlord remedies (unless Tenant has fully paid all damages otherwise due Landlord), Tenant shall pay Landlord an amount equal to Landlord's Unrecovered Leasing Investment. These terms shall have these meanings:

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“Landlord’s Leasing Investment” means the sum of: (w) Landlord’s Contribution; (x) Landlord’s actual cost of Landlord’s Initial Work, except demising walls and any costs that Tenant separately reimbursed; (y) all Rent Tenant would pay under this Lease in any Abatement Period but for that Abatement Period (at the same monthly Rent as would apply in the first six months after the Abatement Period); plus (z) any brokerage commission(s) and Legal Costs Landlord actually paid (as allocated in writing by Landlord’s attorneys) to negotiate and enter into this Lease.

“Landlord’s Unrecovered Leasing Investment” means (a) the Lost Recovery Period Factor times (b) Landlord’s Leasing Investment.

“Lost Recovery Period Factor” means a fraction: (a) whose numerator is the number of days from the date of the Event of Default until the Expiration Date as originally defined in this Lease and (b) whose denominator is the number of days from the first day after the Abatement Period (or from the Commencement Date if this Lease provides for no Abatement Period) until the Expiration Date as originally defined in this Lease.

62.3 *Effect of Default.* [If any Event of Default exists] [In any Default Period], the parties’ rights and obligations shall be modified as follows, notwithstanding anything to the contrary in this Lease.

62.3.1 *Landlord’s Obligations Suspended.* Landlord may, without Notice, suspend performing any or all of Landlord’s obligations under this Lease, including providing Utilities, except as nonwaivable Law requires.⁹⁶

62.3.2 *Tenant’s Privileges Suspended.* Tenant may not Transfer this Lease, exercise any Option that may otherwise exist, require Landlord to enforce any exclusive uses that this Lease grants, otherwise limit the activities of Landlord or other tenants outside the Premises, deliver L/C Security in place of Security previously posted, require Landlord to execute or deliver any document, claim any abatement against Rent otherwise available, require Landlord to consent to, approve, or consider any matter, or require Landlord to be “reasonable” in granting or withholding any consent or approval.

62.4 *Notice of Oral Waiver.* Although this Lease may not be modified orally, and none of its terms may be waived orally, if either party nev-

⁹⁶ This paragraph may be excessive but does treat all of Landlord’s obligations as conditioned on Tenant’s performance, not an unreasonable proposition.

ertheless believes the other has made a binding oral waiver or amendment of this Lease (including one affecting this paragraph), then the former party shall give the other Notice of that binding oral waiver or amendment within one Business Day after it was allegedly made. That Notice shall set forth the provisions of this paragraph verbatim. Failure to give that Notice shall constitute an acknowledgment by that party that no binding oral waiver or amendment was made and shall permanently estop that party from asserting any such oral waiver or amendment. If that Notice is timely given, and the other party does not confirm the oral amendment or waiver in writing, then the oral amendment or waiver shall be deemed to have been revoked by agreement. Nothing in this paragraph is intended to allow oral amendments or waivers. Instead, this paragraph is intended to provide an additional mechanism to clarify and confirm that they cannot occur.

62.5 *Claims Against Landlord.* If Tenant is entitled to assert any claim against Landlord, then Tenant may do so only within ___ days after the claim first accrued. After that period expires, the claim shall be forever barred, whether as a direct claim or by way of counterclaim or setoff.

62.6 *Use Restrictions.* Landlord may, but need not, designate any other of Landlord's tenant(s) as third-party beneficiary(ies) or assignee(s) of any use restriction in this Lease. Any other tenant(s) so designated may (nonexclusively) enforce those use restriction against Tenant. Any such enforcement (or failure to enforce) and any related claims or disputes shall not affect the relationship, rights and obligations between Landlord and Tenant or give Tenant any Offset.

62.7 *Asbestos Compliance.* Landlord represents and warrants that Landlord has abated or encapsulated any asbestos and asbestos-containing materials in the Premises, in accordance with Law. To the extent Law requires any written confirmation to that effect, Landlord shall provide it.

62.8 *Tenant's Alarm System.* Tenant may install an alarm system at its expense. If in Landlord's reasonable judgment Tenant's alarm system produces an unreasonable number of false alarms, then Tenant shall modify Tenant's alarm system to correct the problem, in a way reasonably satisfactory to Landlord. Tenant shall maintain and operate Tenant's alarm system and maintain an alarm service contract with a reputable alarm service company. Landlord need not maintain Tenant's alarm system or respond to, or take any other action for, any alarms that Tenant's alarm system produces. Landlord shall have no liability for operation or failure of Tenant's alarm system. Subject to the Section of this Lease on Waiver

of Subrogation, Tenant shall Indemnify Landlord regarding Tenant's alarm system.

62.9 *REIT Compliance.* The parties intend that all Rent payable to Landlord qualify as "rents from real property" under Internal Revenue Code § 856(d) and all related statutes, regulations, revenue rulings, interpretations and other official pronouncements, all as in effect from time to time. If the Rent ever no longer so qualifies, then Landlord may reasonably adjust the Rent to achieve that qualification. Any such adjustments shall produce the substantial economic equivalent to the previous Rent, as Landlord reasonably determines. The parties shall execute such documents as Landlord reasonably requires to make those adjustments.⁹⁷

62.10 *Financial Information.* Within 30 days after Landlord's request (which request Landlord may make no more than once for each fiscal year of Tenant), Tenant shall give Landlord Tenant's and each Guarantor's financial statements, in form and scope reasonably satisfactory to Landlord, for the most recent fiscal year (or the preceding fiscal year, if the most recent fiscal year ended only in the last 90 days before Landlord's request). Only if those financial statements are audited for any other purpose, then the financial statements Tenant gives Landlord shall be audited. Tenant shall promptly Notify Landlord of any material event or occurrence that relates to Tenant's or any Guarantor's creditworthiness.

62.11 *Termination of Lease.* If this Lease terminates for any reason, Tenant shall, if Landlord requests, execute and deliver to Landlord an instrument in form and substance reasonably satisfactory to Landlord confirming that termination and releasing and surrendering Tenant's entire right, title and interest in and to the Premises, under this Lease or otherwise.

62.12 *Attorney in Fact.*⁹⁸ To the extent this Lease requires Tenant to execute any document but Tenant fails to do so within 10 Business Days after Landlord's request, Tenant irrevocably appoints Landlord as Tenant's attorney-in-fact to execute and deliver any such document for and on behalf of Tenant. That appointment is irrevocable and coupled with an interest. Landlord's exercise of that power shall not limit Tenant's obligations. Tenant's failure to execute and delivery any such document shall still constitute a Default.

⁹⁷ A REIT Landlord may have additional requirements.

62.13 *Refunds and Payments.* Notwithstanding anything to the contrary in this Lease, whenever this Lease requires Landlord to pay or refund Tenant any sum (except Landlord's Contribution, if any, or Security), Landlord may elect, by Notice, not to make that refund or payment and instead to allow Tenant to credit against Rent until Tenant has thereby recovered an amount equal to that refund or payment. If the Term ends before Tenant has fully recovered that refund or payment, then, unless the Term ended because of a Default, Landlord shall promptly pay Tenant the remaining balance due.

98 Tenant will often regard as excessive or want to limit to any Default Period.

CHAPTER FIVE

**MODEL COMMERCIAL
LEASE RIDER
(TO SUPPLEMENT STANDARD
REBNY® OFFICE LEASE)**

Abraham B. Krieger, Esq.

This Rider is incorporated into and made a part of the Lease dated _____, 2____ between _____, as landlord, having an address at _____, (“Landlord”), and _____, as tenant,¹ having an address at _____ (“Tenant”); both parties collectively referred to as the “Parties,” of the premises known as Suite _____ as shown on annexed Exhibit “A”² (for general and descriptive purposes only) at _____, New York; both this Rider and printed form of Lease and any subsequent amendments and/or modifications signed by the Parties are together referred to as the “Lease.” If there are any conflicts or inconsistencies between the provisions of this Rider, the annexed printed form of Lease and any other rider or document annexed, the provisions of this Rider shall govern and control.

The paragraph headings contained in the Lease and Rider are for accommodation and reference purposes only and do not prescribe the rights and obligations of the Parties and the provisions may contain terms not necessarily described in the headings themselves.

[5.0] I. RENT

(a) All financial obligations due under this Lease are deemed “Rent” and payable as independent covenants. Fixed monthly rent is due and payable in equal monthly installments on the first day of each calendar month.³ The first installment of fixed monthly Rent is payable upon the signing of this Lease.⁴

(b) Tenant’s obligation to pay Rent under this Lease is not conditioned upon the rendering of a monthly or other statement or notice by Landlord for payment of any and all sums due under this Lease; it being expressly agreed that any such statement or notice is furnished as an accommodation only, not as a condition precedent to Tenant’s obligations, and does not fix, prescribe or limit Tenant’s financial obligations under this Lease.

(c) Tenant shall pay to Landlord as fixed monthly Rent during the Term (as hereinafter defined) annual Rent of \$_____ payable \$_____ monthly

1 If there are multiple tenants, incorporate “joint and several liability” language, signature lines for each, and conform guaranty, if applicable.

2 Include a ‘line drawing’ to avoid any confusion or dispute involving the space dimensions. Suite number alone is insufficient.

3 Consider grace and cure periods.

4 Or as otherwise prescribed.

subject to ____% annually compounded escalations and other charges set forth in this Lease.⁵

[ALTERNATIVE]

\$ ____ per annum from
(\$ ____ monthly);

\$ ____ per annum from
(\$ ____ monthly);

\$ ____ per annum from
(\$ ____ monthly);

\$ ____ per annum from
(\$ ____ monthly); and

\$ ____ per annum from
(\$ ____ monthly).

[ALTERNATIVE]

Lease Period	Annual Rent	Monthly Rent

(d) Rent, not including utility charges, shall be conditionally abated as follows: **[if applicable]**

If Tenant defaults under this Lease beyond any grace, notice or cure periods, all Rent otherwise abated under this Lease shall be recaptured and become immediately due and payable as Rent.

⁵ Consider with the client other formulae of increases such as CPI, Porter’s Wage and operating expenses.

(e) Rent is payable in advance in equal monthly installments on the first day of each calendar month. If the Term does not commence on the first day of a month, Rent and other charges, if charged separately (not by meter), shall be apportioned for the month in which the Term commences.

(f) Tenant covenants to pay, as provided in this Lease, as additional Rent: all amounts and obligations which Tenant assumes or agrees to pay under this Lease; interest at the rate of [15%]⁶ per annum on any item of fixed or additional Rent not paid within [30] days of when otherwise due, subject to any applicable grace period, and a late payment and administrative charge of [5%] of the amount of any item of Rent not paid within [5] days of when due or, if a demand is required by the provisions of this Lease, within [5] days after the date of such demand. If any check is rejected for payment by Tenant's bank, in addition to, and not exclusive of, Landlord's other remedies, Tenant shall pay an administrative charge of [\$150.00] for such returned check, which amount may be adjusted from time to time by Landlord. In the event of any default by Tenant to pay Rent beyond any cure period Landlord reserves all the rights, powers and remedies provided for in this Lease, at law, in equity or otherwise. Nothing shall be construed to extend the due dates of Tenant's payments under this Lease, or waive any rights or remedies of Landlord if Tenant defaults except as expressly provided in this Lease or otherwise agreed by the parties in writing. Tenant's obligations to pay Rent shall survive the expiration of the Term or earlier termination of this Lease. Tenant waives any right to designate the items against which any payments under this Lease are made for which payments may be applied by Landlord in its sole judgment.

(g) No remedy conferred on or reserved to Landlord under this Lease is exclusive of any other remedy or remedies and may be asserted independently, singly or cumulatively at Landlord's election. No delay by Landlord in asserting any remedy under this Lease is deemed a waiver thereof, equitable or otherwise.⁷

(h) All Rent shall be paid subject to collection, by good funds at the office of Landlord as set forth above, or at such place and to such party as Landlord designates in writing.

6 Portions of the Lease containing "[]" references are suggestions only, subject to negotiation and agreement.

7 If a form of guaranty, limited or otherwise, is used in conjunction with the lease, confirm that lease and guaranty language and terms strictly conform since both documents are generally strictly construed by the courts and an inconsistency in language can affect enforceability.

(i) All Rent shall be paid to Landlord without notice, demand, counterclaim, setoff, deduction or defense; which, may be asserted by Tenant only by way of a separate action, except as may be required by law or deemed waived if not asserted, otherwise nothing shall suspend, defer, diminish, abate or reduce any Rent except as specifically provided in this Lease or prescribed by statute.

(j) If Tenant defaults in the payment of Rent or any checks offered for payment are not honored by the bank against which it is drawn twice in any twelve (12) month period, Landlord, without waiving any rights or remedies under this Lease and not by way of limitation, reserves the right to demand that all checks tendered by Tenant for the following twelve (12) months shall be by bank or certified checks. Tenant shall further be required to post an additional one month's security. If Tenant defaults in the payment of fixed or additional Rent beyond any grace or cure period three times in any twelve (12) month period, such defaults shall be deemed "chronic," and a breach of a substantial obligation of this Lease. Landlord may serve a written three (3) days' notice of cancellation of this Lease upon Tenant and, upon the expiration of said three (3) days, this Lease and the Term shall end and expire as fully and completely as if the expiration of such three (3) day period were the day herein definitely fixed for the end and expiration of this Lease and the Term and Tenant shall quit and surrender the Premises to Landlord, but Tenant shall remain liable as elsewhere provided in this Lease.

(k) In the event of the termination of this Lease or Landlord's re-entry into the Premises by or under any summary dispossession or other proceeding or action, or any provision of law, by reason of Tenant's default hereunder, Tenant shall pay to Landlord as additional damages, a sum which at the time of such termination of this Lease or at the time of any such re-entry by Landlord, as the case may be, represents the aggregate of the Rent and the additional Rent payable hereunder (subject to a present value discount as prescribed) which would have been payable by Tenant had this Lease not terminated or had Landlord not re-entered the Premises.

(l) The obligations and liabilities of Tenant in no way shall be released, discharged or otherwise affected (except as expressly provided herein), so long as the condition of the Premises reasonably allows Tenant to operate its business as prescribed in this Lease. Subject to Tenant's ability to so operate its business, Tenant's obligations under this Lease shall continue notwithstanding interruption of service beyond Landlord's reasonable control, any taking by condemnation or eminent domain of the Premises or any part; any title defect or encumbrance; any bankruptcy, insolvency,

reorganization, composition, adjustment, dissolution, receivership, liquidation or other similar proceeding relating to Landlord, or any action taken with respect to this Lease by any trustee or receiver of Landlord, or by any court, in any such proceeding; any claim which Tenant has or might have against Landlord unless said claim is resolved by a court of competent jurisdiction. Except as expressly provided herein or by statute, Tenant waives all rights now or hereafter conferred by statute or otherwise to quit, terminate or surrender this Lease or the demised premises or any part thereof, or to receive any abatement, suspension, deferment, diminution or reduction of any Rent payable by Tenant hereunder.

(m) If any payment under this Lease, regardless of the number of times, is made by a party other than the named Tenant, acceptance or deposit of said payment by Landlord shall not under any circumstances be deemed a recognition of any other permissible use, occupancy or tenancy, sub-tenancy or assignment. The listing by Landlord or Tenant of any party in the Building or floor directory other than that designated as Tenant in this Lease shall not be construed as any form of consent or acknowledgment by the Landlord to the party's occupancy or use of the Premises.

(n) Landlord reserves the exclusive right to apply any payment of Rent or other sums paid by Tenant for any part of the Rent or additional Rent then due or owing, irrespective of any restrictive endorsement placed on the check or correspondence accompanying the check(s) or any reference to such tender being an accord and satisfaction irrespective of whether an action of proceeding is pending, Landlord may further accept such check or payment without prejudice to Landlord's rights to recover the full balance due under this Lease and pursue any and all other remedies provided in this Lease and under law and without prejudice to any notice of default, termination or summary proceeding or action involving this Lease except to the extent of applying any such amount to sums due under this Lease.

(o) If Tenant holds over beyond the expiration or termination of this Lease, with no written agreement signed by Landlord permitting same and notwithstanding any discussions or negotiations involving possible extension of the tenancy or otherwise, Tenant shall, and conclusively agrees to, pay as monthly use and occupancy for the holdover period an amount equal to two (2) times the Rent and additional Rent otherwise due during the last month of the Term, plus all other charges due under this Lease. This provision shall in no manner be construed as an implicit or explicit consent by Landlord to extend the Term but shall only serve as a basis for establishing the amount for use and occupancy due from Tenant during such holdover. The Parties further acknowledge that this provision

is intended to serve as an additional incentive, and not a penalty, to Tenant's obligation to timely vacate the Premises and reimburse Landlord for a portion of damages suffered. It is based on, among other things, the economic and other considerations of Landlord including and not limited to costs and inconvenience arising from Tenant's failure to surrender the Premises as agreed and the interference said delay and failure on Tenant's part will cause in the Landlord's re-letting of the Premises. The Parties further agree that this provision is not intended to serve as a liquidated damages clause or penalty but merely establish the reasonable, agreed-to Rent and other charges otherwise agreed as due for the holdover period. Accordingly, Landlord shall be entitled to all additional remedies provided for in this Lease including reimbursement for all costs and expenses, including and not limited to, reasonable legal fees and expenses arising from the default(s) and incurred regaining possession of the Premises.

(p) If Tenant vacates the Premises either prior to or upon the expiration of this Lease, any personal property remaining in the Premises shall be deemed abandoned and Landlord may elect to remove and dispose of same at Tenant's expense or retain such personal property. Any such costs and expenses shall be deemed Rent due prior to surrender or vacating the Premises. Unless Landlord is notified to the contrary in writing with proof, any such personalty and equipment shall be deemed owned and not leased or financed by Tenant and Tenant shall indemnify Landlord against any claim by any lessor, owner or third party claiming an interest in such personalty or equipment including reasonable counsel fees. Tenant further waives any claim or defense against Landlord under this provision.

(q) If during any time during the Term, Tenant removes or has removed substantially all of the installation(s) in the Premises belonging to Tenant and Tenant has defaulted in the payment of Rent, beyond any grace or cure period, for a period exceeding one (1) calendar month, same shall conclusively be deemed a *de facto* surrender of the Premises by Tenant without requiring Landlord to bring any summary proceeding or action to terminate this Lease.

(r) If Tenant remains in possession of the Premises after the expiration of this Lease, Tenant shall indemnify Landlord against liability and consequential damages arising from such delay involving the loss of Rent and business opportunity from a succeeding or prospective tenant.

(s) If Tenant defaults in performing any covenant or condition of this Lease beyond any grace or cure period, Landlord may, in its sole judg-

ment, and not by limitation or election of any of its remedies, cure said default at Tenant's expense and Tenant shall reimburse Landlord for such expense and all other charges for which Tenant is responsible under this Lease.

(t) Tenant shall surrender the Premises to Landlord at the expiration or sooner termination of this Lease in the same condition as of the Commencement Date (as hereinafter defined) in good order, vacant, free of any interests in the Premises including without limitation tenants, subtenants, licenses or occupants, and broom clean, ordinary wear and tear excepted and excepting work originally performed by Landlord for Tenant's initial occupancy of the Premises. Any installations performed by Landlord whether at Tenant's expense or otherwise, shall be deemed owned by Landlord and not removed from the Premises. Landlord's consent to any alteration performed by Tenant shall not waive or excuse Tenant's obligation to remove such alteration and restore the Premises at the end of the Term termination of this Lease, if Landlord so requires.

(u) As additional security for Tenant's obligations under this Lease, Tenant hereby grants to Landlord a first security interest in all Tenant's equipment, and non-fixture installations owned, and not leased or financed, by Tenant. In furtherance, Tenant also authorizes Landlord to execute and file any UCC-1 Financing Statements confirming the security interests granted herein by Tenant and all filing and administrative fees advanced by Landlord are deemed additional Rent. If Tenant defaults under this Lease beyond any grace or cure period, Tenant authorizes Landlord, at Landlord's election, as an additional remedy, to immediately assert and exercise said security interest towards satisfaction of Tenant's financial obligations under this Lease.

(v) Tenant's loss of authorization to do business shall be deemed a default under this Lease.

(w) If, pursuant to Landlord's instructions, Tenant pays Rent into a "lockbox" (or the like), any deposit of Rent by the lockbox administrator on Landlord's behalf does not waive Landlord's rights under this Lease.

[5.1] II. TERM

The term (the "Term") of this Lease shall be (____) years commencing on _____, 2____ (the "Commencement Date") expiring _____, 2____ (the "Expiration Date"). If the Term does not begin on the first of the month, the number of days within the first month of this

Lease shall be added to the full term set forth and adjusted Rent shall be paid for the portion of the first month of the Lease.⁸

[5.2] A. Real Estate Tax Escalations

(a) Tenant shall pay, during the Term, prescribed amounts as Rent provided for in this Article. As used herein, the following terms shall have the meanings set forth below:

(i) “Real Estate Taxes” shall mean all real estate taxes, school taxes, assessments, water charges and sewer Rents, business improvement district (BID) charges and assessments, Rents and other taxes and charges of every nature and kind whatsoever, whether general or special, ordinary or extraordinary, foreseen or unforeseen, of every character, which at any time may be assessed, levied, charged, confirmed or imposed on or in respect of or be a lien upon the Building including and not limited to those arising from an increase in rate or assessment. “Real Estate Taxes” shall exclude taxes attributable to an increase in the Building’s square footage, income, franchise, inheritance or similar taxes; provided, however, that if the method of taxation or assessment shall be changed so that the whole or any part of the Real Estate Taxes theretofore payable with respect to the Building instead shall be levied, charged, assessed or imposed in whole or in part on the income or Rents received by Landlord from the Building or shall otherwise be imposed against Landlord in the form of a franchise tax or otherwise, then the same shall be deemed Real Estate Taxes for purposes of this Article.

(ii) “Base Year” shall mean calendar _____ and fiscal _____ relative to all real estate and related taxes to which the Building is subject.⁹

8 If the Commencement Date is not a date certain at the time of Lease execution, consider a provision whereby the Landlord provides written notice to Tenant setting forth the commencement, expiration and other critical dates, and whether such notice must be acknowledged by Tenant to avoid later dispute.

9 Include “calendar” and “fiscal” tax years based on Commencement Date.

(iii) “Escalation Year” shall mean the calendar and fiscal years following the Base Year.

(iv) The “Building” shall mean the land and the building of which the Premises forms a part, known as _____, New York.

(v) “Tenant’s Share” shall mean _____%.

(b) Tenant shall pay to Landlord, as additional Rent, a base amount of \$ _____, payable _____ monthly, for present Base Year taxes, plus an amount equal to Tenant’s Share of the amount by which the Real Estate Taxes payable during all Escalation Years shall exceed the Real Estate Taxes paid during the Base Year, irrespective of whether such excess is due to higher tax rates, increases in assessed valuation or other cause. Such additional Rent may be billed by Landlord at or about the dates on which installments of Real Estate Taxes are due and payable by Landlord, or at any time thereafter during the term of the Lease, and such additional Rent shall be payable by Tenant to Landlord within ten (10) days after being billed therefor. Copies of tax bill shall be sufficient evidence of the amount of Real Estate Taxes for purposes of computing the amount payable by Tenant.

(c) The Real Estate Taxes actually payable by Landlord shall be used in computing the additional Rent hereunder. If the amount of Real Estate Taxes for the Base Year is reduced by final determination of legal proceedings, settlement or otherwise, the additional Rent theretofore paid or payable hereunder shall be recomputed on the basis of such reduced amount, and Tenant shall pay to Landlord as additional Rent, within thirty (30) days after being billed therefor, any deficiency between the additional Rent theretofore paid and the amount due as the result of such recomputation. If Landlord receives a refund of any Real Estate Taxes paid during any Escalation Year on which additional Rent shall have been based, as a result of a reduction of Real Estate Taxes by final determination of legal proceedings, settlement or otherwise, the additional Rent shall be recomputed based on the net refund, after deducting Landlord’s expenses, and Tenant shall receive, at Landlord’s option, a credit for or refund of any overpayment of additional Rent.

(d) Landlord shall not be obligated to contest the levy or assessment of any Real Estate Taxes, and it shall be at Landlord’s sole discretion whether any such contest shall be undertaken. Landlord hereby reserves the exclusive right to take and prosecute all such proceedings, including

any such proceedings for the Base Year, and if so taken, Landlord may proceed without notice to Tenant and may prosecute the proceeding, including settlement and discontinuance, in such manner as Landlord may determine in its sole discretion.

(e) In no event shall the first year's annual fixed Rent under this Lease be reduced by virtue of this Article.

(f) The additional Rent provided herein shall be apportioned as of the expiration of the Term or earlier termination of this Lease. The obligations of Tenant to pay additional Rent as provided for herein shall survive the expiration of Term or earlier termination of this Lease. If Tenant continues in possession of the Premises after the expiration of the Lease term or earlier termination of this Lease, as a month-to-month or periodic Tenant or otherwise, the provisions of this Article shall continue in full force and effect.

(g) The additional Rent provided for herein shall be collectible by Landlord in the same manner as the regular installments of fixed Rent due under this Lease. No delay or failure by Landlord in preparing or delivering any statement or demand for any additional Rent shall constitute a waiver of, or impair Landlord's rights to collect, such additional Rent.

(h) Landlord reserves the right to collect Real Estate Taxes payable by Tenant in monthly installments based upon estimated annual taxes divided by twelve (12), adjusting the exact amount due on an annual basis.

(i) Tenant shall cooperate, as necessary, at its expense, in Landlord's efforts to qualify for any tax or governmental benefits.

[5.3] B. CPI Escalations

(a) "Base Year" as used herein shall mean the twelve (12) month period ending _____.

(b) "Consumer Price Index" shall mean the Consumer Price Index published by the Bureau of Labor Statistics of the U.S. Department of Labor, All Items, New York, New York—Northeastern, N.J., for urban wage earners and clerical workers, or any successor or substitute index appropriately adjusted.

(c) "Consumer Price Index for the Base Year" shall mean the average of the Consumer Price Index for each of the twelve (12) months of the Base Year.

(d) Effective as to each anniversary from the Commencement Date, a cost of living adjustment shall be made to the annual fixed Rent payable hereunder. The adjustment shall be based on the percentage difference between the Consumer Price Index for the month preceding the anniversary date (the "Preceding Month") and the Consumer Price Index for the Base Year.

(e) If the Consumer Price Index for any Preceding Month within the Term reflects an increase over the Consumer Price Index for the Base Year, then the annual fixed Rent to be paid commencing on each anniversary date of this Lease (unchanged by any adjustments under this Article 3) shall be increased by the percentage difference between the Consumer Price Index for such Preceding Month and the Consumer Price Index for the Base Year. Said adjusted annual fixed Rent thereafter shall be payable hereunder, in equal monthly installments, until it is readjusted pursuant to this Article 3.

(f) The statements of Rent adjustments to be furnished by Landlord pursuant to this Article 3 shall be based upon data prepared for Landlord by a certified public accountant, who may be the accountant now or hereafter employed by Landlord for the audit of its accounts. The statements thus furnished shall constitute a final determination as between Landlord and Tenant of the Rent adjustments for the periods represented thereby.

(g) If the Consumer Price Index ceases to use 1967=100 as the basis of calculation, or if a substantial change is made in the terms or number of items contained in the Consumer Price Index, then the Consumer Price Index shall be adjusted to the figure that would have been arrived at if the manner of computation had not been changed. If the Consumer Price Index (or successor or substitute index) is not available, a reliable governmental or other nonpartisan publication evaluating the information theretofore used in determining the Consumer Price Index shall be used at Landlord's discretion.

(h) In no event shall the fixed Rent under this Lease be reduced by virtue of this Article 3. The computations under this Article 3 are intended to constitute a formula for an agreed rental escalation and do not necessarily constitute an actual reimbursement to Landlord for costs or expenses paid by Landlord.

(i) The obligations of Tenant to pay the additional Rent provided for in this Article 3 shall survive the expiration of the Term or earlier termination of this Lease. The additional Rent provided for herein shall be appor-

tioned as of the Expiration Date or earlier termination of this Lease. The additional Rent provided for herein shall be collectible by Landlord in the same manner as the regular installments of fixed Rent due under this Lease. No delay or failure by Landlord in preparing or delivering any statement or demand for any additional Rent shall constitute a waiver of, or impair Landlord's rights to collect such additional Rent.

(j) Increases under this paragraph shall not exceed _____% annually.

[5.4] C. Operating Expense Escalations

(a) Tenant shall pay, during the term of this lease, the additional Rent provided for in this Article 3b. As used herein, the following terms shall have the meanings set forth below:

(i) "Operating Expenses" shall mean all costs and expenses paid or incurred by or on behalf of Landlord with respect to the operation, cleaning, maintenance, repair, safety, security or management of the Building, the equipment of Landlord therein, the sidewalks or other areas adjacent thereto, or the services provided to tenants thereof, including without limitation: (i) salaries, wages and bonuses paid to, and the cost of any hospitalization, medical, surgical, union and general welfare benefits, pension, retirement or life insurance plans, and other benefits or similar expenses relating to employees of Landlord engaged in the operation, cleaning, maintenance, repair, safety, security or management of the Building, or said equipment or areas, or in providing said services to tenants; (ii) social security, unemployment and other payroll taxes, and the cost of disability and worker's compensation coverage required by any applicable law, rule, regulation or union contract, or otherwise paid with respect to said employees; (iii) the cost of electricity, gas, steam, water, air conditioning and other fuel and utilities; (iv) the cost of casualty, rent, liability, fidelity, plate glass and any other insurance; (v) the cost of repairs, maintenance and painting; (vi) the cost or rental of all building and cleaning supplies, tools, materials and equipment; (vii) the cost of uniforms, work clothes and dry cleaning; (viii) window cleaning, concierge, guard, watchman or other security personnel, services and systems, if any; (ix) management fees, or if no managing agent is

employed by Landlord, a sum in lieu thereof which is the prevailing rate for management fees payable in _____, New York; (x) charges of independent contractors performing any of the aforesaid work for Landlord; (xi) legal, accounting and other professional fees and disbursements incurred in connection with the operation or management of the Building; (xii) association fees and dues; (xiii) decorations and exterior and interior landscaping; (xiv) depreciation of hand tools and other movable equipment used in connection with the operation, cleaning, maintenance, repair, safety, security and management of the Building; (xv) Real Estate Taxes, as hereinafter defined; and (xvi) such other items or cost or expenses as are normally included in operating expenses of similar buildings. Where work is performed by a contractor, the amount charged Landlord for such work shall constitute the cost of such work for purposes hereof, but if the contractor is related to, or is associated or affiliated with Landlord, then such cost shall not exceed what an independent contractor reasonably would charge for similar services. Operating Expenses, however, shall exclude: (a) executives' salaries above the grade of Building manager; (b) expenditures for capital improvements, other than those which under generally applied real estate practices are expensed or regarded as deferred expenses, except as hereinafter provided; (c) amounts received by Landlord through proceeds of insurance to the extent they are compensation for sums previously included in Operating Expenses; (d) cost of repairs or replacements incurred by reason of fire or other casualty or condemnation to the extent Landlord is compensated therefor; (e) advertising and promotional expenditures; (f) costs of painting and decorating any tenant's space, and costs incurred in performing work or furnishing services to any Building tenant to the extent that such work or service is in excess of any work or service that Landlord is obligated to furnish at Landlord's expense; (g) depreciation, except as provided above; (h) brokerage commissions and rental fees; (i) the cost of electricity (other than for air conditioning) furnished to the Premises or any other space leased to tenants, as estimated by Landlord; (j) refinancing costs and mortgage

interest and amortization payments; (k) any costs incurred in the ownership of the Building, as opposed to the operation and maintenance of the Building and (l) ground rent payments to any ground lessor. If Landlord shall purchase any item of capital equipment or make any capital expenditure which has the effect of reducing the expenses which otherwise would be included in Operating Expenses, or is required by reason of laws, rules or regulations of any governmental authority or insurance requirements, then the costs of such capital equipment or capital expenditure are to be included in Operating Expenses for the Escalation Year in which the costs are incurred and subsequent Escalation Years, on a straight-line basis, to the extent that such items are amortized over an appropriate and reasonable period, not in excess of 10 years, with an interest factor equal to 12% per annum at the time of Landlord's having made such expenditure. If Landlord shall lease any items of capital equipment designed to result in savings or reductions in expenses which would otherwise be included in Operating Expenses, then the Rentals and other costs paid pursuant to such leasing shall be included in Operating Expenses in the Escalation Year in which they were incurred. If during all or part of any Escalation Year, Landlord shall not furnish any particular items of work or service (which otherwise would constitute an Operating Expense hereunder) to portions of the building due to the fact that (i) such portions are not occupied or leased, (ii) such item of work or service is not required or desired by the tenant of such portion, (iii) such tenant is itself obtaining and providing such item of work or service, or (iv) for other reasons; then, for the purpose of computing Operating Expenses, the amount for such item and for such period shall be deemed to be increased by an amount equal to the additional costs and expenses which reasonably would have been incurred by Landlord during such period if Landlord had at its own expense furnished such item of work or services to such portion of the building or such Tenant.

(ii) "Operating Expenses" shall mean the Operating Expenses adjusted to compensate for vacancies in the

Building, and to compensate for amounts that Landlord would have incurred for servicing occupants who furnish their own services in whole or in part, which adjustments shall be based on what would have been charged by an independent contractor, acting reasonably, for the same services.

(iii) The “Building” shall mean the land and the building known as _____, NY of which the Premises forms a part.

(iv) “Tenant’s Share” shall mean _____%.

(b) Tenant shall pay to Landlord, as additional Rent, an amount equal to Tenant’s Share of the Operating Expenses during the Term. In furtherance, Tenant shall pay _____ monthly towards such obligation to be adjusted annually based upon actual charges computed under this paragraph.

(c) As soon as reasonably practicable, Landlord shall submit to Tenant a statement setting forth the computation of the amount of Tenant’s Share of Operating Expenses. Tenant shall pay Tenant’s Share of such amount within ten (10) days after the rendition of such statement.

(d) Commencing as of the first day of the month immediately following the rendition of such statement and on the first day of each month thereafter until a new statement is rendered, Tenant shall also pay to Landlord an amount equal to one-twelfth of the total additional Rent payable under this Article 3 and 3a for the preceding Year. Said monthly payments shall be adjusted to reflect, if Landlord can reasonably so estimate, known increases.

(e) If the payments made by Tenant pursuant to the preceding paragraph of this Article 3 exceed the amount of additional Rent payable to Landlord pursuant to this Article 3 for such year, such excess, at Landlord’s option, either shall be paid to Tenant or credited without interest against the next payments provided for hereunder. If the amount payable by Tenant as additional Rent pursuant to this Article 3 for any year is less than the payments made by Tenant pursuant to the preceding paragraph of this Article 3, Tenant shall pay the difference within ten (10) days after Landlord furnishes to Tenant a statement of the Operating Expenses for such year.

(f) If Tenant shall have paid additional Rent for Operating Expenses for any year and thereafter there is a reduction in the Operating Expenses in a subsequent year during the Term, then Tenant, if not in default hereunder, shall be entitled to an amount equal to Tenant's Share of the reduction in the Operating Expenses for the particular year in question. All such payments to Tenant shall not total more than the aggregate of the payments of Operating Expenses theretofore paid by Tenant, and in no event shall Tenant be entitled to any payment that would result in the reduction of the fixed Rent originally reserved herein, regardless of any reduction in Operating Expenses. If Tenant has paid any Operating Expenses, then Landlord thereafter shall, as soon as practicable after the end of each subsequent Escalation Year, submit a statement of Operating Expenses for each such subsequent year, as long as Tenant may be entitled to share in any reduction in Operating Expenses as provided above. If Tenant shall be entitled to share in any reduction in Operating Expenses, the amount of Tenant's Share thereof shall accompany such statement.

(g) In no event shall the annual fixed Rent under this lease be reduced by virtue of this Article 3. The computations under this Article 3 are intended to constitute a formula for an agreed Rental escalation and do not necessarily constitute an actual reimbursement to Landlord for costs or expenses paid by Landlord with respect to the building.

(h) The additional Rent provided herein shall be apportioned as of the Commencement Date and the Expiration Date or earlier termination of this Lease. If the Commencement Date is not the first day of the first year, then the Rent due hereunder for such first year shall be a proportionate share of the additional Rent that would have been payable for the entire first year. Upon the Expiration Date or earlier termination of this Lease, a proportionate share of the additional Rent payable under this Article 3 for the year during which such expiration or termination occurs shall immediately become due and payable by Tenant to Landlord. Said proportionate share shall be based on the length of time that the Term shall be within such year. Promptly after such expiration or termination, Landlord shall compute the additional Rent due from Tenant, as aforesaid, which computation shall be an estimate based upon the most recent annual statements theretofore furnished by Landlord to Tenant. Promptly after the end of the aforesaid year, Landlord shall cause a final statement showing the computation of the actual additional Rent due from Tenant for that year to be prepared and furnished to Tenant, whereupon any appropriate adjustments of amount owed to Landlord shall be made. The obligations of Tenant to pay additional Rent as provided for herein shall survive the expiration of

the Lease term or earlier termination of this lease. If Tenant continues in possession of the Premises after the Expiration Date or earlier termination of this Lease, as a month-to-month tenant or otherwise, the provisions of this Article 3 shall continue in full force and effect for so long as Tenant remains in possession of the Premises.

(i) The additional Rent provided for herein shall be collectible by Landlord in the same manner as the regular installments of fixed Rent due under this Lease. No delay or failure by Landlord in preparing or delivering any statement or demand for any additional Rent shall constitute a waiver of, or impair Landlord's rights to collect, such additional Rent.

(j) The statements provided by Landlord pursuant to this Article 3 shall constitute a final determination as between Landlord and Tenant of the additional Rent for the periods represented thereby, unless Tenant, within thirty (30) days after they have been furnished, gives a notice to Landlord that Tenant disputes their accuracy or appropriateness, which notice shall specify the particular respects in which the statement is inaccurate or inappropriate. If Tenant fails to give such notice within thirty (30) days, Tenant's rights under this provision are waived and Landlord's computation shall be conclusive. Pending the resolution of such dispute, Tenant shall pay the additional Rent to Landlord in accordance with the statements furnished by Landlord. After payment of said additional Rent, Tenant shall have the right, during reasonable business hours and upon not less than three business days prior written notice to Landlord, to examine Landlord's books and records with respect to the foregoing, provided such examination is commenced within thirty (30) days and is concluded within sixty (60) days following the rendition of the statement in question.

[5.5] D. Electricity and Utilities

(a) Landlord shall furnish electricity to Tenant on a "Rent inclusion" basis based upon an annual attributable usage of \$_____ at an annual cost to Tenant of \$_____ payable \$_____ monthly. This amount shall be increased proportionally to reflect any increases in electrical rates charged by the utility providing service over the rate then in effect as of the Commencement Date.¹⁰

[**ALTERNATIVE**] (a) Tenant shall timely pay all charges for all public or private utility services provided to the Premises and billed directly

¹⁰ Advise Landlord to periodically check rates to adjust increases, if applicable, under this provision.

by the utility to Tenant or Landlord for Tenant's use and shall comply with all requirements of said service including but not limited to all rules and regulations of governmental authorities and the public utility.

(b) Landlord shall furnish reasonable use of such lighting, electrical equipment or appliances presently installed in the Premises or as Landlord hereafter may permit to be installed. To the extent not provided pursuant to Section 5(g) below, Tenant shall be responsible to replace any bulbs, ballasts and outlets at its expense during the term of the Tenancy. Tenant shall not make alterations or additions to the electrical equipment or appliances without the prior written consent of Landlord. Landlord and its agents and consultants may inspect the electrical equipment and appliances in the demised premises at any time and from time to time. Landlord shall not be liable or responsible to Tenant for any loss, damage or expense which Tenant may sustain or incur if either the quality or character of electric current is changed or is no longer available or suitable for Tenant's requirements or is interrupted.

(c) Tenant covenants and agrees that its use of electric current shall never exceed the capacity of the existing conductors, feeders, risers, wiring installations or other equipment servicing the Building. Tenant shall not alter or make any addition to the electrical equipment without the prior written consent of Landlord. If Landlord grants such consent, all additional risers and other equipment shall be provided by Landlord, and the costs and expenses thereof shall be paid by Tenant to Landlord on demand, as additional Rent, without setoff or deduction.

(d) Landlord reserves the right to interrupt, suspend or cease any of the services referred to herein when necessary by reason of accident, or repairs, alteration or improvements which in Landlord's opinion are necessary or desirable, or difficulty or inability in securing supplies or labor, or strikes, or any other cause beyond the reasonable control of Landlord whether similar or dissimilar to those herein above mentioned. Tenant shall not be entitled to any diminution or abatement of Rent or other compensation, and Tenant's obligations under this Lease shall not be affected or reduced, by reason of any interruption, suspension or cessation of services or losses arising from or relating to such interruption in service whether caused by Landlord or arising from an interruption of service by the utility providing such service. Landlord shall not be responsible to Tenant for any damage to Tenant's equipment arising from any interruption in services including brownouts. No interruption, suspension or cessation of services shall constitute a constructive or partial eviction.

(e) Landlord shall not be liable for any injury to or death of any person or persons, or injury or damage to property from steam, gas, electricity, water or rain which may seep into, issue or flow from the Building.

[**ALTERNATE**—Include (f) and (g) if utilities are provided on a Rent Inclusion basis:]

(f) Tenant agrees that an electrical consultant, selected by Landlord, may survey the electrical lighting and power load of the premises to determine the average monthly consumption of electric current in the demised premises. The findings of the consultant as to the proper electrical usage and charges based on such average monthly consumption of electric current, which may be greater than or less than the amount stated above, shall be conclusive and binding upon the Parties, unless contested in accordance with the procedures set forth below. Tenant shall pay such increase, if any, with the monthly installments of fixed Rent reserved herein.

(g) The determination of the electrical consultant shall be binding and conclusive on Landlord and Tenant, unless within thirty (30) days after delivery of a copy of such determination either party shall give notice to the other that such party disputes the determination of the electrical consultant selected by the other party. In such event, the party giving notice, at its own expense, shall obtain its own determination from a reputable, independent electrical consultant and deliver to the other party a copy of said determination within thirty (30) days after the delivery date of the aforesaid notice. Landlord's electrical consultant and Tenant's electrical consultant then shall seek to agree upon the proper Rent increase based on such electrical consumption. If they cannot agree within forty-five (45) days following the delivery of the aforesaid notice, said electrical consultants shall choose a third reputable, independent electrical consultant, whose costs shall be shared equally by Landlord and Tenant, to make said determination. If the electrical consultants of Landlord and Tenant cannot agree on such third electrical consultant within ten (10) days after the said forty-five (45) day period, then either party may apply to the Supreme Court of the State of New York for the appointment of such third consultant. The determination of the third consultant shall be final and conclusive. Pending the resolution of any dispute as to the proper Rent increase, Tenant shall pay to Landlord a Rent increase in accordance with the determination of the original electrical consultant. If the final determination of the proper Rent increase shall differ from the determination of the original electrical consultant, then Tenant shall pay, on demand, any deficiency owed by Tenant; and Landlord shall credit or remit to Tenant any overage paid by Tenant.

(h) If Tenant installs additional or substituted electrical equipment or appliances, or otherwise increases its use of electric current, then the fixed Rent reserved herein shall be increased by an amount determined by the electrical consultant as provided above. The fixed Rent shall be appropriately adjusted if Tenant removes any electrical equipment or appliances from the demised premises. If electric rates or charges paid by Landlord are increased or decreased, the aforesaid additional Rent shall be increased or decreased in the same proportion.

(i) Landlord's failure to issue a statement under paragraphs 3, 3a and 4 shall not prejudice Landlord's right thereafter to render a statement for any amounts due under these paragraphs nor shall said failure or delay effect Tenant's obligation to pay same. The obligations of Tenant pursuant to Articles 3 and 4 shall survive the Expiration Date or earlier termination of this Lease. Furthermore, Tenant's right to dispute said charges must be made in writing within thirty (30) days of notice of said charge otherwise any right to dispute same shall be conclusively waived.

[5.6] E. Work To Be Performed

(a) Prior to the Commencement Date, Landlord at its sole cost and expense, and if so agreed, shall perform the work and make the installations in the Premises set forth in the exhibit entitled "Landlord's Work" attached hereto and made a part hereof and the plans approved by the Parties, if such is the agreement between the Parties.

(b) If Landlord hereafter agrees to perform, upon Tenant's request, and upon submission by Tenant of necessary plans and specifications, any additional or nonstandard work over and above that described in the exhibit entitled "Landlord's Work," such work shall be performed at Tenant's sole cost and expense. Prior to commencing any such work requested by Tenant, Landlord shall submit to Tenant a written estimate of the cost of such work. If Tenant shall fail to approve any such estimate within [five (5)] days after receipt of such estimate, the same shall be deemed disapproval by Tenant in all respects, and Landlord shall not be required to proceed thereon. Tenant agrees to pay to Landlord, as additional Rent, upon being billed therefor, an amount equal to the cost of all such work plus an amount equal to [fifteen (15%)] percent of such cost as compensation for Landlord's overhead. Such bills may be rendered by Landlord as the work progresses.

(c) In all instances in which Tenant is required to supply information with regard to the work to be performed by Landlord, including, where

applicable, paint color, Tenant shall supply such information within [three (3)] days after request therefor.

(d) Notwithstanding the date provided in this Lease for the Commencement Date, Tenant's obligations for the payment of fixed Rent shall not commence until Landlord shall have substantially completed¹¹ all of the work to be performed by Landlord as described in the exhibit hereto entitled "Landlord's Work." However, if there shall be any delay in Landlord's making the Premises ready for Tenant's occupancy by reason of (i) delay or failure by Tenant to supply information, to approve estimates or to give authorizations, (ii) Tenant's making changes or additions in the plans and specifications or materials originally approved, including without limitation, requests for additional or non-standard work, (iii) interference by Tenant or Tenant's contractors with the performance of work by Landlord or Landlord's contractors, or (iv) delay or failure of delivery of specific or additional new materials selected by Tenant, then the Commencement Date shall be deemed to have occurred on the date when Landlord would have substantially completed the Premises but for such delay or failure. If by reason of such factors, Landlord incurs any additional cost to prepare the Premises for Tenant's initial occupancy, such additional cost shall be paid by Tenant to Landlord on demand as additional Rent.¹²

(e) Upon completion of the work set forth in the exhibit hereto entitled "Landlord's Work," Landlord shall have no obligation, liability or responsibility of any nature with respect to any work or installations in the Premises, except as may be expressly set forth herein. Tenant covenants and agrees to maintain or, if necessary, replace all such work and installations, including without limitation, carpeting and other floor covering materials.

(f) Tenant has examined and inspected the Premises. Tenant agrees to accept possession of the Premises "as is" except as otherwise expressly provided in this Lease. Landlord shall not be responsible for making any improvements, alterations or repairs therein or for spending any other money to prepare the Premises for Tenant's occupancy, except as expressly provided herein. With respect to Landlord's Work and the delivery of the Premises by Landlord, Tenant further waives any and all rights otherwise conferred under N.Y. Real Property Law section 223-a. All

11 Consider defining "substantially complete."

12 If Tenant's contractor performs the work, Tenant should look exclusively to such contractor for punch list, warranty and corrective work. The Commencement Date should not be extended as a result of any delay by Tenant's contractor to substantially complete the work.

other improvements and alterations to the Premises prior to or at any time after the Commencement Date shall be made at Tenant's sole cost and expense, in accordance with the provisions of this Lease. The approval by Landlord of any of Tenant's plans and specifications shall not constitute an assumption of any liability on the part of the Landlord for their accuracy or conformity with applicable municipal regulations.

(g) At Landlord's option, Landlord or its designee shall furnish and install all replacement lighting, tubes, lamps, starters, bulbs and ballasts required in the Premises and Tenant shall pay Landlord or its designee upon demand the then established charges therefore as Additional Rent.

[5.7] F. Alterations and Additions

(a) Tenant shall not make any alterations of or additions to the Premises without the prior written consent of Landlord in each instance.¹³ Landlord shall not unreasonably withhold or delay such consent provided that Tenant is not in default under this Lease and provided the alterations and additions: do not change the general character, reduce the value or impair the usefulness of the Premises; are effected with due diligence, in a good and worker-like manner and in compliance with all applicable laws, rules and regulations of governmental authorities including and not limited to compliance with The Americans with Disabilities Act of 1990 as amended 142 U.S.C. §§ 12101–12213 (“ADA”) and requirements of insurance companies; are promptly and fully paid for by Tenant; and are made under the supervision of an architect or engineer acceptable to Landlord in accordance with plans and specifications approved by Landlord. Notwithstanding, Landlord may withhold its consent to any work intended to be performed by or on behalf of Tenant if, in the Landlord's opinion, said work may affect either the structure or integrity of the Building or any of the utility systems servicing the Building.

(b) All permissible work performed by Tenant shall be on prior written notice to Landlord setting forth the nature and extent of work, the parties performing the work and the time frame within which the work is intended to be completed. In addition, all such permissible work shall be performed in compliance with the Building's Rules and Regulations Governing Tenant Alterations. No such work shall interfere with the use of the common facilities and systems of the Building and shall be performed during hours prescribed by the Landlord or its managing agent.

¹³ Consider a carve out to allow decorative or cosmetic alternations not to exceed [\$_____] in the aggregate without Landlord's consent but upon prior written notice.

(c) Tenant, in connection with such alterations and additions, shall provide and maintain at all times workers' compensation insurance covering all persons, contractors and subcontractor who will perform work for Tenant, in amounts, with companies, and in form and substance satisfactory to Landlord and public liability insurance naming Landlord as an insured in amounts prescribed in Article 14 of this Lease. Before proceeding with any work Tenant shall provide to Landlord certificates of such insurance. Landlord may, at its option, require Tenant to post a bond or other guarantee to insure completion of any alteration or addition prior to Tenant commencing any such alteration or addition.

(d) No approval by Landlord of any of Tenant's plans for work in the Premises shall in any way be deemed an acknowledgment by the Landlord that the plans comply with any legal, zoning, municipal or other requirements or certificate of occupancy conformance. Nor shall any such approval be deemed a waiver by Landlord of any provisions of this Lease other than that relating to Landlord's approval.

(e) Landlord's consent to any Tenant alteration shall not waive Tenant's obligations to remove or restore such alteration at the expiration, surrender or termination of this Lease.

(f) Tenant shall reimburse Landlord for architect and other related fees incurred for reviewing such plans and proposed alterations.

(g) Tenant shall provide copies of all such plans to Landlord and shall also keep all records of such plans and approvals, if granted, for a period of six (6) years and shall further provide copies to Landlord upon request.

(h) At the expiration or termination of this Lease, at Landlord's option, Tenant shall either remove or leave behind all cables, conduit, wires and or installations inside the sheetrock walls.

(i) Tenant shall not and is specifically prohibited from doing any of the following:

(i) installing or hanging, or in any way attaching, any equipment, machinery, appurtenances, or the like in or on any structural elements of the Building or the exterior of the Building including, but not limited to, the roof;

(ii) cutting any holes into any structural element of the Building or any exterior portion of the Building including, but not limited to, the roof;

(iii) making any structural modifications to the Premises or any portion of the Building;

(iv) making any modifications or alterations to the Building's systems as they existed on the Commencement Date;

(v) installing any equipment that generates electromagnetic fields ("EMF") or interference¹⁴ for which in any event Tenant shall be exclusively responsible to cure or remediate, by removal of such equipment or otherwise; and

(vi) placing a load upon any floor of the Premises which exceeds the load per square foot for which the floor was designed. All machines and equipment installed in the Premises shall be properly shielded and so placed, equipped, installed and maintained by Tenant so as to eliminate the transmission of noise, vibration or electricity or other interference with other occupants of the Building. Tenant shall not move any equipment or bulky matter in or out of the Building without Landlord's prior written consent, which consent shall not be unreasonably withheld, and Tenant shall repair any damage caused by such movement at Tenant's expense.

[5.8] G. Liens

(a) Tenant shall indemnify and hold Landlord harmless from and against any and all bills for labor performed or equipment, fixtures and materials furnished to or for Tenant, and from and against any and all liens or claims therefor or against the Premises or the Building of which it forms a part, and from and against any and all liability, claim, loss, damage or expense, including reasonable attorneys' fees, in connection with any work performed by or for Tenant. The Premises and the Building shall at all times be free of liens for labor and materials supplied or

¹⁴ Interference is deemed where the electromagnetic field generated is above the level generated by a consumer microwave appliance.

claimed to have been supplied to or on behalf of Tenant, and no financing statements or other security instruments shall be filed against the Premises or the Building or the contents thereof.

(b) Tenant shall not directly or indirectly create or permit to be created any mortgage, lien, security interest, pledge, conditional sale, or other encumbrance on this Lease, the Premises or any part thereof, any equipment, fixtures or materials therein, Tenant's interest under this Lease or any Rent hereunder. The foregoing shall not apply to liens for impositions not yet due, or liens of mechanics, materialmen, suppliers or vendors, incurred in the ordinary course of business for sums which are not yet due, provided that adequate provision for the payment thereof shall have been made and the following paragraph is complied with.

(c) At no time may Tenant use this Lease, the security, its installations or the value of this Lease or its leasehold as collateral for loans or any similar purpose.

(d) If, in connection with any work being performed by or for Tenant or any subtenant, or in connection with any materials being furnished to Tenant or any subtenant, any mechanic's lien or other lien or charge shall be filed or made against the Premises or any part thereof, or if any such lien or charge shall be filed or made against Landlord as owner, then Tenant, at Tenant's expense, within thirty (30) days after such lien or charge shall have been filed or made, shall cause the same to be canceled and discharged of record by payment thereof or filing a bond or otherwise. Tenant promptly and diligently shall defend any suit, action or proceeding which may be brought for the enforcement of such lien or charge; shall satisfy and discharge any judgment entered therein within ten (10) days after the entry of such judgment by payment thereof or filing a bond or otherwise; and on demand shall pay any and all liability, claim, loss, damage or expense, including reasonable attorneys' fees, suffered or incurred by Landlord in connection therewith.

(e) Nothing in this Lease shall constitute any consent or request by Landlord, express or implied, for the performance of any labor or services or the furnishing of any materials or other property in respect of the Premises or any part thereof, nor as giving Tenant any right, power or authority to contract for or permit the performance of any labor or services or the furnishing of any materials or other property in any fashion that would permit the filing or making of any lien or claim against Landlord, the Premises or the Building.

[5.9] H. Use of Demised Premises¹⁵

(a) Tenant covenants that Tenant shall use and occupy the Premises solely for general and administrative offices for the conduct of Tenant's business as and for no other purpose. Tenant shall not use or permit all or any part of the Premises to be used for the: (1) storage for purpose of sale of any alcoholic beverage; (2) storage for retail sale of any product or material; (3) conduct of manufacturing, printing or electronic data processing business, except that Tenant may operate business office reproducing equipment, electronic data processing equipment and other business machines for Tenant's own requirements (but shall not permit the use of any such equipment by or for the benefit of any party other than Tenant); (4) rendition of any health or related services, conduct of school or conduct of any business which results in the presence of the general public in the Premises; (5) conduct of the business of an employment agency or executive search firm; (6) conduct of any public auction, gathering, meeting or exhibition; (7) conduct of a stock brokerage office or business; and (8) occupancy of a foreign, United States, state, municipal or other governmental or quasi-governmental body, agency or department or any authority or other entity which is affiliated therewith or controlled thereby and which has diplomatic or sovereign immunity or the like with respect to a commercial lease. The use permitted by Tenant under this Article shall not constitute a representation or warranty by Landlord that Tenant's business may be conducted in the Premises or is lawful or permissible under any certificate of occupancy issued for the Building or applicable zoning or that Tenant's use is otherwise permitted by law, for which conformance and determination, Tenant is exclusively responsible. If Tenant's use of the Premises results in a requirement of ADA conformance, Tenant shall be exclusively responsible therefore at its expense, excepting initial work, if performed by Landlord.

(b) Tenant covenants that it shall continuously conduct its business at the Premises in the regular and usual manner and in the event Tenant and any of its principals or employees shall fail to occupy the Premises for a continuous period of thirty (30) days and shall further fail to pay Rent as prescribed for said period, Tenant shall be deemed to have abandoned and surrendered the Premises and any personalty contained therein without the need for a summary proceeding confirming same, and surrenders all right and interest to the Premises under this Lease and further waives any

15 As Landlord, tailor use to be as narrow as possible. As Tenant, the use should be as expansive as possible and consider, for example, including "and for any legally permissible use."

right to redeem the Premises or assert any claim against the Landlord under the Lease in any summary proceeding or otherwise.

(c) Prior to the Commencement Date, if Tenant is then in possession and at all times thereafter, Tenant, at Tenant's sole cost and expense, shall promptly comply with all present and future laws, orders and regulations of all state, federal, municipal and local governments, departments, commissions and boards and any discretion of any public officer pursuant to law and all orders, rules and regulations of the New York Board of Fire Underwriters or any similar body which shall impose any violation, order or duty upon Landlord or Tenant with respect to the Premises arising out of Tenant's use thereof or with respect to the Building if arising out of Tenant's use of the Premises or the Building (including the use permitted under this Lease).

(d) Tenant shall adhere and conform to all environmental rules and regulations of all local, state and federal agencies and offices. This shall include, but not be limited to, insuring that no hazardous or potentially hazardous materials are stored or kept in the Premises. In furtherance, the officer signing on behalf of the corporate Tenant herein is deemed personally obligated on all matters involving this paragraph. This obligation is confirmed by the officer's signature to this Lease and Rider and no further confirmation shall be required. Such obligations shall survive expiration or earlier termination of this Lease.

(e) If Tenant's use of the Premises is governed or licensed by any local, municipal, county, state or federal office or agency and a determination is made by said office or agency revoking or suspending any license or authority issued to Tenant to operate its business or a determination is made that Tenant's use of the Premises violates any laws or ordinances of the State of New York or its municipalities, same shall constitute a default under this Lease entitling Landlord to remedies prescribed herein.

(f) The Parties agree that the Premises being leased herein does not include any air rights or zoning lot rights nor does it include any use whatsoever of the roof portion of the Building for any purposes; all such uses, rights, and access being excluded and prohibited and reserved exclusively to Landlord; this covenant being a material element of consideration of this Lease.

[5.10] I. Right to Relocate

Landlord reserves the right to relocate Tenant's Premises to another part of the Building in which the Premises are located in accordance with the following:

(a) The new premises shall be substantially the same in size, dimensions, configuration and decor as the Premises described in this Lease and shall be placed in that condition at the expense of Landlord.

(b) The physical relocation of the space shall be accomplished at the expense of Landlord.¹⁶

(c) Landlord shall give Tenant sixty (60) days written notice of Landlord's intention to relocate the Premises.

(d) The physical relocation of the Premises shall take place in a manner least disruptive to Tenant and, if possible, completed over a weekend. If the relocation extends beyond the weekend, Tenant shall be entitled to an abatement of the Rent until the relocation is completed.

(e) The Parties agree to execute an amendment to the Lease reflecting all changes caused by the relocation.

[5.11] J. Signs and Exterior Appearance

Tenant shall not be permitted under any circumstances to place or install any signage on the exterior portion of the Building or Tenant's entrance and/or exit doors or the exterior hallway of the Premises except in those areas designated by the Landlord as main floor and tenant floor directories in conformity with Landlord's requirements, the cost for same to be paid by Tenant. Landlord shall install [at Tenant's expense] signage for the entrance doorway and Building directory consistent and in conformity with Landlord's requirements and Building standard.

[5.12] K. HVAC Services¹⁷

(a) Landlord shall furnish to the Premises cold and temperate air at reasonable temperatures, pressures and degrees of humidity and in reasonable volumes and velocities, from 8:00 A.M. to 6:00 P.M. on business

¹⁶ Consider including a provision for Landlord's reimbursement of reasonable costs incurred by Tenant, including changing stationary, business cards and directories.

¹⁷ Consider provision for notice and cost for overtime HVAC Service.

days from May 15th to September 30th, as required for the comfortable occupancy of the Premises. Tenant shall pay Tenant's Share of costs for the HVAC services.

(b) Tenant shall cooperate fully with Landlord and shall abide by all rules and regulations which Landlord may reasonably prescribe for the proper functioning and protection of the HVAC system. Tenant shall cause to be kept closed the doors, when not in use, and to lower and close the blinds when reasonably necessary because of the sun's position so that the HVAC system can operate effectively. Landlord, throughout the Term, shall have free and unrestricted access to the air conditioning facilities in the Premises.

(c) Landlord reserves the right to interrupt, suspend or cease any of the services referred to herein when necessary by reason of accident, or repairs, alteration or improvements which in Landlord's opinion are necessary or desirable, or difficulty or inability in securing supplies or labor, or strikes, or any other cause beyond the reasonable control of Landlord whether similar or dissimilar to those herein above mentioned. Tenant shall not be entitled to any diminution or abatement of Rent or other compensation, and Tenant's obligations under this Lease shall not be affected or reduced, by reason of any interruption, suspension or cessation of services. No interruption, suspension or cessation of services shall constitute a constructive or partial eviction.

[5.13] L. Limited Liability

(a) If Landlord defaults hereunder, Tenant shall look solely to the interest of Landlord in the Premises for the satisfaction of any judgment or other judicial process requiring the payment of money by Landlord based upon any default hereunder, or any claims arising from the landlord/tenant relationship of the Parties or any rights and obligations involving the Premises or this Lease. No other assets of Landlord or any such successor shall be subject to levy, execution or other enforcement procedure for the satisfaction of any such judgment or process. Upon any conveyance or transfer of the Building, the transferor shall be relieved from all liability hereunder.

(b) Landlord shall not be held liable for any injury to or death of any person or persons, or injury or damage to property, from theft or accident, or from steam, gas, electricity, water, rain which may seep into, issue or flow from the Building, unless same shall be due to Landlord's otherwise foreseeable gross negligence.

(c) Landlord makes no implied covenants, representations or warranties. Accordingly, Landlord's responsibilities and obligations are limited to those expressly set forth in this Lease. Tenant's rights herein are subject to the rights of mortgagees, grounds lessors, and Tenant being in conformance with the terms of this Lease and not being in default beyond any expressly prescribed cure or grace periods set forth in this Lease.

(d) Tenant acknowledges and agrees that the Building's front desk/concierge services, if any, are provided for the limited purpose of directing parties to the appropriate Building tenant and not for the purposes of providing any security for the Building and/or the Premises or occupants.

[5.14] M. Indemnification By Tenant

Tenant indemnifies and holds Landlord harmless from and against any and all liability, claim, loss, damage or expense, including reasonable attorneys' fees, by reason of any injury to or death of any person or persons, or injury or damage to property, or otherwise, arising from or in connection with the occupancy or use of the Premises or any work, installation or thing whatsoever done in, at or about the Premises, or resulting from any default by Tenant in the payment or performance of Tenant's obligations under this Lease or from any act, omission or negligence of Tenant or any contractors, agents, employees, customers, subtenants, licensees, guests or invitees of Tenant and in the exercise of Landlord's rights to assert any security interest granted herein. This Article shall apply prior to the Commencement Date if Tenant then has possession or use of the Premises.

[5.15] N. Insurance¹⁸

(a) Tenant, at all times during the term of this Lease and at Tenant's expense, shall provide and keep in force with insurers then reasonably acceptable to Landlord, comprehensive public liability and property combined limits and coverage insurance protecting Landlord, the Building's managing agent and any other related parties designated by Landlord, against any and all liability occasioned by negligence, occurrence, accident, disaster and other risks included under "extended coverage" policies, occurring in or about the Premises or any part thereof which amounts at the date hereof shall be, in the case of public liability, \$_____ per person and \$_____ per accident, and \$_____ in the case of property damage,

¹⁸ Insurance provisions in any lease should be reviewed by the Parties' respective insurance agents/brokers/carriers.

and insurance against such other hazards; any and all such policies to be issued by Best A rated or better insurance companies. Tenant shall comply with such other requirements as Landlord from time to time reasonably may request for the protection by insurance of Landlord's interest.

(b) All insurance maintained by Tenant pursuant to this Article shall also name Landlord, and any other parties designated by Landlord in writing as "additional insureds," and shall provide that any loss, excepting that involving Tenant's equipment and trade fixtures, shall be payable to Landlord notwithstanding any act or failure to act or negligence of Landlord, Tenant or any other person and shall provide that no cancellation, reduction in amount or change in coverage thereof will be effective until at thirty (30) days after receipt by Landlord of written notice thereof, and shall be reasonably satisfactory to Landlord, in all other respects. Tenant shall, at its expense and throughout the Term, procure a clause in, or endorsement to, all such insurance whereby the insurance company waives subrogation or consents to a waiver of right of recovery against Landlord for any sums paid to Tenant.

(c) Upon commencement or earlier possession by Tenant of the Premises, Tenant may provide proof of insurance required herein by ACORD certificates duly issued and approved by the carrier, and thereafter when issued, a counterpart of issued policies and endorsements and thereafter not less than thirty (30) days prior to the expiration date of any policy delivered pursuant to this Article, Tenant shall deliver to Landlord the originals of all policies or renewal policies, as the case may be, required by this Lease, bearing notations evidencing the payment of the premiums therefor and accompanied by copies of such policies with proof of premium payment. [Such insurance may be provided through a blanket policy or policies in form and substance satisfactory to Landlord. Such blanket policies shall provide specific allocation to the Premises of the coverage afforded thereby, and shall give to Landlord no less protection than that which would be afforded by separate policies as prescribed by this Lease.

(d) If at any time Tenant shall neglect or fail to provide or maintain insurance or to deliver insurance policies in accordance with this Article with proof of payment, Landlord may effect such insurance as agent for Tenant, by taking out policies in a company satisfactory to Landlord, and the amount of the premiums paid for such insurance shall be paid by Tenant to Landlord on demand. Landlord, in addition to Landlord's other rights, powers and remedies, shall be entitled to recover as damages for any breach of this Article the uninsured amount of any liability, claim,

loss, damage or expense, including reasonable attorneys' fees, suffered or incurred by Landlord, and shall not be limited in the proof of damages which Landlord may claim against Tenant to the amount of the insurance premiums not paid or incurred by Tenant which would have been payable for such insurance. Evidence of insurance may be provided by delivery of an original ACORD 27 form, or similar or successor form then in effect, conforming to the within requirements.

[5.16] O. Estoppel Certificates

Tenant shall execute, acknowledge and deliver to Landlord, in form provided by Landlord or required by any lender or purchaser and from time to time, promptly upon request, a certificate stating: (a) that this Lease is unmodified and in full force and effect (or, if there have been modifications, that this Lease is in full force and effect, as modified, and identifying the modifications); (b) the commencement and expiration dates of the Term; (c) the dates through which fixed Rent and additional Rent have been paid; (d) whether or not there is any existing default by Landlord or Tenant with respect to which a notice of default has been delivered, and if there is any such default, specifying the nature and extent thereof; (e) that this Lease is subordinate to any existing or future mortgage placed by Landlord on the building; and (f) whether or not there are any setoffs, defenses or counterclaims against the enforcement of any of the agreements, terms, covenants or conditions of this Lease to be paid, complied with or performed by Tenant; (g) the amount of security deposit held by Landlord under this Lease; and (h) any other information requested by Landlord or any lender. Any such certificate may be relied upon by Landlord and any mortgagee, purchaser or other person with whom Landlord may deal.¹⁹

[5.17] P. Security Deposit

(a) Tenant shall deposit²⁰ with Landlord upon the signing of this Lease, the sum as security, to be adjusted through the term of this Lease to equal to _____ () months of the then current Rent and actual or estimated electrical charges, for the full and faithful performance and observance by Tenant of the terms, covenants and conditions of this Lease subject to adjustment as provided for in this Lease. If Tenant defaults in the performance or observance of any term, covenant or condition of this

19 Consider making Tenant's failure to timely execute the estoppel certificate a default under the Lease.

20 Consider letter of credit option.

Lease, including without limitation the obligation of Tenant to pay any Rent or other sum required hereunder, Landlord may use, apply or retain the whole or any part of the security so deposited to the extent required for the payment of any Rent or any other sum as to which Tenant is in default or for any sum which Landlord may expend or may be required to expend by reason of Tenant's default, including without limitation any damages or deficiency accrued before or after summary proceedings or other re-entry by Landlord, legal fees or otherwise. If Tenant shall fully and faithfully observe and perform all of the terms, covenants and conditions of this Lease and provided Tenant has not been in default under the Lease the security shall be returned to Tenant after the end of the Term and the delivery of possession of the Premises to Landlord in the manner prescribed in this Lease.

(b) In the event of a sale, transfer, leasing or financing of the Premises by Landlord, Landlord reserves the right to transfer the security to the transferee or mortgagee whereupon Landlord shall be deemed released by Tenant from all liability for the return of said security upon written assumption by such transferee of such obligation, upon which, Tenant shall look solely to such new owner or landlord or designated party for the return of said security. This paragraph shall apply to every transfer or assignment of the security to a new owner or landlord as provided herein.

(c) Tenant shall not assign or encumber the security deposit and Landlord shall not be bound by any such attempted assignment and encumbrance.

(d) In no event shall the security deposit be applied to or credited against the obligations otherwise due by any guarantor under this Lease.

(e) If Tenant defaults beyond any cure period, at any time during the Term, in addition to any other rights Landlord may have arising from said default, if Landlord elects to continue this Lease, the security deposit prescribed herein shall be increased by an amount equal to ____ month(s) of the then current Rent.

[5.18] Q. Assignment and Sublet

(a) Tenant covenants not to voluntarily or involuntarily assign, encumber, mortgage or otherwise transfer this Lease, or sublet the Premises or any part thereof, or suffer or permit the Premises or any part thereof to be used or occupied by others, by operation of law or otherwise, without the prior written consent of Landlord in each instance, [which consent shall

not be unreasonably withheld]²¹. Absent such consent, any act or instrument purporting to do any of the foregoing shall be null and void.

(b) The transfer or sale of 50% or more of the capital stock of any corporate tenant, or of a majority of the total interests in any partnership tenant, however accomplished and whether in a single transaction or a series of transactions, shall be deemed an assignment of this Lease, except that a transfer of stock for purposes hereof shall not include sales of stock by persons through the “over-the-counter market.” Notwithstanding the foregoing, Tenant may assign this Lease to a corporation into which or with which Tenant is merged or consolidated or to an entity to which substantially all of the assets of Tenant are transferred, or, if Tenant is a partnership, to a successor partnership, and Tenant may sublet the Premises to subsidiaries or affiliates of Tenant for so long as any such subsidiary or affiliate shall retain the status of a subsidiary or affiliate of Tenant and proof thereof is delivered to Landlord. For purposes hereof, a “subsidiary” or “affiliate” shall mean a corporation of which at least 50% of the common stock is owned by Tenant or a partnership of which at least 50% of the equity is owned by Tenant.

(c) If Tenant desires to assign or sublet the Lease, Tenant shall submit to Landlord in writing: the name and address of the proposed assignee or sublessee (a “Transferee”); a counterpart of the proposed agreement of assignment or sublease and all other instruments or agreements pertaining thereto; such information as to the nature and character of the business of the proposed Transferee; the proposed use of the space; banking, financial or other credit information relating to the proposed Transferee sufficient to enable Landlord to determine the financial responsibility, reputation and character of the proposed Transferee and any proposed guarantor; a statement of all sums or other consideration paid or to be paid to or by Tenant by or for the account of the Transferee in connection with such assignment or sublease, including without limitation sums paid or to be paid for the sale or rental of Tenant’s fixtures, leasehold improvements, equipment, furniture, furnishings or other personal property; and such other information as Landlord may reasonably request. Tenant shall pay all of Landlord’s costs and expenses, including reasonable attorneys’ fees and disbursements, incurred in connection with the review, preparation and execution of any documents pertaining to any proposed assignment or sublease if Landlord approves such party.

21 Consider limitations very carefully.

(d) No assignment or transfer, irrespective of any consent by Landlord, shall be effective unless the assignee shall execute, acknowledge and deliver to Landlord an agreement, in form and substance satisfactory to Landlord, whereby assignee assumes the obligations and performance of this Lease and shall agree to be bound by all of the terms, covenants and conditions of this Lease, including restrictions on use, to be observed, performed or complied with by Tenant, and whereby the assignee shall agree that the provisions of this Article shall continue to be binding upon it in the future notwithstanding such assignment or transfer. No sublease shall be effective, irrespective of any consent of Landlord, unless the subtenant shall execute and deliver to Landlord a recordable agreement, in form and substance satisfactory to Landlord, whereby the subtenant agrees to comply with all applicable terms, covenants and conditions of this Lease, including restrictions on use, to be complied with by Tenant hereunder.

(e) Each assignment, as the case may be, shall specifically state that: (1) it is subject to all of the terms, covenants and conditions of this Lease; (2) the assignee shall not have the right to a further assignment, or to allow the Premises to be used by others, without the prior written consent of Landlord in each instance; (3) a consent by Landlord thereto shall not be deemed to modify or amend the provisions of this Lease or Tenant's obligations hereunder, which shall continue to apply to the Premises involved and the occupants thereof as if the assignment had not been made; (4) if Tenant defaults in the payment of any Rent, Landlord is authorized to collect any Rents due and accruing from any assignee, or other occupant of the Premises and to apply the net amounts collected to the Rents reserved in this Lease; and (5) the receipt by Landlord of any amounts from any assignee, or other occupant of any part of the demised premises shall not be deemed or construed as releasing Tenant of Tenant's obligations hereunder except to the extent of the amount received or the acceptance of that party as a direct tenant.

(f) In no event shall Tenant be entitled to assign this Lease or to sublet all or any portion of the Premises to: any tenant or occupant of any other space in the Building, or to any affiliate or any associated entity of any tenant or occupant of other space in the Building; any person or entity who has dealt with Landlord or Landlord's agents, directly or through a broker, with respect to space in the Building during the twelve (12) months preceding the assignment or subletting; any person or entity whose business or activities or intended use of the Premises is not in keeping with the standards of the Building or of the floor or floors upon which the Premises is located; any person or entity entitled directly or indirectly

to diplomatic or sovereign immunity; a governmental or quasi-governmental organization, authority or agency; or charitable or a not-for-profit corporation or nonprofit organization. In no event shall Tenant be entitled to assign this Lease or sublet the Premises or any part thereof if there shall have been a default by Tenant, beyond any applicable grace or cure period, under any term, covenant or condition of this Lease.

(g) Tenant shall not advertise, or authorize any broker to advertise, for a subtenant or assignee, without the prior written consent of Landlord in each instance. No advertisement or public communication shall mention or refer to a rental rate or to any other matter which directly or indirectly might adversely reflect on the dignity and prestige of the Building.

(h) Landlord's consent to an assignment or transfer shall not be deemed or construed as a consent to any further assignment or transfer, or a waiver of this provision of this Article. Any person or representative of Tenant to whom Tenant's interest under this Lease passes by operation of law, or otherwise, shall be bound by the provisions of this Article.

(j) No assignment of this Lease or acceptance of Rent by Landlord from any assignee or other party shall discharge or release Tenant or any person, firm or corporation which previously assumed Tenant's obligations hereunder, and Tenant and such persons, firms and corporations shall remain liable for the payment of Rent due and to become due under this Lease and for the performance and observance of all of the terms, covenants and conditions of this Lease on the part of Tenant to be observed or performed for the balance of the Term as if no assignment has been effected. If this Lease is assigned, whether or not in violation of this Article, Landlord may collect Rent from the assignee. If the Premises or any part thereof are sublet or occupied by anybody other than Tenant, Landlord, after any default by Tenant, may collect Rent from the subtenant or occupant, and apply the net amount collected to the Rent due hereunder. Such collection of Rent by Landlord shall not be deemed or construed as a waiver of the provisions hereof, the acceptance of the assignee, subtenant or occupant as a tenant, or a release of Tenant from the further performance and observance by Tenant of the terms, covenants and conditions of this Lease.

(k) Whenever Tenant shall claim under this Article or any other provision of this Lease that Landlord has unreasonably withheld or delayed its consent to any request of Tenant, Tenant shall have no claim for damages by reason of such alleged withholding or delay, and Tenant's sole remedy

therefor shall be a right to obtain specific performance without recovery of damages.

(l) In the event Tenant is in default in the payment of Rent or additional Rent due under this Lease, Landlord is hereby authorized by Tenant to collect and accept Rent from any of Tenant's subtenants, licensees or assignees and apply the net amount collected to sums otherwise due by Tenant. This shall not be deemed a waiver of any of Landlord's rights against Tenant nor shall it be deemed an acknowledgment of any leasehold interest purportedly held by any such subtenant, licensee or assignee unless expressly acknowledged in writing by Landlord.

(m) In the event Landlord consents to an assignment of the Lease or a subletting of the entire Premises, in either event the security deposit shall be increased by an amount equal to ____ months of the then current Rent.

(n) In the event any assignment or sublet results in sums payable to Tenant in excess of that paid by Tenant to Landlord, such excess shall be divided equally between Landlord and Tenant after deducting the direct costs incurred by Tenant in effectuating such assignment or sublet income.

(o) Notwithstanding the terms of this paragraph, in the event Tenant wishes to assign this Lease, simultaneous with such request, Tenant shall offer to surrender the Premises to Landlord, and Landlord, at its sole option and discretion, may elect to accept such surrender as an alternative to considering an assignment in which event and subject to all sums otherwise due under the Lease having been fully paid and obligations of Tenant having been otherwise performed to the time of surrender, the Lease shall terminate and be cancelled for all purposes. This provision shall in no manner confer any rights to Tenant to compel Landlord to accept a surrender of the Premises.

(p) Landlord's consent to any assignment or sublet under this Lease is conditional upon Tenant not being in default at the time of such request through assignment or subletting and delivery by Tenant of an estoppel certificate to Landlord with copies of all required documents in furtherance of such request.

(q) The right to assign or sublet in accordance with this Section 17 is personal to the current named Tenant and is not assignable or otherwise transferable with this Lease.

[5.19] R. Subordination and Attornment²²

This Lease, and all rights of Tenant hereunder, are and shall be subject and subordinate in all respects to all mortgages which may now or hereafter affect the Premises, whether or not such mortgages shall also cover other lands or buildings, to each and every advance made or hereafter to be made under such mortgages and to all renewals, modifications, replacements, spreaders, consolidations and extensions of such mortgages. In the event of any sale of the Premises in a foreclosure of any such mortgage or the exercise by the holder of any such mortgages of any other remedies provided for by law or in such mortgage, Tenant, upon written request of the holder of the mortgage or the purchaser at such foreclosure or any person succeeding to the interest of the holder of the mortgage, shall attorn to such holder, purchaser or successor in interest, as the case may be, without change in the terms, covenants or conditions of this Lease. If such a request is made, this Lease shall not be deemed to be terminated by any foreclosure proceedings or other remedies for the enforcement of the mortgage by such holder, purchaser or successor in interest. The provisions of this Article shall be self-operative and no further instrument of subordination and/or attornment shall be required. In confirmation of such subordination and/or attornment, Tenant promptly shall execute and deliver at Tenant's expense any instrument that Landlord or the holder of any such mortgage may reasonably request to evidence such subordination and/or attornment. As used in this Article the term "mortgages" shall mean all mortgages, deeds of trust, mortgage deeds and similar instruments now or hereafter affecting the Premises

[5.20] S. Option to Extend Term

(a) Subject to the satisfaction of the conditions set forth below in this Article, Tenant shall have the option to extend the Term for an additional period of ___ (___) years, subject to all of the terms, covenants and conditions of this Lease. During said extended term of this Lease, Tenant shall pay fixed Rent at the rate of <\$___> per annum, payable <\$___> monthly, for the first year of the option period [ALTERNATIVE: in an amount equal to the fair market rental for the Premises as reasonably determined by Landlord], but in no event less than the Rent payable in the last month of the Lease, in the manner provided in the Lease, and then subject to annually compounded increases of _____ percent (___%) plus all other items of Rent and additional Rent as prescribed in the Lease.

²² Consider the size and nature of the tenancy and whether Landlord should be obligated (or use commercially reasonable efforts) to obtain an SNDA for the benefit of Tenant.

b. To be effective, Tenant must give Landlord written notice of Tenant's election to extend the Term and Landlord must receive said notice not less than [eight (8)] months prior to the expiration of the then existing term of this Lease, *time being of the essence*. Tenant's right to extend the term of this Lease pursuant to this Article shall be expressly conditioned upon Tenant not having been in default beyond any cure period under this Lease. If Landlord does not receive said notice as prescribed, this option shall automatically terminate with no further rights or obligations enuring to either party and this Lease shall expire as otherwise prescribed, and this option being deemed void *ab initio*.

c. This renewal option is personal to the current named Tenant herein and is not assignable or otherwise transferable with this Lease. This option shall also terminate without further notice or requirement if Tenant defaults in the payment of Rent or additional Rent [twice] in any [nine (9)] month period.

[5.21] T. Brokerage

Tenant represents and warrants that Tenant has not dealt with any broker in connection with this Lease or the negotiation or execution thereof, other than _____ whose commission Landlord agrees to pay pursuant to a separate agreement. Tenant agrees to indemnify and hold Landlord harmless from and against any claims, damage, liability or expense, including attorneys' fees, pertaining to any other broker with whom Tenant has dealt. Landlord shall not have any liability for any brokerage commission arising out of any subletting or assignment of this Lease by Tenant, and Tenant shall indemnify and hold Landlord harmless from and against any claims, damage, liability or expense, including attorney fees, pertaining to brokerage commissions in connection with any such subletting or assignment.

[5.22] U. Modifications and Corrections

If, in connection with obtaining financing or refinancing for the Building of which the Premises form a part, a banking, insurance or other institutional lender shall request reasonable modifications to this Lease as a condition to such financing or refinancing, Tenant shall not unreasonably withhold or delay its consent thereto, provided such modifications do not materially adversely affect the leasehold interest hereunder or increase Tenant's obligations hereunder, except to the extent that Tenant may be required to give notices of any defaults by Landlord to such lender or permit the curing of such defaults by such lender together with the granting

of such additional time for such curing as may be required for such lender to get possession of the Building. In no event shall a requirement that the consent of any such lender be given for any modification of this Lease or for any assignment or sublease be deemed to materially adversely affect the leasehold interest hereby created.

[5.23] V. Notices²³

(a) All notices required or permitted hereunder shall be given by either certified mail²⁴ or nationally recognized overnight mail, next-day delivery with proof of delivery, addressed to Landlord at the address herein above stated and to Tenant at the Premises. Any notices required by Landlord under this Lease or any actions or summary proceedings, may be given and signed and affirmed by the Landlord, its employees, attorneys or agents and may be served by certified mail or nationally recognized overnight-mail service upon Tenant.

(b) Tenants, its subtenants, successors and assigns, if any, waive the requirements of personal service of any process upon them in any action or proceeding arising from this Lease and consent that all service of process may be made by certified mail or recognized overnight-mail service addressed to the Tenant at the address of the Premises. Tenant, by its signing this Lease, further consents to the personal jurisdiction of the District, Civil and Supreme Courts in the county and or district in which the Building is located in any action or proceeding brought by Landlord.

(c) Notice of any complaint involving Building services or related matters provided for in this Lease or any claimed default by Landlord under this Lease shall be provided in writing by Tenant to Landlord within no more than [twenty-one (21) days] of Tenant's knowledge of any such issues or problems, signed by a specified officer or manager of Tenant. Such writing in form and notice prescribed by this Lease is a condition precedent to Tenant pursuing any claimed remedies provided for in this Lease.

[5.24] W. Condemnation

(a) If the whole or materially all of the Premises shall be taken for any public or quasi-public purpose by any lawful power or authority by the

23 Consider including the Parties' respective counsel.

24 *Not* return receipt requested, which otherwise requires a potentially or actually defaulting tenant to cooperate accepting Landlord's notice by acknowledging receipt.

exercise of the right of condemnation or eminent domain or by agreement between Landlord, Tenant and those authorized to exercise such right (herein called "Total Taking"), this Lease, the term hereby granted, shall terminate and expire on the date of such taking and the Rent shall be apportioned and paid to the date of such taking.

(b) The term "materially all of the Premises" shall be deemed to mean such portion of the Premises, as when so taken would leave remaining a balance of the Premises which, due either to the area so taken or the location of the part so taken in relation to the part not so taken, would not under economic conditions, zoning laws or building regulations then existing or prevailing, readily accommodate a new building or buildings in nature similar to the Building existing upon the land at the date of such taking, and of floor area sufficient, together with such portion of the Premises not taken in the condemnation, to reasonably permit the use of the Premises for the conduct of the business heretofore conducted thereon by Tenant. If there be any dispute as to whether or not there has been a Total Taking, such dispute shall be submitted to a court of competent jurisdiction.

(c) In the event of a Total Taking, the entire award relating to the Premises except for trade fixtures and moving expenses shall be paid to Landlord and this Lease shall be deemed terminated.

(d) If less than materially all of the Premises be taken or condemned (herein called "Partial Taking"):

(i) This Lease shall continue in full force and effect as to the part of the Premises not so taken.

(ii) Tenant, shall proceed diligently to repair and restore any remaining part of the Premises not so taken.

(iii) The entire award with respect to the Premises shall be payable to Landlord (subject to the right of Landlord to elect to have the award deposited with any mortgagee) and subject to the provisions and limitation in this Section, Landlord agrees to make available to Tenant so much of the portion of the award actually received and held by Landlord, if any, less all reasonable expenses paid or incurred by Landlord in the condemnation proceedings, as may be necessary to pay for the cost of repairing and restoring for use and occupancy the part of

the Premises no so taken. Any balance of the award with respect to the Premises thereafter remaining shall be distributed to Landlord.

(iv) The annual Rent due and payable hereunder shall be reduced equitably. If Landlord and Tenant cannot agree on such reduction, such reduction shall be determined by a court of competent jurisdiction.

(e) In the event of a Total Taking, or a Partial Taking, Tenant waives all claims for any value for its leasehold or its interest in this Lease or in the Premises or any part thereof and all claims for any compensation for the cost of construction or otherwise, except as herein specified.

(f) The Premises or a part thereof, as the case may be, shall be deemed to have been taken or condemned on the date on which actual possession of the Premises or a part thereof, as the case may be, is acquired by any lawful power or authority or the date on which title vests therein, whichever is earlier.

(g) In the event of a taking for a temporary use, this Lease shall continue unaffected and Tenant shall continue to pay in full the Rent. Tenant shall be entitled to receive the entire proceeds for such taking which shall be attributable to the Premises unless the period shall extend beyond the termination of this Lease in which case (x) the proceeds shall be apportioned between Landlord and Tenant as of the date of such expiration, and (y) Landlord shall be entitled to be paid out of the proceeds for any damage to the Premises or to the condition as it was before the taking. If the Lease shall not have expired prior to the termination of the taking, Tenant shall upon termination of the taking, restore the Premises. Notwithstanding the foregoing, but without affecting (x) above, if any portion of such proceeds relates to a period subsequent to the date of payment, such portion shall be deposited with Landlord as security for Tenant's obligations under this Lease and be released to Tenant in monthly installments over the period to which such proceeds relate.

(h) In the case of any governmental action not resulting in a taking of any portion of the Premises, but creating a right to compensation therefor, such as without limitation, a change of the grade of any street, this Lease shall continue in full force and effect; Tenant shall, if any governmental action results in physical damage to the Premises, proceed with reasonable diligence to conduct, at Tenant's own cost and expense, all restorations necessary to remedy any such physical damage; and any awards or

awards in connection with any such governmental action shall be paid to Landlord and disposed of as provided in this Article, as in the case of a Partial Taking.

[5.25] X. Miscellaneous

(a) Tenant shall pay Landlord for all reasonable attorneys' fees incurred in connection with or arising from any defaults by Tenant under this Lease or actions to compel compliance by Tenant with any provision of this Lease or to recover damages resulting from non-compliance. Such amounts shall be deemed additional Rent and shall be paid on demand.

(b) All amounts which are due from and payable by Tenant under this Lease shall be deemed Rent and/or additional Rent.

(c) Except as otherwise expressly set forth in this Lease, wherever the Landlord's consent shall be required under this Lease, same shall not be unreasonably withheld or delayed.

(d) Tenant shall not use the elevators during business hours for the haulage or removal of materials or debris nor for the moving of any furniture or equipment except as permitted in writing by Landlord.

(e) Neither this Lease nor any memorandum thereof, whether or not notarized and/or acknowledged, may be recorded and any such recording shall be deemed a nullity.

(f) Tenant hereby waives any right of redemption which may otherwise be available by virtue of any state or federal statute.

(g) The failure of Landlord anytime during the term of the Lease to bill Tenant for item of Rent or additional Rent or to insist upon strict performance of any term, covenant or condition herein or Landlord's acceptance of any late or partial Rent shall not be deemed a waiver of any rights or remedies that Landlord may have under this Lease.

(h) If any provision of this Lease shall be unenforceable or invalid, such unenforceability or invalidity shall not otherwise affect this lease or any other provision of this Lease.

(i) This Lease may be executed in any number of counterparts each of which shall be deemed an original. Furthermore, any photocopied, facsimile copy, or pdf signed of this Lease shall be deemed an original so long as it fully conforms to the original(s) signed by the Parties.

(j) The submission of this Lease to Tenant is not an offer or option to Lease and Tenant shall not have any rights hereunder unless and until Landlord executes a copy of this Lease and deliver same to Tenant; the parties acknowledge that submission of the Lease is for discussion purposes only.

(k) This Lease is governed by the laws of the State of New York. All actions or proceedings under this Lease shall be brought in the county in which the Building is situated before the court having jurisdiction over the subject matter of the litigation.

(l) If any provision in this Lease shall to any extent be deemed unenforceable, the remainder of the Lease and Rider shall not be affected thereby and shall remain in full force and effect.

(m) The Parties acknowledge that this Lease has been reviewed by respective counsel and Tenant had an opportunity to and did consult with counsel and advisors of its choice on matters involving this Lease, all terms have been considered and negotiated independently. Accordingly, the rule that any ambiguity shall be interpreted against the drafter shall not apply and there shall be no presumption favoring one party or the other in the interpretation of this Lease. Furthermore, no prior draft of this shall be used or considered in the interpretation of this Lease.

(n) Landlord shall cause the Building and Premises to be cleaned in accordance with Landlord's standards, if so expressly provided for in this Lease.

(o) Tenant shall not permit any refuse or boxes, empty or for shipping, to accumulate or be placed in the hallway contiguous to its space.

(p) Tenant shall be permitted to both move into the Building upon the Commencement Date and out of the Building at the expiration or earlier termination of this Lease only upon times scheduled, prearranged and agreed upon with the Landlord and consistent with applicable Building requirements then in effect including and not limited to insurance requirements as established by the Landlord, applicable, without limitation, to Tenant and its moving company.

(q) [If applicable] Tenant shall be entitled to _____ monthly parking spaces for its employees at a cost of \$_____ per parking space monthly as may be reasonably adjusted over the term of this Lease. These spaces are for daily parking in the ordinary course of Tenant's use

of the Premises and not for storage of vehicles, either overnight or long term. It is expressly agreed as a material element of this provision that parking is exclusively at Tenant's risk, Tenant is not relying upon any undertaking or responsibility by Landlord to provide security for the parking portions of the Building and Landlord is not responsible for any injury, or any theft or damage to Tenant's or Tenant's invitee's automobile(s) or contents. Parking stickers for the Building garage may be issued at Landlord's election and, if so, must be affixed to the front passenger side of the car's windshield. Only cars with authorized parking stickers are allowed in the Building garage, except for Tenant's visitors, customers and/or clients. Violators will initially receive a non-removable warning notice posted on the car window. Repeat offenders will be subject to having their cars towed at their own risk and expense.

(r) No smoking whatsoever is permitted in or contiguous to the Premises or the Building.

(s) No pets are permitted in the Building.

(t) No music or sound systems shall be played or used in the Premises at a level otherwise causing such sound to emanate to other premises or common areas of the Building.

(u) Tenant shall not utilize any cooking or related equipment (microwave or otherwise) which cause the emission of odors to other portions of the Building.

(v) No posters, signs, bills, promotional materials or the like shall be posted or distributed anywhere in the Building or elevators.

(w) The doors to the Premises shall be kept closed during the hours Tenant utilizes the Premises and Tenant shall provide Landlord with copies of all keys to the Premises and offices failing which Tenant shall be responsible for all damages arising from Landlord's or other required access to the Premises.

(x) No remedy conferred on or reserved to the Landlord under this Lease is intended to be exclusive of any other remedy or remedies and may be asserted singly or cumulatively at the Landlord's election. Each and every remedy under this Lease, law or statute, shall be cumulative. No delay in asserting any remedy under this Lease shall be deemed a waiver thereof, equitably or otherwise.

IN WITNESS WHEREOF of the Parties have signed this Lease as of the date set forth above.

LANDLORD:

By: _____

Name:

Title:

TENANT:

By: _____

Name:

Title:

EXHIBIT "A"
Description of Premises

for general and descriptive – (and not sq. footage) – purposes only

LANDLORD'S WORK

TENANT'S WORK

SCHEDULE I

RULES AND REGULATIONS GOVERNING TENANT ALTERATIONS

a. Complete architectural, mechanical, and structural drawings including but not limited to demolition plans, floor and reflected ceiling plans, electrical plans, heating, ventilation and air conditioning (HVAC) plans, plumbing plans, and furniture plans at a scale of ¼" equaling one foot, plus any elevations, sections, details and finish schedules relative to the work must be submitted to the Owner ("Owner") of the building for approval prior to the commencement of work. Tenant will provide Owner with complete working drawings and specifications, one set sepias and three sets of black and white prints plus a diskette with all the above information plus a partition layout plan on AutoCAD 2003.

Where new or altered work affects the building's mechanical, electrical or structural facilities, Tenant's drawings may be referred to Owner's consulting engineers for review. The working drawings will be referred to Owner's Building Code Consultant for review. The cost of all reviews shall be borne by Tenant.

b. Tenant agrees further to comply with all reasonable changes and requirements that may be recommended in writing by Owner and/or its consultant(s).

c. Tenant shall be responsible for any disturbance or deficiency created in the air conditioning or other mechanical, electrical, or structural systems within the Building as a result of the alteration. Of such disturbance or deficiency results, it shall be Tenant's responsibility to correct the resulting conditions and restore the services to the complete satisfaction of Owner, its architect and engineers.

d. A complete list of all contractors (general contractor and subcontractors) must be submitted to the Owner for its approval prior to the commencement of any work.

e. All work involving mechanical systems within the building (electrical, plumbing, air conditioning, fire alarm, locksmith, sprinkler, etc) must be accomplished by the Building's service contractors.

All workmanship and materials furnished shall comply with applicable lease provisions and other specifications that are available from Owner

upon request. All work shall be performed at Tenant's sole cost and expense. Owner shall have no responsibility for or in connection with the work, and Tenant will remedy at Tenant's sole cost and expense and be responsible for any and all defects in all such work that may appear during or after the completion thereof whether the same shall affect the premises in particular or any parts of the Building in general.

a. All work shall comply with the codes, rules and regulations of the city, state and federal government agencies having jurisdiction. Tenant's architect and contractor, utilizing the Owner's Building Code Consultant, shall file drawings and have them stamped approved (by the N.Y.C. Dept. of Buildings), and Tenant's contractor shall secure all permits and amendments for controlled inspections in compliance with the present rules of the Department of Buildings, prior to the commencement of any work. Duplicate originals of all Department of Buildings approved documents and drawings are to be submitted to Owner prior to the commencement of any work.

b. Tenant, utilizing Owner's Building Code Consultant, will file Building Department documents utilizing the Building Notice Application Form PW-1 and other supporting documents required by the Building Department. Owner, upon Tenant's satisfactory completion of documents, will execute Owner's Inspection Request section of Building Department Form PW-1.

c. Before commencement of work, Tenant's general contractor and all subcontractors plus any directly contracted entities must furnish to the Owner, certificates of worker's compensation insurance and certificates of comprehensive liability and property damage insurance on an occurrence and per project basis covering all workers employed in the execution of the contract, including those of all subcontractors in a combined limit of liability of \$_____, or a combined limit of liability of \$_____, and a minimum umbrella of \$_____ (naming Owner and managing agent as additional insured).

Contractors insurance to include contractual liability and completed operations coverage.

In addition, the general contractor must submit to Owner the following indemnity and save harmless clause:

"We indemnify and save harmless Owner and its managing agent against loss or expense by reason of liability

imposed by law upon Owner and agent because of bodily injuries, including death, at any time resulting therefrom, accidentally sustained by any person or persons or on account of damage to property arising out of or in consequence of the performance of the contract whether such injuries to persons or damage to property are due to or claimed to be due to any negligence of the contractors, the tenants, the owners, their employees or agents or any other persons. We will repair or replaced, or at Owner's election reimburse Owner for the cost of repairing or replacing any portion of the Owner's real or personal property so damaged, lost or destroyed in the performance of this work."

All insurance certificates are to be made out to Owner of the Building and its managing agent with notice given 30 days in advance if canceled or modified.

- a. Tenant and its contractors or materialmen shall comply with the rules and requirements of the Building including but not limited to unions having jurisdiction, noise and vibration abatement and cleaning, etc.
- b. Freight elevator use for handling construction material, equipment, and debris must be coordinated with management.
- c. If any work being done shall cause excessive noise, vibration, or disturbance to any other tenant, said work shall be stopped immediately on the advice of the Building Manager, or Property Manager representative, and completed only after a reschedule has been approved by Owner.
- d. When demolition or construction is in progress, all proper precautions shall be taken to prevent any dust or odors from escaping to adjacent tenant areas, Building corridors, or mechanical areas. No spraying will be allowed.
- e. All construction debris must be kept inside Tenant's Premises until removed from the job site. No stock piling of debris that constitutes a fire hazard will be allowed.
- f. When openings on Public Corridor Walls are made, the General Contractor will provide suitable protection to insure against dust and interference with other tenants. Work shall be performed outside normal business hours. Tenant shall be responsible for all restoration costs.

g. All demolition, rubbish removal, and noisy operations must be done per Building Manager's directions. A Building Maintenance Mechanic must be present during all demolition. Tenant will be required to pay overtime costs for the mechanic.

h. All tradesmen/materialmen are to follow specific instructions from both the Building Manager and Property Manager representatives with regard to building systems and operations.

i. The delivery and handling of materials, equipment and debris must be arranged to avoid any inconvenience any annoyance to other tenants.

j. A copy of the approved plans and permits shall be kept on the Premises available for inspection at all times.

k. All labor employed by Tenant, directly or indirectly, in connection with Tenant's work shall be harmonious and compatible with labor employed by Owner and/or other tenants.

l. All work involving mechanical system that affect the Building operation or other tenants must be accomplished after normal business hours and coordinated with the Building Manager.

Tenant and/or Tenant's contractors shall submit the following to Owner upon completion of work:

a. Written acknowledgment on Owner approved Final Payment and Waiver of Lien forms from all contractors, subcontractors, materialmen, architects, engineers and expeditors involved in the work that all of their charges for the work performed and materials furnished have been paid in full.

b. As-built reproducible drawings.

c. Duplicate originals of all approvals and sign-offs as required by New York City Building Department and governmental agencies having jurisdiction.

d. Electrical and Fire Department sign-offs as required by governmental agencies.

TENANT'S CHECKLIST OF SILENT LEASE ISSUES (THIRD EDITION)

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- * Copyright © 2017 S.H. Spencer Compton (shcompton@firstam.com); Joshua Stein (www.joshuaastein.com); and New York State Bar Association. This checklist was initiated and edited by Joshua Stein. It has appeared in the Practical Real Estate Lawyer; the New York State Bar Association Real Property Law Journal; multiple updates of John Busey Wood and Alan M. Di Sciuolo, *Negotiating and Drafting Office Leases* (Law Journal Press); and in numerous other publications. It appears here with consent by the copyright holders. The first and second editions of this checklist were contributed to extensively by a subcommittee of the New York State Bar Association, Real Property Law Section, Commercial Leasing Committee. That subcommittee was chaired by Messrs. Compton and Stein, who were the primary authors of every edition of the checklist. They prepared the third edition without subcommittee involvement. For the third edition, the co-authors acknowledge the helpful editorial assistance of Obianuju Enendu (obianuju.enendu@gmail.com), who worked with Joshua Stein when both were at Latham & Watkins LLP and thereafter. For earlier editions of this checklist, members of the Tenant's Silent Lease Issues Subcommittee included David Badain, Joel Binstok, Harvey Boneparth, Robert Bring, Philip Brody, Steven Cohen, Nancy Connery, Kathleen Cook, Samuel Gilbert, Holly Gladstone, Barry Goldberg, Gary Goodman, James Grossman, Andrew Herz, Gary Kahn, Andrew Lance, Bruce Leuzzi, Benjamin Mahler, Melvyn Mitzner, John Oler, Robert Reichman, Rhonda Schwartz, Karen Sherman, Barry Shimkin, David Tell, Michael Utevsky, Dana Wallach, Benjamin Weinstock and Allen Wieder.

[6.0] I. INTRODUCTION

A landlord's lease form won't always remind the tenant's counsel of everything they might need to think about and negotiate to properly protect their client.

Any lease can conceivably raise hundreds of issues, from the glaringly obvious, to the somewhat obvious, to the obscure. The language of the lease suggests many of those issues, starting with "economic" issues and continuing with "noneconomic" ones, most of which will turn out to be "economic" issues at the end of the day, if they ever actually become relevant.

When you negotiate a lease for a tenant, thinking about and responding to issues that the landlord and its counsel have already raised in the draft lease is the easy part. For example, if the landlord got the rent or some date wrong, you will ask the landlord's counsel to correct the error. You may ask for longer notice periods, a more extensive opportunity to cure defaults, "reasonableness" as the standard for handling any number of issues, a narrowing of any open-ended tenant obligations or landlord discretion and flexibility on use and transfers. You will also demand absolute clarity on all monetary and other significant obligations, deletion of inappropriate or excessive obligations and restrictions and correction of errors and internal inconsistencies. To the extent that anything in the lease is incomprehensible, you will try to have it translated into comprehensible language. Finally, you will respond to any other issues that you find while reviewing the language of the lease.

When you identify all these issues, you will respond to the landlord's lease document by asking for changes based on your experience and knowledge and the tenant's specific needs. It is a reactive process that starts with the express language of the lease itself.

To do a complete job, though, you also need to think about what the lease does not say. If the tenant will need or want something that the lease doesn't cover, you must ask for it or it won't be there – and it won't be there for the entire term of a document that can remain in place for a very long time. That's a daunting prospect. It forces the tenant's counsel to think outside the agenda that the landlord and its counsel defined within the terms of the lease they circulated.

The courts won't necessarily agree with a tenant who later asserts that some missing lease provision "should be inferred" because it's consistent

with the basic relationship between the parties. Instead, if it's not there, it is not part of the agreement.

That isn't the only way a legal system might deal with leases. For example, in civil law countries, a statute defines most of the rights and obligations between landlords and tenants, filling in a lot of gaps that might otherwise constitute "silent lease issues." The parties simply need to memorialize their basic business terms. They rely on the generally applicable leasing statute for all the other rights and obligations regarding the leased premises. If the statute doesn't make sense for them, they may be able to modify it by contract. But if they don't, then the statute governs their relationship, and they don't have to contractually "think of everything." The statute is supposed to define a bundle of rights and obligations that should work for most landlords and tenants.

In the United States, in contrast, if you represent any tenant, you bear the burden of identifying and dealing with issues that a landlord's typical standard lease does not mention at all, but that may nonetheless matter a lot to your client. These are the "silent issues" in any lease. Unlike the obvious issues covered in any landlord's lease form, the silent issues are hard to identify, because the landlord doesn't do you the favor of reminding you about them.

[6.1] A. Genesis Of The Checklist

In 1999 and 2000, a subcommittee of the Commercial Leasing Committee of the New York State Bar Association Real Property Law Section developed and published a checklist of silent lease issues for attorneys who represent commercial space tenants. That original checklist was republished extensively, drawing many responses from readers. Based on those comments, further thought, subsequent experience and further review by members of the subcommittee, the authors (again with help from the subcommittee) issued a second edition of the tenant's silent lease issues checklist in 2003.

After that, the co-authors of the tenant's checklist kept their eyes and ears open for other additions and changes to make to the tenant's checklist of silent lease issues. At first, they resolved never to publish a third edition, but changed their minds when they realized that the cumulative effect of all their notes and improvements added up to a third edition. Like the previous editions, this third edition seeks to help tenants' attorneys identify and, if they choose to, raise "silent lease issues" when they review a typical landlord's standard commercial lease.

The original “silent lease issues” checklist project expanded over time to include other significant issues, not just “silent” issues, that a tenant’s counsel might want to raise in lease negotiations. Reminders were also added for some, but not all, of the due diligence that a tenant (or its counsel or other advisers) might want to undertake before the tenant signs a lease. The third edition of the checklist continues that approach.

This checklist mentions each possible issue only once, even if it might reasonably belong under more than one heading. Even when an issue in one section relates closely to some other issue somewhere else, the checklist never offers a cross-reference. Any user who wants the full benefit of this checklist needs to read it from beginning to end.

This checklist covers most issues alphabetically, which makes no logical sense, but creates at least the appearance of order and accessibility. The last few sections of the checklist cover the various stages of the lease negotiation process, which don’t logically belong in the same alphabetical sequence. For anyone who negotiates leases for tenants, this checklist offers a useful set of reminders about nearly everything that could matter. This checklist will even help a landlord’s counsel, although any landlord’s counsel may prefer the Landlord’s Checklist of Silent Lease Issues, which is also in its third edition with a similar history.

[6.2] B. What The Checklist Is And Does

This checklist discusses a tremendous range of issues. Those issues represent, or at least touch on, almost every possible issue or event that could arise when two parties have potentially conflicting interests in the same real property over a very long time – one occupies it and the other owns it and will have rights of possession later.

A lease amounts to a private statute. The parties who must live with this statute have no way to change it except by persuading the other party to agree to a change. This might require the writing of a check—perhaps a large one.

Thus, a lease must get it right the first time. Before embarking on the relationship that the lease will govern, each party can try to shape the private statute that will govern the relationship. This checklist should help a tenant and its counsel seize that opportunity to the tenant’s advantage.

[6.3] 1. Which Issues to Raise

Depending on the market, the parties, their relationship and history, the nature of the transaction and its timing, the scope and terms of your engagement and any other circumstances, you may or may not choose to raise issues from this checklist. Even if you do raise these issues, you will not necessarily prevail on any of them. But if you never even raise an issue, you cannot possibly prevail on it. You can't win it if you aren't in it.

You should only “consider” raising each checklist item, as opposed to automatically raising it because you found it on this checklist. No checklist substitutes for thought and judgment. So if an issue doesn't really matter or apply to the lease you are working on, don't raise it. You'll lose credibility. And in a very landlord-friendly market (such as Manhattan since 2011), you may waste time and run up needless legal fees if you raise some of the issues suggested here. And before you ask for some concession, make sure the lease doesn't already give you that concession. If you raise an issue that the lease already resolved in your favor, you may lead the landlord to scrutinize and worsen what was already there, thus producing a less favorable outcome than if you had kept your mouth shut.

The fact that any particular lease does not reflect positions suggested here does not necessarily mean that the tenant's counsel did a bad job. To the contrary, to serve its client best, sometimes the tenant's counsel should raise no issues at all and just get the deal signed, or identify and raise issues that are outside this checklist. And even if tenant's counsel raises every issue in this list, the landlord may have enough leverage to do nothing more than laugh.

Sometimes, a tenant will tell its counsel to “just raise the major issues, and don't bother with the minor stuff.” In those cases, this checklist might help the counsel raise a few “major” issues, but the client will probably not appreciate it if the counsel makes extensive use of this list. Of course, some issues the tenant may consider “minor” may have implications not known to or considered by the client or counsel. Watch out for these. Counsel your client accordingly.

If your client tells you to focus only on the critical issues because of budget, transactional or time constraints (i.e., the client's typical instructions that extraordinary time pressures mean we “just need to get this deal done”), you may want to focus first on these sections of the lease and the corresponding issues suggested in this checklist, probably in this order of priority.

1. Use — Section 42
2. Rent (no separate section in this checklist)
3. Services by Landlord, Particularly Air Conditioning — Section 38
4. Operating Expenses — Sections 24, 25
5. Real Estate Tax Escalations — Section 31
6. Assignment and Subletting — Sections 3, 4
7. Security Deposit — Section 37
8. Alterations (Initial Occupancy)—Section 2
9. Electricity — Section 11
10. Utilities, Other Than Electricity — Section 43

Counsel may also want to include on the “short” list of “top” issues these topics, depending on circumstances and the client’s agenda:

11. Alterations Generally, Not Only For Initial Occupancy — Section 1
12. Failure To Deliver Possession — Section 16
13. End Of Term — Section 13
14. Parking, At Least For A Suburban Building — Section 27

The authors counsel against the minimalist approach just suggested. To the contrary, counsel should consider the entire lease and also at least consider raising issues suggested in this checklist. If the client insists on minimalism, counsel will want to establish a record of the client’s instructions and the fact that counsel warned of the resulting risks. Business people sometimes have little patience for details like those suggested in this checklist, and want to move decisively to “get it done.” But then they will be the first people to express shock and outrage when the lease turns out not to be perfect over its multi-year term.

On the other hand, if the tenant’s business strategy consists of trying to prolong lease negotiations, an easy goal to achieve, this checklist will provide plenty of help. More than almost any other category of real estate negotiations, lease negotiations can take as much or as little time as the

parties want. They give the parties an opportunity to think about and deal with an incredible array of issues: all the practicalities related to operation and occupancy of a building over an extended period. For example, the definition of “operating expenses,” in and of itself, can raise dozens of knotty issues that may amount to a reinvention of cost accounting and federal income tax law.

In deciding which issues to raise, a tenant may also want to think ahead and assess how those issues may turn out once the tenant raises them. If the lease already covers an issue in a vague way, the tenant may prefer that vagueness and uncertainty over the adverse certainty that might result if the tenant tried to clarify the language in question, and the landlord clarified it in a manner that benefited the landlord. The tenant may prefer uncertainty in the lease, especially if coupled with a high likelihood of a tenant-oriented judge. In other words, keep in mind the principle that sometimes one should not ask a question unless one will like the answer. On the other hand, five years later, the “vagueness” may look like tenant’s counsel didn’t do such a good job.

[6.4] 2. What Types of Leases?

This checklist applies primarily to substantial commercial space leases for retail and office tenants. Most issues here will apply to some leases but not others. You should interpret almost every item in the checklist as if prefaced by the caveats: “if applicable, appropriate, desired, possible, under the circumstances, taking into account the size and nature of the transaction, market conditions, practicalities, the tenant’s business agenda and anticipated use of the premises, accounting considerations and current accounting rules, the needs and negotiating positions of the parties, what the tenant expects of lease negotiations, the tenant’s instructions to counsel, the timing and all other circumstances.”

Many items on the checklist make sense only for very large tenants that might occupy all or most of a large building. If a smaller tenant raised some of these issues, a landlord might reasonably regard the tenant’s requests as bizarre and overreaching, or perhaps even a bad joke. In contrast, for a chain store tenant, making the same request might seem entirely routine.

The checklist makes no effort to explain which issues apply to which types of leases. The checklist also makes no consistent effort to suggest how a landlord might respond to any lease provisions suggested here.

The checklist does not consider “triple-net” leases, ground leases, “bondable” leases, “synthetic” leases, “build-to-suit” leases, leases from a seller to a purchaser of a company or other specialized leasing transactions, some of which are not really leases at all, but debt or equity financing masquerading as a lease.

The discussion in this checklist sometimes states that a tenant “should” consider or even “should” obtain certain provisions. Each such statement must be taken with a bushel of salt, because the co-authors do not purport to establish or define “standard” requirements for what any lease “should” or “should not” say. It is very easy to say in retrospect that a lease is “flawed” because it doesn’t say something one might want it to say. But leases are typically negotiated under substantial time pressure with an impatient client who just wants the deal to be done. And every lease represents its own negotiation, depending largely on the business and marketplace contexts. The making of definitive one-size-fits-all recommendations would thus be inconsistent with reality in the world of commercial real estate leasing. Nevertheless, it focuses the presentation.

This checklist considers lease negotiations from the tenant’s perspective. It is a tenant’s checklist. The authors and all previous checklist contributors do not necessarily believe that any landlord should accept the tenant’s position on any issue suggested in this checklist.

The checklist does not represent a position statement or recommendation by any co-author, publisher, subcommittee member or any organization with which any of them is affiliated. The checklist does not define a “minimum standard of practice.” It’s more like a “maximum standard of practice.” It does not give anyone a “smoking gun” to prove malpractice if any particular lease omits any particular provision(s) suggested here. This checklist is not exhaustive or complete. It is just a checklist. It’s a resource for leasing practitioners. It creates no legal duties or obligations. Users of this checklist are cautioned not to rely on it in any way or for any purpose. Some of its comments and suggestions may be inappropriate, or worse, in any particular transaction or even generally.

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1. Alterations

- 1.1 Acceptable Contractors.** Attach as an exhibit a list of pre-approved contractors, architects and other vendors. If the landlord has approval rights, have the landlord pre-approve as many names as possible. If the landlord reserves the right to delete pre-approved names, insist that the landlord act reasonably and, in any case, that the list must always contain at least a minimum number of names in each category. To the extent that the landlord's list does not include the tenant's desired team, fix that before signing the lease. Prohibit the landlord from delisting vendors of particular importance to the tenant.
- 1.2 Flexibility.** The tenant will want to maintain some freedom in choosing its architects, engineers, other consultants and contractors. It will not want to be limited to the landlord's approved list. At a minimum, the tenant should have the right to propose, at any time, additions to the landlord's list for the landlord's reasonable approval.
- 1.3 Consent Requirements.** The landlord should consent in advance to the tenant's initial alterations and any anticipated future alterations. If the initial alterations haven't been fully determined, try to get the landlord to approve as much as possible, even just a sketch. For nonstructural changes, try to eliminate any landlord consent requirement. Instead, just give the landlord at most the right to confirm that the intended work complies with objective and limited criteria that the lease defines. If that doesn't work, try to get the landlord to agree to be reasonable about approving any non-structural tenant alterations. Prohibit the landlord from requiring the tenant to make any changes in alterations that would increase their cost, except when the tenant's plans do not comply with law or with objective criteria in the lease.
- 1.4 When Consent Not Required.** Try to persuade the landlord to agree to limit any requirement for the landlord's consent to alterations. For example, perhaps the tenant should not need the landlord's consent for decorative or minor (less than a stated cost?) alterations or partition walls. Changes in the economy and work structure may make it necessary for many tenants to have more flexibility than in the past to relocate partition walls or make other nonpermanent changes.

- 1.5 Proprietary Design Features.** If the tenant regards its space arrangements, designs and office layouts as proprietary information, the tenant may want the landlord to let the tenant make any alterations permitted by law, with no need to obtain the landlord's consent or even to deliver plans to the landlord.
- 1.6 LEED Compliance.** If the tenant seeks to comply with LEED "green building" standards, the tenant may need to include suitable language in the lease and modify some typical lease provisions. That subject otherwise lies outside the present checklist.
- 1.7 Multiple Floors.** A multi-floor tenant may want the right to construct internal stairs and drill through floors for cabling. Such a tenant may also want the right to use the building's internal fire staircases for access between floors. If the landlord allows the tenant to cut through the slab to install an internal staircase, the landlord will generally require the tenant to restore, either specifically or under a general alteration restoration clause. The tenant should seek to negate that requirement. If the tenant has the right to "give back" a floor to the landlord, what happens if that floor contains communications cables serving the tenant's other floors? The tenant may want the right to leave those cables in operation, even after giving back the floor.
- 1.8 Risers and Other Passages.** The tenant may want to use riser spaces, shafts, chambers and chases to run ducts, pipes, wires and cables. Although, conceptually, limiting each tenant to its proportionate share of this space seems fair, such a limitation may not allow the tenant to meet its needs, especially if the landlord's building is inadequate (as a whole) to meet the needs of modern tenants. Try to have conduits and risers exclusively allocated to the tenant, not shared. At a minimum, try to control who else may use them and how. The tenant may want the right to control access to any conduits and risers serving the tenant. Provisions concerning riser use may need to be coordinated with those concerning telecommunications access. The entire area of telecommunications is one where many landlords ignore applicable provisions of federal law that mandate free access. Instead, landlords seek to impose restrictions and fees that may simply be void.
- 1.9 Hoist.** The tenant may want the right to install and use an outside hoist. Conversely, if the landlord decides to install an outside hoist, the tenant may want the right to use it, and the landlord should

agree to remove it as promptly as possible. What will hoist usage cost? Try to define or eliminate that cost.

- 1.10 Limit Fees.** If the tenant agrees to reimburse the landlord for fees to its architects, engineers, or other consultants in connection with the landlord's review of any alterations, the tenant will want to limit or negotiate those fees. More generally, assuming the tenant uses its own architect and the tenant's architect is competent and licensed, why should the tenant agree to pay the landlord's architect at all?
- 1.11 Time to Remove Liens.** If the tenant's work produces liens, the tenant will want enough time to remove them, taking into account procedural requirements of applicable law and related delays. The landlord should agree not to pay any lien that the tenant has bonded or is otherwise actively and diligently contesting in compliance with the lease.
- 1.12 Right to Finance Alterations.** The tenant may want the right to finance alterations, perhaps even on a secured or quasi-secured basis. Require the landlord to assist the tenant's lender as needed, such as by signing landlord's waivers, or at least subordinations. Consider attaching the required form of waiver or subordination to the lease. If the landlord will not let the tenant grant liens to secure equipment financing, perhaps ask the landlord to provide the financing instead, with repayment built into the rent or documented separately.
- 1.13 Bonds.** If the lease requires the tenant to obtain any type of bond relating to payment for alterations, ask a bonding company whether the tenant can actually obtain the bond in question. Often the answer will be no.

2. Alterations (Initial Occupancy)

- 2.1 Initial Criteria and Specifications.** State the criteria and specifications for the landlord's initial construction of the building, common areas, parking lot and any related improvements that concern the tenant in any way -- not just limited to the premises. Will the landlord upgrade any systems or other tenancies? Request that the landlord configure the space so the tenant can easily sublease, demise or break up the space. Avoid including anything burdensome in the space such as bathrooms, HVAC or parking lots.

- 2.2 Entering Premises Before Lease Commencement.** The tenant may want the right to enter the premises before the lease “commences”— even if the tenant will have a free rent period after “commencement.” The tenant may want to use that pre-commencement period to start preparing the space for the tenant’s needs. In that time, the tenant may need to take deliveries of building materials and equipment. Where will those deliveries go? Don’t let the landlord charge for storing them.
- 2.3 Landlord’s Space Preparation.** The lease should define how the landlord will prepare the space for the tenant, including the landlord’s responsibilities for asbestos abatement or removal, demolition, re-fireproofing, floor leveling, and closing of floor penetrations. Does the space contain any unusual existing improvements, such as vaults, that the tenant will want the landlord to remove? What level of completion must the landlord achieve? An architect’s certificate? A certificate of occupancy? Temporary? Permanent?
- 2.4 Delayed Completion.** If the landlord’s work is late or defective, treat this as a failure to deliver possession, or at least provide meaningful consequences, typically day-for-day additional free rent after delivery that escalates (e.g., two days free for each day of delay) if the delay continues. Try to extend the free rent period by the time spent for landlord’s turnaround/responses for plans and any other approvals required to be issued, and for as long as any violations exist that delay the tenant’s work. Require the landlord to give regular progress reports and estimated completion dates to create accountability for delays. So long the landlord has open building permits that prevent the tenant from obtaining a permanent Certificate of Occupancy, ask the landlord to pay for the renewal fees for the tenant’s temporary Certificate of Occupancy.
- 2.5 Right To Re-measure.** Allow the tenant to re-measure the square footage of the premises when the landlord has finished its work, at least for a new building or extensive remodeling. (In the alternative, consider prohibiting any re-measurement by either party. Is a later re-measurement more likely to produce an increase or a decrease in rent?)
- 2.6 Existing Violations.** The landlord should agree to cure any existing violations against the building that may prevent or interfere with the tenant’s intended alterations, or create issues when the

tenant tries to obtain a building permit. It is up to the tenant's experts to determine whether any such violations exist and whether they would, in fact, interfere with the tenant's work. They very well might not.

2.7 Credit Issues. Is the landlord creditworthy? If the landlord fails to build out or contribute to the tenant's work, what can the tenant do? Most leases say that the landlord has no liability beyond its interest in the premises, if that. At a minimum, the tenant will want a right to offset against rent—with a “default interest” factor—for any landlord contribution not paid or work not performed after a substantial cure period. The tenant will also want to assure that its offset right remains valid if the landlord's lender forecloses against the property. Toward that end, the tenant might consider whether an “offset” right is such a good idea, given that most nondisturbance agreements provide that a foreclosing lender will not be bound by any “offset” rights in the lease. Instead, the tenant might want to replace the “offset” for nonperformance with language that gives the landlord an opportunity to increase the rent payable for the space if and only if the landlord does what the landlord was supposed to do. This may produce a better result for the tenant (than an “offset” right would) under nondisturbance agreements. If the landlord has a construction loan in place for the very purpose of paying for the tenant's improvements, the tenant could seek a direct right to receive those advances as part of negotiating the nondisturbance agreement with the lender. The feasibility of such arrangements will depend on state law on permitted uses of building loan proceeds.

2.8 Building Systems. Are the existing building systems adequate? Should the landlord agree to complete any upgrades? By when? Should the landlord construct any new installations outside the tenant's premises? What about HVAC, fire safety or other system connections? Directional and wayfinding signage? Does the tenant have any special electrical requirements? Does the tenant require any space outside the premises to install electrical, communications or other equipment for its own use? A backup generator? Should the landlord install these things? Does the landlord have a backup generator that the tenant would like the right to use? A fuel tank that the tenant would like to use for its own backup generator? Think about future flexibility in these areas if the tenant's needs change. And if the tenant has a backup generator, will legal occupancy of the building in a blackout also require the landlord to

have a backup generator for common areas? If so, the landlord needs to assume that obligation in the lease – in a meaningful way, without too many caveats, excuses and exculpations.

- 2.9 Staging or Storage Area.** Will the tenant need any staging area, “lay-down” area, or storage area for its construction activities and move-in program? If the building has a loading dock, service elevator or outside hoist, the tenant may want the right to some guaranteed usage or priority, particularly while it moves in and out, without charge. Hourly rates for these services can otherwise be quite high.
- 2.10 Substantial Completion.** If the landlord performs the tenant’s initial alterations, “substantial completion” should require the landlord to have installed and activated all communications systems, utilities and interior elevator service. Require the landlord to deliver a permanent certificate of occupancy if at all possible in the particular circumstances, because a temporary certificate of occupancy, which expires after 90 days (in New York City), may not suffice. Treatment of this issue will vary by location.
- 2.11 Rent Commencement.** The tenant should not pay rent until particular anchor tenants are open for business; the landlord has finished specified construction, including common areas; and the landlord has paid the tenant the agreed construction cost reimbursement.
- 2.12 New York City Commercial Rent Tax.** New York City commercial tenants, in certain areas of the city, pay a “commercial rent tax” that is almost unheard of outside New York City. When it applies, it equals 6% of base rent. It supplements the City’s efforts to collect in real estate taxes about 30% of gross rent, an aggregate burden equal to about 36% of gross rent before even considering federal, state and city income taxes. In a particularly formalistic (or “creative”) application of that tax, city tax officials impose a commercial rent tax on the rent that a tenant would have paid but for an express rent credit that the lease gives the tenant to compensate the tenant for work it did in building out its space. The city treats that credit as if it were a “deemed” payment of rent, hence a taxable event — ignoring the fact that the credit probably results in some other taxable increase in the stated rent under the lease. If the parties achieve the same economic result through a free rent period or some other dollar adjustment of the rent not expressly tied to the cost of the tenant’s work, the rent forgone does not trigger a com-

mercial rent tax. So a wise New York City tenant will ask for a free rent period or a general rent abatement rather than a rent credit tied in any way to the cost of the tenant's alterations.

- 2.13 Tenant's Build-Out Allowance.** If the tenant performs initial alterations for its space, then allow the tenant to apply its build-out allowance to any "hard" or "soft" costs. When the tenant finishes its work, if any allowance remains the landlord should disburse it directly to the tenant or as the tenant directs. If the landlord fails to disburse any allowance within some reasonable period (e.g., 90 days) after the tenant properly requests it, then allow the tenant to abate rent to recover the amount due, with interest at some high rate. Focus on simplifying and speeding up the tenant's work allowance disbursement procedures, by, for example, defining the exact paper required to release funds and having the landlord create an escrow account at lease signing for the tenant's work allowance. Prevent delays by not letting the landlord condition releases on prior lender disbursements or third party approvals.
- 2.14 Simultaneous Work.** Prohibit the landlord from doing any non-emergency work in or affecting the space while the tenant performs its initial build-out. If the landlord must enter the tenant's space to perform any work during the tenant's build-out, all landlord's work must conform to the tenant's and its contractors' reasonable instructions and timing requirements.
- 2.15 Tax Implications of Build-Out Allowances.** When a landlord contributes funds to a tenant's alterations, that payment may create immediate taxable income to the tenant, though the landlord cannot recoup the same outlay except through depreciation on a schedule of up to 39 years, regardless of the lease term. Only the Internal Revenue Service wins. The tenant may wish to negotiate instead that the landlord owns (and depreciates) the tenant's improvements for tax purposes, in exchange for some other benefit to the tenant. As an alternative, the parties might characterize the allowance as reimbursement for current expenses, such as the tenant's cost of moving, buying out its existing lease, or purchasing tangible personal property like furniture, fixtures or equipment. Although the tenant may still suffer taxable income, the recharacterization will improve the landlord's position by giving the landlord either a current deduction or a much shorter depreciation period. The parties can shift this benefit to the tenant by adjusting other economics of the lease. Have an engineer or

appraiser prepare a cost segregation study to determine which property can be depreciated over such shorter periods. If the amounts are significant, involve a tax lawyer to consider possible tax mitigation or deferral.

2.16 Permitting Process. The landlord should authorize and designate the tenant to sign permit applications on the landlord's behalf.

2.17 Warranties. If the landlord performed the tenant's installation construction, the landlord should assign all construction warranties to the tenant or make the same warranties to the tenant.

3. Assignment And Subletting: Consent Requirements

3.1 Landlord's Consent. Ideally, allow the tenant to assign or sublet without the landlord's approval. This seems particularly justified under particular circumstances where governing law prohibits giving any prior notice of a transaction, such as securities laws prohibiting prior notice of a merger. At a minimum, the landlord should not unreasonably withhold its consent. Try to set standards for reasonableness. Try to provide that the landlord's consent will be automatically given if the proposed transaction meets specified objective and easy criteria (e.g., net worth, reputation, no felony convictions, experience and proposed use). In the case of a sublease, the amount of subrent to be paid should not be a permitted criterion for approving subleases. The tenant must keep paying the landlord's rent no matter what, so why should the subrent matter, unless the landlord proposes to lower the rent to match the subrent?

3.2 Assignment vs. Subletting. Don't assume the conditions and procedures for assignment and subletting should always match. Even if the lease tightly restricts assignment, a tenant should often have much more flexibility on subletting.

3.3 Simple Approval Procedure. Make the approval process as simple and expeditious as possible. And try to complete it early in the assignment or subletting process. Instead of requiring the tenant to submit to the landlord fully executed assignment or subletting documents, ask the landlord to agree to approve or disapprove the transaction in principle — before the tenant even starts its marketing — based solely on the tenant's anticipated pricing. As a fallback, defer the landlord's approval only until the tenant has

delivered a term sheet, the identity of a proposed assignee or subtenant and (in the case of an assignment only) financial information about the proposed assignee. These early clearance procedures seem particularly appropriate if the landlord can recapture the space if the tenant proposes an assignment or subletting.

- 3.4 Consent Form.** Attach as an exhibit the required landlord's consent form to any transfer. Goal: prevent the landlord from adding new conditions and restrictions when consenting to a particular transaction. Although such conditions and restrictions may not conform to the lease, the tenant may agree to them because there is no choice or simply because the tenant is/was not paying careful enough attention (or saving money on lawyers) at the time. The consent form should include language allowing the tenant to assign to any subtenant or assignee all of the tenant's rights against the landlord.
- 3.5 Carve-Out for Affiliates.** Expressly permit any assignments and subleases to affiliates (defined as broadly as possible) or successors, or in connection with the sale of the tenant's business. If the tenant operates multiple locations, a "sale of business" should include the sale of a single location or, worst case, some reasonable group of locations. Define "affiliate" to include trusts, estates and foundations in which the tenant or its officers are involved. The lease should impose no burdens at all (brokerage commissions, recapture or consent rights, pricing constraints and the like) for affiliate transactions. For an affiliate transaction, the tenant should merely agree to notify the landlord of the transaction—nothing more.
- 3.6 Suppliers, Vendors, Customers And Others.** Let the tenant sublet (or license space) to its suppliers, vendors, or customers, as appropriate for the tenant's business convenience. Will the tenant or its principals form joint ventures or other new businesses (e.g., "new business incubators") that should have the right to share the tenant's space without any need for landlord approval? Today multiple companies are collaborating on projects more than in the past, and the lease should not stand in the way.
- 3.7 Lender Approval Requirements.** The lease should not require approval from the landlord's lender for subleases or assignments. If it does, get copies of the loan documents, check them for lender approval requirements and insist on limiting (or at least receiving copies of) any burdensome changes in lender approval requirements in future refinancings.

- 3.8 Licensees.** The tenant should not need the landlord's consent to grant *bona fide* concessions or licenses.
- 3.9 Prohibited Transfers.** Try to persuade the landlord to commit to providing notice and an opportunity to cure if the tenant violates a lease restriction on transfer. Just like any other default under the lease, a tenant can and should have the right to cure that default — in this case by rescinding the transfer. The landlord will probably ask that the right to cure apply only to innocent or minor transfers, thus raising a factual dispute likely to create more trouble than it's worth.
- 3.10 Recapture Of Premises.** If the tenant requests approval of an assignment or subletting but the landlord elects to "recapture" the space, the tenant may want to have the right to withdraw the request. If the landlord recaptures the premises for any reason, the landlord should reimburse the unamortized cost of the tenant's furniture, furnishings, equipment and improvements. Any recapture notice by the landlord must be accompanied by mortgagee consent to be effective. If the landlord elects not to exercise a recapture right, then the landlord should not unreasonably withhold consent to the tenant's proposal.
- 3.11 Assignment/Sublet Involving Other Tenants.** The landlord should consent in advance to any assignment or subletting between this tenant and other tenants in the building, whether this tenant provides or receives additional space. Ask the landlord to waive in advance, for the benefit of this tenant, any provisions in other tenants' leases that would prohibit or limit such transactions or discussions, including recapture rights, profit participation and consent requirements.
- 3.12 Divestiture.** If the tenant must (or "agrees to") sell a location to satisfy a divestiture requirement under antitrust law, that should not require the landlord's consent or entitle the landlord to any rights.
- 4. Assignment and Subletting: Implementation**
- 4.1 Assignor and Guarantor Protections.** As a general legal proposition, when the tenant assigns the lease, the original tenant remains liable for any default by the current assignee, or any later assignee. To facilitate future transactions, the tenant may want to try to mitigate that long-term post-assignment exposure, as it may severely con-

strain the tenant's flexibility when negotiating a future assignment. Try to say that both the assignor and any lease guarantor have no more liability -- their liability terminates -- if the tenant assigns the lease and meets certain conditions, such as delivering a guarantor that meets an objective credit test (or at a minimum make sure the assignor's insolvency or other financial trouble does not create an Event of Default). If the tenant cannot obtain this protection, then the tenant may ultimately need to structure any future lease transfer as a sublease.

- 4.2 Guarantor Protections.** Ask the landlord to agree to give any unreleased assignor (guarantor) notice of any assignee's default and an opportunity to cure it. In any such case, the assignor's guaranty liability would terminate if the landlord did not give the notice. An unreleased assignor (guarantor) might also want a right to obtain a "new lease" if the landlord terminates the lease and the unreleased assignor (guarantor) later performs the tenant's obligations.
- 4.3 Suretyship Language.** If, after an assignment, the landlord and the assignee modify or extend the lease, a typical suretyship boilerplate provision in the lease may say that the unreleased assignor and its guarantor remain fully liable under the modification or extension. Although such boilerplate may make sense in the context of an affiliate guaranty, it makes no sense for an unreleased assignor of a lease where the assignee is an independent third party. Insist that in such case the assignor's and guarantor's liability will never exceed what it would have been under the original lease.
- 4.4 Stock Transfers.** If a lease treats an equity transfer as an assignment for consent purposes, the lease should not then treat it that way for purposes of requiring the assignee to assume the lease, except where the equity consists of a general partnership interest in the tenant. Many landlords' forms are written in a way that might require such an assumption of liability. If the lease deems an equity transfer to constitute a lease assignment, the tenant should exclude mergers, consolidations, initial public offerings, any change of corporate control of a substantial operating company, transfers of publicly traded stock, the sale of all or substantially all of the tenant's assets (or of all assets within some particular category), transfers among affiliates and any transfer resulting from an exercise of remedies by a bona fide pledgee.

- 4.5 Assignment Of Security Deposit.** A tenant will want the right to assign the security deposit to any assignee of the lease. If the security is a letter of credit, the landlord should cooperate in substituting one letter of credit for another (so two letters of credit are never both outstanding at once) if the tenant assigns the lease or changes banks.
- 4.6 Confidentiality.** The landlord should agree to keep confidential any submission for approval of an assignee or subtenant, including any financial information that a prospective assignee or subtenant furnishes. Rather than provide for a future confidentiality agreement, build it right into the lease to prevent painful delays later as the result of trying to negotiate a confidentiality agreement. Such an agreement would include a requirement to return any confidential information if a transaction does not close. Similar requirements should apply for any final transfer documents delivered to the landlord.
- 4.7 Splitting The Lease.** The tenant may want the right to sever a large lease into two or more separate and independent leases, to facilitate assignment in pieces -- a more flexible exit strategy. This could produce greater flexibility down the road and perhaps tax benefits depending on the particular circumstances. It also would, in the worst case, allow the tenant to "walk away" from one lease without imperiling the other lease, if the tenant can successfully resist the landlord's desire to cross-default the two leases. Any such cross-default would vitiate the lease-splitting effort.
- 4.8 Protections For Subtenants.** The landlord should agree to give "nondisturbance" or "recognition" rights to subtenants if the subleasing transaction satisfies certain tests. Usually one of those tests will require that the subrent must equal or exceed the rent under the lease. Any such requirement makes the nondisturbance/recognition protections relatively worthless because they are so unlikely to ever apply. Instead, the tenant should insist that the landlord protect any subtenant whose subrent is at least "fair market." But what does "fair market" mean? Comparable existing rents? Advertised rents? The phrase invites disputes. In the alternative, if any such sublease ever becomes a direct lease with the landlord, then the rent might adjust to match the lease rent, although this might defeat the whole point as viewed by a prospective subtenant. The lease should also give subtenants as much flexibility as possible,

perhaps the same flexibility as the tenant, on future assignments and subletting.

4.9 Participation In “Profits.” If the landlord will participate in any net “profits” that the tenant realizes from assignment or subletting, define the tenant’s costs as broadly and inclusively as possible. For example, include brokerage commissions, professional fees, build-out, costs (including rent payable to the landlord) of carrying the space vacant during a reasonable marketing period, any free rent period, transfer taxes, cost of furniture included in the transaction and the unamortized balance of the tenant’s original improvements to the space. Try to let the tenant claim all these deductions at the beginning of the sublease term, from the first subrent dollars received, rather than amortize them over the sublease term. If the landlord insists on amortization, then at least try to include an interest factor on the unamortized balance. If some of the payments from the assignee or subtenant cover personal property or a loan from the original tenant, try to exclude those payments from the tenant’s cash receipts. Once the “profit” for a sublease has been measured, the tenant should avoid paying the landlord’s share of it as a lump sum at the time of the subleasing—even with a discount factor—because the tenant may never see the alleged “profit.” Instead, any “profit” payments to the landlord should be due only to the extent the tenant actually receives the anticipated “profit.” If the subtenant or assignee defaults, allow the tenant to stop paying and perhaps even recalculate (and receive a suitable refund of) any payments already made.

4.10 Multiple Lease Transfers. If the landlord is entitled to a “profit” payment for any assignment or sublease, the tenant may want to negotiate a “basis adjustment” in the case of future transactions. For example, suppose an assignee pays \$1 million for a lease assignment, and the landlord receives 50% of that payment. What happens when the new tenant, the assignee, later assigns that lease again? At that point, the landlord has already “taxed” the first \$1 million of increased value of the tenant’s leasehold. The lease should let the assignee treat that lease purchase payment as part of the assignee’s cost of the lease when subleasing or assigning to someone else. The assignee tenant’s deductions should include any consideration that the tenant paid to acquire the lease, straight-lined, possibly with an interest component, over the remaining term of the lease.

- 4.11 Minimum Subrent.** The lease should not prohibit the tenant from subletting its space for less than the current stated rent, because that's exactly what the tenant will very likely need to do.
- 4.12 Bills and Administration.** If the tenant sublets, try to have the landlord agree to bill the subtenant directly for any services the landlord provides to the subtenant and any other landlord sundry charges that apply to the subleased part of the premises. Although the tenant cannot expect to be relieved of liability for these charges if the subtenant does not pay, the tenant can avoid time and effort, and probably an endless series of billing errors and inconsistencies, by extricating itself from the billing process. The same goes for any other function—e.g., requesting overtime HVAC or other building services—where the tenant might otherwise act as a mere communications channel between subtenant and landlord. The tenant will still want to see copies of bills and prompt notices of unpaid amounts to avoid unpleasant surprises.
- 4.13 Guarantor.** If the tenant can assign without the landlord's consent, the tenant also needs the right to replace any guarantor with a replacement guarantor that meets certain criteria. If the assignee delivers such a replacement guarantor—or if the landlord consents to an assignment without requiring a new guarantor—the first guarantor should be released automatically.
- 4.14 Landlord as Sublease Broker.** If the tenant cannot avoid having the landlord or its agent as the “broker” for a sublease or assignment, try to define the terms of that brokerage engagement and consider all the usual brokerage issues, starting with the formula for the commission. In particular, no commission should ever be payable absent an actual closing and delivery of all required consents and third-party documents. Consider how to make the tenant comfortable that the broker will not “favor” any direct space then available in the building.

5. Bills and Notices

- 5.1 When Notice Is Required.** Define when notice is required, but also try to limit when notice is necessary. The tenant should not have to comply with notice clauses if the tenant is sending, for example, only plans for approval, ordinary communications about the construction process, disbursement requests and the like. The lease should require compliance with formal (and tedious) notice

procedures only for notices that could give rise to meaningful rights and remedies under the lease.

- 5.2 Attorneys And Managing Agents.** Let attorneys and managing agents give notices on behalf of their clients. This should apply not only to any attorney or managing agent identified in the lease, but also to any future replacement, whether or not the party making the change has formally notified the other party of the change.
- 5.3 Copies.** If the landlord gives the tenant any notice, the landlord should agree to give a copy to the tenant's central leasing personnel, and perhaps to other specified recipients, such as counsel.
- 5.4 Delivery.** The landlord should deliver formal notices by personal service or nationally recognized overnight courier. State when notices become effective. Establishing receipt of notice by email can be problematic. Emailed notices seem particularly likely to get lost in the abyss. Thus, the co-authors have traditionally disfavored allowing formal notices to be given by email. On the other hand, a large organization might set up a special address for emailed notices and nothing else, with the idea that someone will check that address regularly and pay attention to, and act on, all incoming email. One could also perhaps live with email notices by establishing some reliable mechanism to assure that the notices were in fact received.
- 5.5 Notices Before and After Lease Commencement Date.** Until the lease commencement date, the landlord should agree to deliver all notices to the tenant's existing address, not the premises under the new lease. Even after the commencement date, it may not make sense for formal legal notices to go to the new premises. For example, the tenant may have a central leasing office that should receive and handle all incoming notices. In those cases, do something about the typical lease language that allows the landlord, after lease commencement, to send all formal notices to the leased premises.
- 5.6 Delivery Notices.** Require the landlord to give written notice of delivery of any part of the premises, with a "punchlist" of the work the landlord acknowledges remains incomplete. The premises should not be deemed delivered until the tenant has received that notice and, perhaps, a certain period of time has elapsed. The tenant may also want the notice not to become effective until the tenant has reasonably approved it. As a practical matter, a tenant is

often not ready to begin using the space immediately after receiving it from the landlord. The more process, formalities and delay the tenant builds into the rent commencement date, the less rent the tenant will need to pay for space it is not ready to use.

5.7 Deemed Waivers. If the tenant will be deemed to have waived any claims because of its failure to assert them within a specified period (e.g., objections to the landlord's delivery of the premises), then the lease should require the landlord to remind the tenant of the deemed waiver provisions as part of the notice that triggers the waiver.

6. Building Security

6.1 Description Of Program. Describe (and require the landlord to provide) a security program in accordance with agreed criteria. The program could include package scanning and messenger interception, lobby attendant, the tenant's own lobby desk, security guards, keycards, night access doors and specified operating hours.

6.2 Tenant's Security. Let the tenant establish its own security system and connect that system to the landlord's system.

6.3 Windows Film. The tenant may want the right to install blast resistant glass or film on exterior windows.

6.4 New Measures. The landlord should be required to obtain the tenant's consent for any new security measures (e.g., messenger interception) or changes in existing measures. This would, for example, allow the tenant to prevent establishment of security measures if the tenant considered them superfluous and merely burdensome. The tenant should also seek the right to require changes to the landlord's security program if the tenant determines changes make sense. Set performance standards for the landlord's security program, such as maximum approval times or a requirement to hire more staff if lines chronically form. A tenant's exercise of these consent or control rights should impose no liability on that tenant for criminal actions of third parties or other adverse events.

7. Casualty

7.1 Right to Terminate. If a material casualty occurs and the landlord either cannot or does not restore the premises within a specified

time period, or if the casualty occurs during the last two or three years of the lease term, let the tenant terminate the lease.

- 7.2 Adverse Impact on Business.** Allow the tenant to terminate the lease or abate rent if a casualty or other event (e.g., a terrorist attack affecting some other building)—or restoration from any such casualty or other event—causes any temporary or permanent material change in the tenant’s permitted use (e.g., loss of nonconforming use status), access, parking, traffic volume, pedestrian volume or visibility of the premises.
- 7.3 Extent Of Restoration; Interaction With Loan Documents.** Ideally, require the landlord to restore in all cases—whether or not the landlord has adequate insurance proceeds, i.e., whether or not the landlord decided to adequately insure the building. Perhaps, require the landlord to maintain a minimum required net worth or personal guaranty to cover the risk of insufficient insurance. Beware of the terms of subordination, nondisturbance and attornment agreements, which may, in effect, modify the restoration requirements of the lease to match those of the loan documents. If the tenant negotiates a broad obligation to restore but the landlord’s loan documents let the lender take the money and run, then the tenant loses if, as often happens, the tenant agreed in a subordination, nondisturbance and attornment agreement that the loan documents would govern. A major tenant will usually not tolerate this possible outcome.
- 7.4 Abatement During Restoration.** Try to abate rent, escalations, alteration fees and any other payments during all restoration — both the landlord’s and the tenant’s. Avoid any suggestion that rent abatement is available only to the extent that the landlord happens to receive rent insurance proceeds. It should be the landlord’s job to maintain suitable rent insurance. The tenant shouldn’t bear the risk of the landlord’s failure to do so. The landlord should refund prepaid rent and other items. These measures will often be a “win-win” for both parties, because the landlord often can insure the loss (on a property-wide basis) more easily, economically, consistently and reliably than can all the tenants individually.
- 7.5 Other Premises.** If a casualty affects only improvements outside the tenant’s premises, don’t allow the landlord to terminate the tenant’s lease unless the landlord: (1) makes the tenant whole (e.g., reimburses the tenant’s amortized investment in the space); and (2)

terminates all other similarly situated leases. And if the tenant's occupancy assumes the continued existence of other nearby buildings (such as a multi-building "retail mecca" destination), allow this tenant to terminate if some level of casualty affects those other buildings, even if it doesn't affect the tenant's building.

- 7.6 Landlord's Waiver Of Right To Sue.** Even without a waiver of subrogation, the landlord should agree not to sue the tenant for negligently causing a casualty that a typical casualty insurance policy would have covered.
- 7.7 Lease Extension.** Ask the landlord to agree to extend the lease termination date to compensate the tenant after a loss for any period when the tenant could not use and occupy the premises. Even if the lease terminates, if the premises are tenantable and may legally be occupied, seek some short extension of the lease term to give the tenant additional time to operate and ease the transition to new premises.
- 7.8 Time To Restore.** Limit or perhaps even negate any landlord right to obtain an extension of time to restore in the case of a *force majeure* event. The tenant might reasonably take the position that the tenant simply doesn't want to wait around very long to see if the landlord decides to, and does successfully, restore.
- 7.9 Insurance Program.** The entire discussion of casualty and restoration really relates to insurance more than space leasing. Who will insure what? Can tenant self-insure? (Probably yes, if credit-worthy.) Risks and responsibilities on casualty and restoration should match the insurance program. And because insurance is supposed to remove "negligence" from the discussion by shifting it to an insurance carrier, either party's "negligence" shouldn't change how the lease treats these issues.
- 8. Condemnation**
- 8.1 Partial.** Require the landlord to restore the premises in the case of a partial condemnation, at least to the extent of available condemnation proceeds. If the partial condemnation affects the premises or more than some percentage of the whole building, the tenant may still want the right to terminate the lease.

- 8.2 Separate Claim.** A tenant wants to be able to submit a separate claim to the condemning authority for: (1) the value of the leasehold estate; and (2) moving expenses, trade fixtures, goodwill, advertising and printing costs, phone lines and damages for interruption of business. Landlords and lenders rarely tolerate item (1) but may accept it provided that the tenant's award does not diminish sums payable to the landlord and its lender.
- 8.3 Physical Impairments.** The tenant may want a right to terminate or abate rent if any condemnation, including a road widening or other change, materially and adversely affects the tenant's business, such as by impairing parking, access (e.g., loss of curb cuts), traffic volume, or visibility. Similarly, if a condemnation affects nearby property within a multi-building "retail mecca" destination project, then the tenant may want the right to terminate, even if the condemnation doesn't affect the tenant's own building.
- 8.4 Landlord Participation.** The landlord should agree not to instigate, support or cooperate in any condemnation or taking of the tenant's leasehold interests, rights under a reciprocal easement agreement or any other interest in the property. If the landlord violates that prohibition (for example, if the landlord enlists a governmental authority to cut off the tenant's exclusivity rights to facilitate expansion of the landlord's regional mall, which has happened in a mall development variation of the *Kelo* case), then all rent should abate and the lease should allow the tenant to terminate and recover significant liquidated damages.
- 9. Consents**
- 9.1 Quick Exercise.** Require the landlord to grant or deny any required consent quickly. After a certain time, silence should be deemed consent. As a compromise, the tenant might agree to remind the landlord of the response deadline in its consent request or to give a reminder notice if the landlord has not responded within a certain time. Insist that no landlord consent may be unreasonably withheld. And if the landlord cannot unreasonably withhold consent, the lease should say, once, that the landlord also cannot unreasonably condition or delay consent.
- 9.2 Reasonableness vs. Objectivity.** Legal documents often use "reasonable consent" as a technique to solve many problems. No one quite knows what it means, beyond inviting litigation. If particular

categories of consent seem particularly problematic, consider defining “reasonableness,” by replacing the concept with objective standards that the tenant must meet in whatever matter would otherwise need the landlord’s “reasonable” consent. Then, instead of giving the landlord a “consent” right just give the landlord a “confirmation” right, i.e., the right to confirm that whatever the tenant wants to do does in fact meet the objective standards. If the landlord thinks it doesn’t, then the landlord bears the burden of saying why. Even with the issues that arise about the meaning of “reasonableness,” a tenant would prefer a landlord to agree to be reasonable, ideally about all consents in the lease, rather than not agree to be reasonable.

- 9.3 Expedited Dispute Resolution.** Some major leases build in an expedited dispute resolution procedure for certain consents—assignments, subletting, and alterations—and even designate the third party who will decide the dispute. If that third party can’t serve, then the lease may designate alternatives. Reports from the field indicate that one of the great advantages of such expedited dispute resolution procedures is that they almost never actually get used.
- 9.4 Pre-Consent.** Does the tenant anticipate any possible future changes in the tenant’s needs for which the tenant wants the landlord’s consent today (e.g., a pending merger, change of name, change of business)?
- 9.5 Grounds For Disapproval.** If the landlord decides not to consent, then the landlord’s notice to that effect should specify all grounds for that failure, so the landlord can’t manufacture other grounds later. The tenant could go a step further and require that any notice of disapproval must also specify reasonable changes in the proposal that would lead the landlord to approve it.
- 9.6 Use of Name.** The landlord should consent to the tenant’s use of the building’s name and likeness in the tenant’s promotional and publicity materials.
- 9.7 Site Plan.** For new construction, the tenant may want the right to consent to the landlord’s site plan (particularly as it relates to parking) and any substantial changes.

- 9.8 Press Releases.** The landlord should obtain the tenant’s approval of press releases, tombstones and announcements about the lease. The landlord should not disclose any terms of the lease without the tenant’s consent. Will the tenant want any such press release to identify—or not identify—the tenant’s broker, counsel, or other advisers? The lease should not preclude the tenant from posting the lease on any securities disclosure website, if legally required.
- 9.9 Tenant Consent Rights.** Does any tenant anticipate any matters for which the landlord should seek the tenant’s consent, such as changes in building security? Indicate in the lease that such consent will be required.
- 9.10 Damages.** For unreasonable denial of consent, try to trim back the standard lease language by which the tenant waives any right to recover damages. Perhaps the lease should allow the tenant to recover damages up to a specified dollar amount, or at least a reimbursement of the tenant’s attorneys’ fees in establishing that the landlord acted unreasonably. The tenant’s position seems particularly compelling where the lease requires the landlord’s consent in connection with the sale of the tenant’s business, and the landlord withholds consent—in violation of the lease—and thus derails the tenant’s entire transaction.
- 10. Defaults and Remedies**
- 10.1 Notice and Opportunity To Cure.** The tenant should have the right to notice of and the opportunity to cure any monetary or other default—including a prohibited transfer. Request a double cure period before the landlord can exercise its right to terminate the tenant’s lease. Why should lease termination be easy?
- 10.2 Default Triggered By Bankruptcy.** Although “ipso facto” clauses are typically unenforceable against a debtor-tenant, beware of any event of default triggered by someone else’s bankruptcy, for example that of a guarantor. A landlord can typically declare and enforce any such event of default against the tenant without a problem. Conversely, if the tenant becomes subject to an involuntary bankruptcy but the guarantor steps up and reaffirms the guaranty (and remains in reasonable financial shape), then perhaps that should suffice to cure the default for all purposes.

- 10.3 Limited Liability.** Limit the tenant's liability and the liability of the tenant's general partners to their interest in the lease. Allow for release of departing or deceased partners.
- 10.4 Limitation On Landlord's Remedies.** Limit the landlord's remedies (for example, to exclude lease termination or eviction) for defaults or disputes below a threshold level of materiality. Request that the landlord obtain an order from the court before it can exercise any right to terminate the lease. Why should the risk of lease termination hang over the tenant for every possible lease default or alleged default and hence almost every conceivable (even minor) dispute with the landlord? Also, ask the landlord to waive any right to recover consequential damages from the tenant.
- 10.5 Nonmonetary Defaults.** The tenant might want to eliminate all "nonmonetary" defaults. This can be accomplished by requiring the landlord to convert any "nonmonetary" default into a monetary default by curing it and sending the tenant a bill for reimbursement (a provision common in old Woolworth's leases—though apparently it was not enough to save the chain from oblivion). As an alternative, state that so long as the tenant remains current in its monetary obligations, the landlord cannot exercise certain remedies (e.g., lease termination) for a nonmonetary default until the landlord has obtained a court order. In practice, of course, a court will often put the landlord in the same position anyway, regardless of what the lease says, such as through the "Yellowstone" procedure in New York.
- 10.6 Future Equipment Financing.** Require the landlord, as well as its mortgagee, to waive or subordinate any statutory or other liens on fixtures, equipment and other personal property of the tenant, either in all cases or if the tenant's asset-based lender or equipment lessor requests it. To allow such a lender or lessor to exercise its remedies and remove any financed equipment, the landlord should also agree to enter into a landlord's consent, joined in by the landlord's mortgagee. This document could give the lender a brief right to enter the premises after the lease terminates and the right to conduct an auction on the premises. Ideally, attach the form to the lease. Try to avoid requiring the lender or lessor to pay rent for any brief occupancy period. Just don't mention it, and try not to call it an extension of the lease.

- 10.7 Holdover Rent.** Prorate holdover rent on a per diem basis for partial months, at least for the first month of holding over. As a practical matter, that may be the single most important concession for a tenant to request in the typical “boilerplate” of any lease, which will usually impose a full month’s holdover rent—often at double the contractual rent—for a day’s delay in departing. Establish a short-term right to hold over at the same rent, to give the tenant some flexibility in case of delays in relocating. Try to negate any holdover rent during some limited period, if the parties are negotiating a lease extension in good faith for the premises, or the tenant is diligently negotiating for space in another building. Try to eliminate holdover rent at any time when a new tenant is not ready to occupy the premises.
- 10.8 Mitigation Of Damages.** The landlord must seek to mitigate damages. (New York still imposes no such requirement on commercial landlords.) For example, the landlord must try to re-let the premises.
- 10.9 Waiver Of Self-Help.** Ask the landlord to waive any right of self-help (to retake possession) and any right to lock out the tenant.
- 10.10 Acceleration Of Rent.** If the landlord has the right to accelerate all rent as liquidated damages, first try to eliminate this remedy, as it is “off market” even in the typically very landlord-friendly New York City market. If you can’t, seek the following: (1) the tenant gets credit for fair and reasonable rental value; and (2) the highest possible discount rate (for example, prime rate rather than four percent per annum).
- 10.11 Default By Subtenant.** Extend the tenant’s cure period in the case of nonmonetary defaults arising from the actions of a subtenant. Try to give the tenant time to enforce the sublease and, if necessary, to obtain possession of the subleased premises. As long as the tenant is diligently exercising its rights against the subtenant – including through litigation – try to negate any risk of lease termination.
- 10.12 Statute of Limitations.** Limit the landlord’s right to collect unbilled rent, particularly escalations, once a certain time has passed (e.g., 18 months).

10.13 Piercing the Veil. Require the landlord to waive any theory that might let the landlord “pierce the corporate veil” of the tenant named in the lease. The landlord should acknowledge it has no claims against the tenant’s principals or affiliates under any circumstances, including tort-based theories relating to the lease or the premises, except to the extent they have actually signed a guaranty. Recognize that the “corporate” or “limited liability company” separation may not be as sacrosanct as lawyers usually assume it is.

10.14 Reletting Costs. To the extent that the lease requires the tenant to reimburse the landlord’s cost to “relet” the space after the tenant’s default, try to limit that obligation to apply to only an equitable portion of the landlord’s reletting expenses. For example, perhaps the tenant should pay reletting costs only to the extent reasonably allocable to the reletting period within the original lease term. If the reletting covers one year of the remaining lease term and nine later years, the tenant should pay only 10% of the reletting costs.

11. Electricity

11.1 Totalized Submeter Readings. Landlord should totalize readings from multiple submeters, using a third-party service and appropriate security controls to limit access to submetering equipment and computers.

11.2 Usage Survey. Let either party, not just the landlord, initiate a usage survey. The tenant may want, or may want to require the landlord, to periodically test electrical submeters for accuracy and to make sure they are not charging the tenant for any power delivered to any areas outside the premises.

11.3 Rate For Submetered Electricity. The tenant should pay for submetered electricity using the same tariff under which the landlord purchases electricity. If the landlord purchases electricity from a private provider, the rate the tenant pays should not exceed the public utility’s rate. If the landlord is required to stop providing power to the premises (one of those many bizarre hypothetical possibilities that every significant lease seems to address, perhaps because it once happened somewhere somehow), then the landlord should pay the tenant for the conversion costs of obtaining alternate sources of power, and should not shut off power to the tenant until the conversion has taken effect.

- 11.4 Sufficient Wattage.** The landlord should assure the tenant that the existing electrical system provides enough power for the tenant's present and anticipated needs, usually expressed in watts per usable (or sometimes rentable) square foot.
- 11.5 Additional Electrical Capacity.** If needed, the tenant should be able to obtain more electrical capacity quickly, at a defined or ascertainable cost. The landlord should reserve a certain number of watts per foot for the tenant, even if the tenant will not need it at first. If the tenant later needs more electricity but the building has no available capacity, the resulting delays in obtaining additional capacity may hurt the tenant's business. And the additional capacity will probably cost more than anyone expected. It may, among other things, require the landlord to provide additional mechanical space outside the premises, and the lease should provide for that.
- 11.6 Location for Power Delivery.** Specify the delivery point for electrical power.
- 11.7 Tenant's Backup Power Generator.** Let the tenant install a backup power generator and fuel tank, or other arrangements for fuel storage and refueling. Allocate ownership, responsibilities (including responsibilities for regular testing and refueling) and costs between the landlord and the tenant. Give the tenant the right, but not the obligation, to remove this equipment at the end of the lease term. If a tenant installs its own generator, it will want the right to have 24/7 access to the generator and any related equipment (fuel tank, meters, piping, etc.) without needing to go through the landlord's personnel. Even if the landlord generally arranges to keep the building fuel tank full, in a blackout or other emergency, the tenant will want the right to refill the fuel tank itself. If the tenant installs a backup power generator for its space, the landlord needs to have, maintain, operate and adequately fuel a backup power generator for the common space in the building. Without that, the fire department may shut down the building and make the tenant move out even though the tenant has its own separate backup power generator.
- 11.8 Backup Electrical Operation.** The landlord should give the tenant prior notice before any scheduled electrical shutdown or testing of the landlord's backup power generators. Limit the frequency of shutdowns and the periods when the landlord can test its

backup power generators. These generators, when running, can make as much noise as jet engines.

- 11.9 Building Generator.** Give the tenant the right to use the building generator. The landlord should reserve a certain amount of generator capacity for the tenant and agree to keep the fuel tanks full. The tenant may also want the right to monitor the landlord's generator maintenance and testing activities. A landlord will usually expect the tenant to reimburse a share of these costs, but that is ultimately a business negotiation.
- 11.10 Capacity.** Allow the tenant to reserve additional riser space and additional capacity in the bus duct or other main electrical distribution system.
- 11.11 Retroactivity.** Try to limit the period in which the landlord can retroactively bill the tenant for increased rates or usage.
- 11.12 Auditing.** Allow the tenant to audit electrical bills, the same way the tenant can audit operating expenses, and perhaps under similar procedures, including an obligation for the landlord to pay for the audit if it reveals discrepancies above a certain level. The tenant should also have the right to request that a qualified third party periodically check the landlord's meters for accuracy.
- 11.13 Maintenance.** Require the landlord to maintain and periodically calibrate any submeters and maintain evidence that the landlord has done so.
- 11.14 Termination Right.** If the landlord terminates electric service (which many leases allow the landlord to do) and the tenant cannot get replacement service on comparable terms and pricing, then allow the tenant to terminate. Consider whether the landlord should then reimburse the tenant's costs to relocate.

12. Elevators

- 12.1 Freight Elevators for Moving.** Ask to use the freight elevators to move in and move out. The tenant should seek the use of several elevators—e.g., all the passenger elevators in the building—on weekends and at night for the same purposes. Ideally, all this elevator usage, or at least a certain number of hours of usage, should be free, both for the move in and the move out. A “move” should

include the period of any construction, alterations or demolition plus the period when the tenant is moving its equipment, furniture and other personal property into the space.

- 12.2 Night Service.** The lease should provide that “night service” for elevators (restricted or limited service) cannot begin before a specified time. Require the landlord to have a minimum number of elevators in service at all times.
- 12.3 Changing Elevator Banks.** Prohibit the landlord from reconfiguring elevator banks. If the tenant’s space is the first stop, it should remain so.
- 12.4 Exclusive Service.** The tenant may want exclusive elevator service for certain floors. The tenant may want idle cars parked at, or returned to, the tenant’s floor for the tenant’s convenience.
- 12.5 Routine Repairs.** Require the landlord to perform routine elevator repairs and maintenance only outside business hours and within a certain turnaround time (shorter if multiple elevator cars are out of order).
- 12.6 Waiting Time.** Specify the maximum average waiting time for elevators. Establish measures to monitor elevator performance. In particular, a major office tenant might require the landlord to install in the ground floor elevator lobby a video display showing the elevator system and the status of each car. This would give the most likely critics of elevator performance—people waiting for an elevator—an immediate ability to know what to complain about (e.g., too many cars out of service). Establish consequences if elevator performance falls short of agreed benchmarks.
- 12.7 Security Measures.** Does the tenant want to institute any special security measures for the elevators? For example, does the tenant want to require keycard access controls for its own floor(s), or at least some of them?
- 12.8 Service Contract.** Require the landlord to maintain an elevator service contract that obligates the maintenance contractor to respond to a stuck elevator within a certain very short time frame.

13. End Of Term

- 13.1 Duty To Restore.** The tenant will want to disclaim any obligation to restore (i.e., remove the tenant's alterations) at the end of the lease term. As a compromise measure, the tenant might agree to remove any of the tenant's improvements that are unusual, particularly difficult to remove, or improperly made, or if the landlord reasonably required restoration as a condition to consenting to the tenant's work. But, what's "reasonable"? Instead, try to specify an objective test for determining what the tenant must remove. It may make sense to attach an exhibit, defining specific items that the tenant must remove at the end of the term. The lease might still need to deal with possible additions to the list if the tenant does more work later in the lease term. Require the landlord to give a reminder notice at least a certain number of months, but no more than some shorter number of months, before the end of the lease term if the landlord intends to enforce the restoration requirement.
- 13.2 Restoration.** If the tenant must restore, let the tenant: (1) perform any necessary restoration rather than pay the landlord to do it; (2) enter the premises on favorable terms for some reasonable time after the end of the lease term as needed; (3) during the post-term restoration period, pay only an equitable *per diem* payment (or nothing at all) rather than holdover rent; and (4) meet only a "substantial completion" standard rather than a higher standard that might apply to delivery of new space. Once the tenant notifies the landlord that the work is done, the landlord should have a short time to object. Silence should be deemed approval. Require the landlord to specify all objections, in reasonable detail, within the objection period. If the landlord's objections are minor and the tenant resolves them within a reasonable period, then the tenant should no longer be required to pay any rent (if the tenant agreed to pay any rent) during the post-term restoration period.
- 13.3 Condition Of Returned Premises.** The tenant should have no duty to return the premises in any particular condition. For example, it should have no obligation to replace a worn-out compressor in the last year of the lease term. And any requirement for the tenant to "repair any damage" caused by its departure just asks for trouble, with no corresponding genuine benefit to the landlord.
- 13.4 Removal Of Personal Property and Confidential Information.** Let the tenant enter the premises for a short time after the lease expires to remove the tenant's personal property. Tenants with heightened concern about confidential information may want the

landlord to agree not to remove any computers or files from the premises, even after the lease terminates, without giving the tenant one last chance to come and get them. If the tenant doesn't do that, then the tenant might go a step further and insist that the landlord store them at the tenant's expense for some reasonable period.

- 13.5 Demolition Clause.** If the tenant cannot negotiate away a demolition clause, then don't allow the landlord to terminate under that clause unless the landlord: (1) gives reasonable notice; (2) acts in good faith; (3) gives termination notices under all other leases where the landlord has the right to do so; (4) has entered into a binding noncancellable demolition agreement or contract to sell the building to a developer; and (5) deposits the lease termination payment in escrow. If the tenant can think of anything else to require, the tenant should do so, all toward the goal of delaying the lease termination as long as possible. The tenant might even try to require that the landlord has obtained a demolition permit before the landlord can terminate the lease – a requirement that in some municipalities could never be satisfied as long as the tenant remains in possession. This requirement would also not make sense if the landlord sells to a developer and needs to vacate the building before closing.
- 13.6 “For Rent” Signs.** The landlord should not post “for rent” signs until the lease term has actually ended. The landlord should agree to remove any “for rent” signs as soon as the landlord has signed a new lease for the space, or perhaps even when the landlord and the next tenant have entered into a nonbinding term sheet.
- 13.7 New Location Sign.** For a reasonable time after the lease has terminated, the tenant may want the right to install a sign directing customers to the tenant's new location.
- 13.8 Prepaid Rent.** Upon any termination not arising out of the tenant's default, the landlord must promptly refund prepaid rent and other payments, with accrued interest. If the landlord doesn't do it promptly, perhaps charge an administrative fee.
- 13.9 Subtenant Problems.** Sometimes a tenant cannot vacate solely because a subtenant fails to surrender its own subleased premises, which might consist of only a small part of the tenant's premises. To protect the tenant in such a case, try to limit the tenant's liability, by limiting such liability only to the part of the premises that

the subtenant failed to surrender or, at most, to the entire floor that includes those premises. Absent such a concession, the tenant may find itself liable for holdover rent for an entire multi-floor leased premises, even though the tenant moved out and the subtenant's holdover affects only a tiny corner of one floor. Tenants should understand this risk when evaluating prospective subtenants and negotiating subleases. As one way to mitigate the risk, the tenant might have the sublease expire six months before the main lease, at which point the tenant would require the subtenant to deliver appropriate estoppel certificates and other assurances (such as an increased security deposit or a stipulated judgment of eviction) to back its obligation to vacate, and the sublease might convert to a license arrangement. A strong tenant might ask the landlord to agree to bear the risk of subtenant holdover.

13.10 Receipt And Release. Require the landlord to issue a receipt and release upon request at the end of the lease term.

13.11 Inspection. Require that the parties jointly inspect and photograph the premises at the end of the lease term to identify, in a written punchlist, any issues the landlord intends to raise. If the landlord doesn't photograph and raise them at the inspection, then the landlord can't raise the issues later.

13.12 Holdover Right. Negotiate the right to a brief holdover when the tenant cannot timely move out. This would typically require some prior notice from the tenant, so the landlord can plan its re-leasing and marketing program for the space.

14. Escalations (Generally)

14.1 Proportionate Share Computation. In computing the tenant's proportionate share, if the rentable square footage (the numerator) includes the tenant's share of the common areas, confirm that the denominator also includes all common areas. If the square footage of the building increases, then the denominator should also increase accordingly. Exclude basement and mezzanine space from the numerator. Avoid contributing to the landlord's land banking or costs of carrying dead space.

14.2 Over-Reimbursement. Do all of the tenants' percentages add up to 100 percent, or is the landlord being over-reimbursed for escalations? Are the anchor tenants paying their share, or is that share

being shifted to the other tenants? If the latter, this tenant probably can't do anything about it, but may want to take the cost shifting into account in negotiating other terms of the lease.

- 14.3 Mixed Uses.** In a mixed-use building, including office with retail on the ground floor, does the landlord treat all tenant types the same way or at least equitably? Should the landlord do that? Should certain parts of the project be excluded from the tenant's escalation formulas? More generally, the existence of multiple uses in the same building can make any allocations much harder to understand and much more subjective, i.e., it creates much more room for abuse and makes the abuse that much harder to find. If possible, the tenant should contribute only to an allocation of costs within the particular single-use component of the project that the tenant actually occupies. The tenant may want to go a step further and negotiate a fixed contribution to expenses, or even a "gross" rent number.
- 14.4 Occupiable Space.** The lease should allocate escalations based on occupiable space (as the denominator), not occupied space. Let the landlord pay the full operating costs for all unoccupied space.
- 14.5 Multiple Escalations.** The lease should not allow multiple escalations that give the landlord duplicative recoupment of a cost increase, or double-count any charges included in operating expenses or elsewhere. For example, the marketing director's salary should be either an operating expense or a charge to the marketing fund, but not both. Anything treated as "real estate taxes" should not also be treated as "operating expenses." These principles can be expressed both generically and by combing through and comparing the various definitions, watching for overlap.
- 14.6 Lease Termination Mid-Year.** Apportion escalations if the lease terminates during a calendar year. Otherwise, the landlord could argue that annual calculation procedures and payment schedules obligate the tenant to contribute to an entire year's escalations.
- 14.7 "Base Year."** Any "base year" should fully include all expenses. Did the landlord not yet incur any ordinary expenses in the base year? Did any exclusions apply? Was the landlord not providing full building services? Was the building new, so the landlord could rely on contractors' warranties instead of paying for regular repair and maintenance?

- 14.8 Cap On Escalations.** The tenant might try to negotiate an annual limit on escalations—either a specific dollar figure, a percentage, a percentage of the consumer price index (CPI), or the comparable cost increases in a “basket” of comparable buildings, if such information can be obtained.
- 14.9 Free Rent Period.** Does the “free rent” period apply to escalations or just base rent?
- 14.10 “Porter’s Wage” Escalation.** For “porter’s wage” escalations (relatively rare in modern leases), the lease should exclude fringe benefits and the value of “time off.” Try to limit the measure to reflect only the base hourly rate. If you cannot exclude fringe benefits, try to define how to calculate them.
- 14.11 Consumer Price Index Adjustment.** To the extent that lease includes a CPI adjustment, try to have that adjustment measure any increase consistently from the starting year of the lease, rather than from the preceding year’s CPI. This will usually work better for the tenant, as it will give the tenant the benefit of intervening decreases in the CPI. The adjustment clause should specify exactly which CPI index the lease intends to use and what happens if that index stops being issued.
- 14.12 Escalations Below Base.** State that if an escalation amount falls below the original base, the tenant should receive a credit against fixed rent.
- 14.13 Fixed Rent Increases.** To avoid controversy over calculating escalations, negotiate fixed rent increases in place of all pass-throughs of expenses. This may be a new trend, particularly in place of an escalation for operating expenses.
- 14.14 Waiver Of Escalations.** The landlord should waive any escalations not billed within a certain period.
- 14.15 Fair Market Rent.** If the lease provides for a “fair market rent” adjustment, how will the rent increase after the appraisal date? The appraisers can either determine the amount of future increases (as part of determining “fair market rent”) or assume certain future increases in their analysis. Many leases leave it open-ended, creating the possibility that the appraisers will determine a current “fair

market rent” and then the landlord will be able to pile on future increases.

15. Estoppel Certificates and Other Confirmations

15.1 By Whom. Both the landlord and the tenant should agree to furnish estoppel certificates. How often?

15.2 Who Can Rely. Allow subtenants and assignees to rely on the landlord’s estoppel certificate, not just lenders. If the tenant delivers an estoppel certificate, negate any right for the landlord to rely on it; allow only third parties to rely on it.

15.3 Form. Attach an acceptable form of estoppel certificate as an exhibit to prevent subsequent issues or creative efforts by the landlord or its future lenders to turn future estoppel certificates into lease amendments (e.g., environmental indemnities or lender protection agreements without tenant protections). Limit the assurances the tenant must provide, both substantively and by adding “knowledge” requirements and as many other qualifiers as possible. Avoid restating any lease terms, except where they can’t be determined from the face of the lease, such as the actual commencement date if uncertain. Tell the lender, or anyone else relying on an estoppel certificate, to read the lease. They should rely on the estoppel certificate only for comfort that the landlord and the tenant have not secretly amended the lease and to confirm facts outside the four corners of the lease. Issuance of an estoppel certificate should not preclude the tenant from making audit corrections in the ordinary course, if the time to request an audit has not expired.

15.4 Legal Fees. Require the landlord to reimburse the tenant for the tenant’s reasonable legal fees in researching, reviewing and preparing future estoppel certificates.

15.5 “Knowledge.” Qualify appropriate sections of any estoppel certificate to apply only to the tenant’s knowledge, especially for issues of additional rent. Also, think about what “knowledge” means. Actual knowledge? As an alternative, say that the tenant reserves its rights on these claims. A typical 10-day requirement to deliver an estoppel certificate doesn’t give the tenant enough time to conduct adequate due diligence to knowingly surrender claims involving complicated and potentially debatable billing of operating

expenses and utility charges. This is particularly true when the tenant is a large company with multiple departments involved in overseeing the lease.

15.6 Conflict Of Terms. If the estoppel certificate and the lease conflict, the lease should govern. The delivery of an estoppel certificate should not be deemed to waive or modify any rights or remedies of the tenant.

15.7 Failure To Sign. Negate any liability of the tenant (e.g., claims of “tortious interference”) if the tenant does not sign the estoppel certificate. Limit the landlord’s remedy to an injunction, a deemed estoppel or a nuisance fee. This is just like the landlord’s desire not to incur liability for derailing a transaction if the landlord unreasonably withholds consent to an assignment or transfer. And make sure the tenant has a reasonable turnaround time for any estoppel certificate, and the landlord cannot demand these certificates with an excessive frequency.

15.8 Commencement Date Letter. State that the parties will promptly sign a commencement date letter when the date has been determined, if the lease does not specifically define it.

16. Failure To Deliver Possession

16.1 Remedies. Let the tenant terminate or receive a substantial rent abatement if the landlord does not deliver possession by a certain date. Also try to get day-for-day, or better, rent credit for the delay. Require the landlord to pay for or provide temporary space or pay the tenant’s holdover damages in its present space. If the lease sets a formula for any payment or credit to the tenant for delayed delivery, courts may test it as “liquidated damages,” although when a New York court did so, that particular ruling was reversed on appeal.¹ Just in case, though, add the typical recitations that attempt to validate any liquidated damages clause. Beyond establishing consequences for the landlord’s failure to meet a delivery date, establish consequences if the landlord fails to meet individual interim milestones. Those milestones might relate, for example, to completion of HVAC upgrades or construction of demising walls, the walls that separate this tenant’s space from common areas and space leased to other tenants.

¹ See *Bates Adver. USA, Inc. v. 498 Seventh, LLC*, 291 A.D.2d 179, 739 N.Y.S.2d 71(1st Dep’t 2002).

- 16.2 Lender's Approval.** If the lease is conditioned on a lender's (or anyone else's) approval, set an outside date for approval and let the tenant terminate if the landlord misses that date. Try to have the landlord deliver the approval when the parties sign the lease, particularly if the tenant is under time pressure to resolve its occupancy arrangements.
- 16.3 Termination Of Lease.** If the tenant terminates the lease because the landlord does not timely deliver possession or obtain any required approval, the landlord should refund all payments and redeliver any other documents (such as letters of credit) delivered on lease signing. Also ask the landlord to agree to compensate the tenant for the tenant's costs.
- 16.4 Late Delivery of Premises.** The landlord should push back all rent abatements and adjustments as well as the expiration date (and base years, at some point) if the landlord delivers the space late.
- 16.5 Relocation.** If possible, delete any clause that allows the landlord to relocate the tenant to other space. Otherwise, if the tenant agrees to give the landlord a right to relocate the tenant, require: (1) the new premises must be physically higher (or no more than ___ floors lower) than the existing premises; (2) the landlord must pay all direct and indirect relocation costs (e.g., new letterhead, announcements, rewiring costs); (3) the configuration, size and layout of the new premises must meet the tenant's reasonable approval; (4) the tenant need not relocate until the new premises are fully built out and legally occupiable, all at the landlord's expense; (5) a free rent period; and (6) instead of relocating, allow the tenant to terminate the lease, particularly if less than a certain period remains in the lease term. The landlord should also have no right to relocate the tenant more than once.
- 16.6 Seasonal Businesses.** For seasonal businesses, the tenant may not want to be obligated to initially open for business just before its slow season. Try to control periods or dates during which the landlord may deliver the premises. A certain day of the week? Only outside the winter holiday season?
- 17. Fees And Expenses**
- 17.1 Reasonableness.** Limit fees and expenses to any that are reasonable, actual and out-of-pocket. Do not agree to allow fees "as

established by landlord” or as “modified from time to time” or “based on landlord’s standard schedule.” The tenant should not be required to pay fees for any review of plans (or possible subtenants) by the landlord’s internal personnel, even if those persons are professionals.

17.2 Legal Fees And Expenses. Make the obligation to reimburse attorneys’ fees run both ways. Whoever prevails should recover attorneys’ fees, including the value of in-house counsel’s time. Exclude legal fees and expenses relating to a claimed default if no default exists or the landlord otherwise does not prevail.

17.3 Indemnification. The tenant should be responsible only for the direct consequences of its own acts and omissions. Keep any indemnity narrow. Negate tenant liability for consequential damages.

18. Heating, Ventilation And Air-Conditioning (HVAC)

18.1 Specifications. Specify required HVAC service, with variations by day of week and season, both during and outside business hours. Require the landlord to air-condition all interior public areas. Obtain the right to test air quality and other characteristics from time to time. Remember that HVAC includes “heating” and “ventilation,” not just air conditioning, so the specifications should address those services as well.

18.2 Rates. The lease should state the rates (and the basis of rates) for overtime HVAC. Squeeze out any profit component. If the landlord later charges any other tenant a lower rate, the landlord should agree to notify this tenant, and this tenant should get the benefit of that lower rate.

18.3 Installation. If the landlord must install any HVAC system, the lease should also require the landlord to get the system working properly. That means installing all meters, controls and thermostats, in locations satisfactory to the tenant and testing and balancing the system. Try to make this all a condition to the landlord’s delivery of the space, although some of the “testing and balancing” may need to await a change of seasons.

18.4 Allocation Of Charges. Allocate overtime HVAC charges among multiple simultaneous users. Otherwise, the landlord may charge

each tenant the full cost to the landlord of providing overtime HVAC for the entire building.

- 18.5 Notice For Overtime.** Minimize or eliminate any prior notice requirement for overtime HVAC. Even if the tenant misses the notice deadline, the landlord should agree to try to provide overtime HVAC.
- 18.6 Discount.** The landlord should give the tenant a discount on overtime HVAC if the tenant commits in advance to specified levels of usage for a specified period. With sufficient notice, the tenant should still have the right to withdraw or change its usage commitment and later reinstate it.
- 18.7 Water Treatment.** Require the landlord to add appropriate chemicals to any HVAC-related water lines to prevent pipe corrosion and system breakdowns. The landlord should maintain records of these treatments and give them to the tenant upon request. The tenant may want the right to test the HVAC system to confirm that the landlord is properly treating the water lines.
- 18.8 Miscellaneous Issues.** Should the tenant have the right to install supplemental HVAC? How much condenser water must the landlord provide? Chilled water? Who owns the equipment? How much will installation and usage cost? Who must repair/restore? Should the tenant be able to reconfigure building standard HVAC as needed for supplemental service? Will the tenant need access to fresh-air louvers? Where?
- 18.9 Generally.** After rent, HVAC is often the most important issue in any lease where the tenant will not arrange its own HVAC. If the parties get it wrong, the cost to the tenant can be shocking and the leased space can be unusable. And HVAC raises far more issues than rent.
- 19. Inability To Perform**
- 19.1 Force Majeure.** Give force majeure protections to the tenant, not just the landlord. The landlord must give notice of a “force majeure” event within a specified time, or lose the right to claim that event as force majeure. Any delays that result from a contractor that the landlord required the tenant to use (or perhaps even

merely approved) should constitute “*force majeure*” for the tenant’s obligations.

19.2 Right to Cure. If the landlord fails to perform an obligation, let the tenant cure the failure to perform, even if the landlord can argue that its failure is caused by “*force majeure*.” If the landlord fails to reimburse the tenant’s cure costs, with interest at some high rate, then let the tenant offset rent.

19.3 Force Majeure Exceptions. Although “*force majeure*” clauses always have a certain logic and fairness to them, should the tenant always allow the landlord the potentially open-ended extensions of time that a “*force majeure*” clause might justify? If the lease requires the landlord to restore after casualty within a certain time, should the landlord be entitled to an endless extension of time? What about delivery of the premises? What about maintenance of the roof? At some point, the “*force majeure*” clock should stop ticking or the “rent abatement” clock should start ticking, perhaps at double speed — even for “*force majeure*” delays.

20. Insurance

20.1 Common Standard. The tenant should have no obligation to provide more insurance than similar tenants customarily maintain in similar buildings, or to provide insurance at rates that are not reasonable.

20.2 Type Of Insurance. Allow the tenant to carry blanket insurance, self-insure, or use a “captive” carrier. In the case of a large corporate tenant, the insurance requirements should conform to the tenant’s company-wide insurance program. If that program later changes, the lease should allow the tenant’s insurance deliveries to conform to the tenant’s changed program. And if the tenant is highly creditworthy, should they have any insurance obligations at all?

20.3 Waiver Of Subrogation. Insurance policies should contain a waiver of subrogation clause. The lease should then contain matching waiver and release language.

20.4 Property And Liability Insurance. The landlord should carry property and liability insurance and give the tenant evidence of that insurance on request. The tenant may also want the right to see

copies of the landlord's insurance policies, a requirement that landlords often impose on tenants.

20.5 Effect Of Sublease. To the extent that the tenant subleases the premises, the lease should state that the subtenant's insurance coverage and insurance certificates (if otherwise substantially in compliance with the lease) will meet the tenant's insurance obligations. On the other hand, small subtenants will often expect to provide less insurance than a direct tenant. Avoid any suggestion in the lease that every subtenant's insurance must meet the insurance standards of the direct lease.

20.6 Landlord's Deductible. A major tenant may care about the size of the landlord's deductible (both a minimum and a maximum) and how the landlord will fund that deductible in the event of a casualty. Whose risk is the deductible? Will that payment constitute an operating expense?

20.7 Terrorism Insurance. If the tenant believes terrorism insurance may rear its head again as an issue in the world of commercial real estate, think about whether the lease should deal with it in any particular way. For example, the tenant might conclude that operating expenses should exclude any costs related to terrorism insurance. Make it the landlord's problem as a risk of owning real estate.

21. Landlord Obligations and Services

21.1 Generally. Does the lease require the landlord to provide any services or do anything at all, such as maintaining the building, insuring, providing security, or otherwise delivering what the tenant legitimately expects? As a "silent issue" staring the tenant in the fact, some landlords' form leases forget to mention that the landlord has any obligations at all.

21.2 Existing Systems. Let the tenant use existing cabling and other systems. The landlord should agree not to damage or remove such systems. These rights should extend to the tenant's use of wiring pathways located on the underside of the tenant's floors. For the tenant to gain access to those pathways, the landlord may need to exercise access rights under the leases of the "downstairs" tenants. The landlord should agree to do so for this tenant's benefit.

- 21.3 Performance Standards.** Set performance standards or criteria for any landlord services (e.g., comparable to those provided in a “basket” of other buildings). Provide that if the building experiences an unreasonable number of false alarms or life safety system breakdowns or problems, the tenant can perform an audit, perhaps at the landlord’s expense, and require changes. The landlord should be responsible for any failure to supply services to the tenant unless, perhaps, that failure is due to causes beyond the landlord’s control. The landlord should, though, perhaps have some obligation to control those circumstances, or at least establish measures so that services can continue even if predictable surprises occur, such as power outages.
- 21.4 Service Shutdowns.** Limit the landlord's ability to shut down building services, particularly for essential tenant functions (e.g., HVAC or electricity for data center). Require ample prior notice, and let the tenant reschedule the shutdown.
- 21.5 Engineering Issues.** Counsel should work with the tenant’s engineers and other consultants to identify needs, standards and specifications for all building services, particularly heating, ventilation and air conditioning, and the landlord’s alterations.
- 21.6 Strike.** If a strike occurs, the landlord should agree to establish a separate gate for the striking union in order to minimize any interference with the tenant. If the landlord or any other tenant uses a labor force that causes disharmony with the tenant’s labor force, require the landlord to remove the former labor force from the building. Most leases express only the converse proposition. Delegate to the tenant the landlord’s legal authority to exercise the landlord’s right to remove trespassers, protesters, etc.
- 21.7 Management Company Replacement.** The tenant may want a right to require the landlord to replace the management company or the leasing broker if specified standards are not being met.
- 21.8 Windows.** Allow the tenant to abate rent if windows are bricked up or covered over for any reason. The landlord should install (and repair/replace) sunscreen or other film on windows if needed, or at least give the tenant the right to do so.
- 21.9 Promotional Fund.** Should the landlord agree to operate—or not to operate—any promotional association, fund, or other similar

activities? Should the lease require that all other tenants participate?

- 21.10 Nonoccupancy Credits.** If the tenant is not in occupancy, the landlord should give the tenant credit for any variable costs that the landlord avoids, such as cleaning. Such a provision appears in some government leases, but rarely, if ever, in commercial leases.
- 21.11 Receipt of Deliveries.** Specify the location, arrangements, timing, and fees (none) for the tenant's receipt of deliveries. Try to allow deliveries at any time of day or night. Coordinate with the security program as necessary.
- 21.12 Contact Person.** Require the landlord to designate a single exclusive (or at least "primary" or "backup") contact person for all questions, problems and issues about the premises, with a 24-hour emergency telephone number to call if problems arise outside business hours.
- 21.13 Overtime Services.** The cost of any overtime services should be shared with any other tenants using such services at the same time. The tenant should receive a "most favored nation" rate.
- 21.14 Lobby Or Parking Lot Renovations.** If the landlord undertakes lobby or parking lot renovations, the landlord must complete them quickly and give the tenant access to the premises equivalent to that which existed before work began. The landlord should shield from view any unsightly construction areas. Prohibit any (non-emergency?) construction work during the tenant's peak months of business. The tenant may want to have the right to give the landlord reasonable instructions regarding how the landlord performs any work that affects the premises or its access or visibility.
- 21.15 Work Outside Premises.** What construction projects or alterations might the landlord undertake outside the leased premises that might cause the tenant concern or hurt the tenant's business? Try to identify them and negotiate appropriate restrictions or rent credits.
- 21.16 Continuation Of Services.** The landlord should continue to provide services to tenant even if the tenant is in default. The tenant should lose services only if the landlord has validly terminated the tenant's lease.

21.17 Other Tenancies. If a tenant cares about the existence and continuation of other nearby tenancies (e.g., a high-end retail store that wants to be part of a high-end retail environment), the lease will often impose co-tenancy requirements. The tenant may have the right to terminate if the landlord doesn't line up or retain a certain level of neighboring leases. The tenant need not open unless a certain number of nearby high-end retail leases have opened or open simultaneously. And if major nearby spaces "go dark," the tenant may also have the right to terminate. As an alternative to terminating, the tenant may also have the right to switch to percentage rent without a floor, typically only for a certain period.

21.18 Protected Areas; Visibility. If the tenant cares about visibility and access for its customers, designate areas where the landlord cannot install anything that would block visibility (even a little bit) or impair access. This might include, for example, a prohibition on kiosks, plantings, artwork, signage, benches and anything else. Depending on the site, these restrictions could affect common areas, sidewalks, parking areas or other public areas of the property. The restrictions should capture installations of any kind, whether temporary or permanent.

21.19 Confidentiality. If the lease requires the tenant to give the landlord any financial, sales-related, or other sensitive information about the tenant, the landlord should agree to keep it confidential. Generally, the tenant should insist that the landlord keep the lease and *all* its terms confidential. That would include, for example, a promise that neither the landlord nor the landlord's counsel will disclose (or use against the tenant in other negotiations) any concessions that the tenant made in negotiating this particular lease. If the tenant provided the lease form, then the tenant should insist that the landlord and its counsel will preserve the confidentiality of the lease form and not re-use it for other transactions, whether with this tenant or anyone else.

Legally Required Actions. If either party is legally required to do anything, the other party will reasonably cooperate.

22. Landlord's Access

22.1 Prior Notice. How much and what type of prior notice should the landlord give to gain access to the tenant's premises?

- 22.2 Purpose Of Access.** Limit the landlord's access to certain defined purposes (e.g., repairs, inspection, or to show the premises to prospective future tenants within the last few months of the lease term only).
- 22.3 Frequency.** Limit how often the landlord can enter the premises.
- 22.4 Sensitive Areas.** Should the lease prohibit or restrict landlord access to "special spaces" (bank vault, securities vault, network control rooms and the like) for cleaning and other purposes? If the tenant regards its entire operation as proprietary and "top secret," then perhaps the lease should not allow the landlord access at all, absent an emergency.
- 22.5 Time Of Access.** Should access be limited to certain hours (business hours, after hours)?
- 22.6 Authorized Personnel.** Precisely who among the landlord's employees, agents and contractors should have access?
- 22.7 Presence Of Tenant's Representative.** The tenant may want its representative to be present whenever the landlord is on the tenant's premises. This is particularly important in any area where the tenant has sensitive, dangerous or expensive personal property.
- 22.8 Disruption and Security.** Require the landlord to minimize interference with the tenant's business and comply with the tenant's reasonable instructions and security requirements, even if this requires the landlord to use overtime labor. If the landlord's personnel or contractors cause any damage or theft, make the landlord responsible.
- 22.9 Landlord's Installations.** If the landlord wants to reserve the right to install pipes and conduits somewhere in the premises, the tenant may want to limit exactly where — such as only within existing walls or above ceilings, or at locations that the tenant reasonably approves. Require the landlord to minimize and repair (or pay to repair) any damage associated with the installation or maintenance of these conduits. Expressly negate any right for the landlord to install any new structural supports or other improvements not requested by the tenant within the premises. Perhaps also provide for significant liquidated damages if the landlord violates the restrictions in the preceding sentence.

22.10 Storage Of Materials. If the landlord stores materials in the premises for making repairs, limit that right to apply only to those materials necessary for repairs within the premises. This can be particularly problematic if the premises includes a terrace — a tempting storage area for long-term exterior projects. In any case, the landlord should store materials in the premises (or an adjacent terrace) only for short periods.

22.11 Repair Work Outside Business Hours. If the landlord's work in or affecting the premises will cause inconvenience, noise, odors or the like, the landlord should work only outside business hours. If the tenant needs the landlord to repair any critical area or function quickly, require the landlord to do so, even if the landlord must hire overtime labor.

22.12 Hazardous Materials. If the landlord will use hazardous materials for any work in or affecting the premises, the landlord should agree to notify the tenant in advance and provide "material safety data sheet" disclosures. If the landlord will make the premises uninhabitable during business hours, should the landlord provide substitute space?

23. Leasehold Mortgages And Tenant's Financing

23.1 Landlord's Consent. Ask the landlord to consent in advance to the tenant's grant of leasehold mortgage(s). The landlord should also agree to execute a recordable memorandum of lease. Any leasehold mortgagee should have the rights to: (1) receive notice of default from the landlord; (2) cure; and (3) obtain a new lease from the landlord if the original lease terminates, except a scheduled termination in accordance with its terms. For the lease to be truly "mortgageable," it needs much more than this. But the tenant may need it.

23.2 Equity Pledges. If the tenant's owners pledge their equity as collateral for a loan, the pledgee may want protections under the lease like those of a leasehold mortgagee.

23.3 Financing, Generally. Does the tenant anticipate entering into any other financing arrangements, such as equipment or inventory financing, that might affect the landlord, the lease, or the premises? If so, add appropriate language to the lease to preserve the tenant's flexibility. Plan ahead to obligate the landlord to comply

with any likely requirements of the tenant's equipment lessor or other financing source.

24. Maintenance And Cleaning

24.1 Structural Repairs. Require the landlord to maintain and repair the "structure" of the building (including the roof, the foundation and other structural elements) and maintain and repair common areas, parking lots, garages and sidewalks. Define "structure" (broadly) to avoid future disputes over what it means. Try to have it cover as much of the building as possible except most improvements unique to a particular tenant.

24.2 Building And Systems Maintenance. The landlord should maintain electrical, plumbing, sewage, HVAC and other building systems, at least to the point of entry into the premises. Require the landlord to maintain service contracts. Let the tenant and its advisors inspect building systems and monitor or confirm the landlord's maintenance program.

24.3 Standard For Maintenance. The landlord should maintain the building and common areas in an attractive and first-class manner, which the tenant may want to define in a specific way. That obligation should extend to any empty shop spaces and all common areas on any multi-tenant floor, whether or not fully occupied. "Maintenance" should include the provision of security. Require the landlord to repaint, recarpet and repave periodically. If any landlord work damages the tenant's finishes, the landlord must restore the finishes to the original standard at the landlord's expense.

24.4 Cleaning Standards. Specify standards for the landlord's cleaning services, both within the premises and in common areas. Limit the scope of possible "extras." Try to define the pricing of "extras." Cleaning standards are an economic issue and potentially a profit center for a landlord. Review and negotiate them accordingly. If the cleaning standards say the landlord does not need to clean any "computer areas," how much space will this exclude for a modern office? If the landlord wants to disclaim any responsibility for cleaning of certain areas (food preparation, etc.), obtain a credit for the value per square foot of the "building standard" cleaning not provided. As an alternative, ask the landlord to give the tenant an allowance. Then the tenant should only be responsible to pay for any cleaning in the space that is above standard.

- 24.5 Cleaning Hours.** Specify the earliest time at which cleaning may commence and the time by which it must finish.
- 24.6 Cleaning Personnel.** The tenant may want the right to approve individuals or cleaning crews that provide cleaning services to the space. The tenant may also want to request background checks for these individuals. If the staffing changes, the tenant may want the same rights for any replacement cleaning staff members. The tenant may also want to require bonding of the cleaning staff.
- 24.7 Right To Terminate.** The tenant may want to be able to terminate the landlord's cleaning services and take over cleaning of all common areas or just the premises, with a rent credit. If the landlord maintains storage and locker areas specific to the premises, for the landlord's cleaning staff, then if the tenant takes over cleaning, the tenant will want the right to use those storage and locker areas.
- 24.8 Garbage Removal.** Define the location, access, timing and other arrangements for garbage removal. The landlord should provide separate recycling containers or areas.
- 24.9 Repairs Covered By Insurance.** Require the landlord to make repairs—even if otherwise the tenant's obligation—where the need arises from an event covered by insurance that the landlord carries or should have carried.
- 24.10 Vermin.** The landlord will exterminate vermin outside of the leased premises. The tenant should particularly worry about this issue if other space in the building has food-related uses.
- 25. Operating Expenses — Calculation And Auditing**
- 25.1 Statement By Professional.** An independent managing agent or, better, a certified public accountant should prepare the landlord's statement of operating expenses. Attach as a lease exhibit the landlord's operating expense statements for the preceding few years. Ask the landlord to confirm that: (1) these were the statements actually used for pass-throughs to existing tenants; and (2) the landlord will calculate future operating expenses the same way.
- 25.2 Time For Revision.** Set a time limit for the landlord's revisions to operating expense statements—and make that limit subject to a “time of the essence” qualifier. The tenant may want to require the

landlord to issue an audit confirmation letter waiving any unbilled charges beyond a certain point from when the operating expense statement is prepared.

- 25.3 Gross-Up.** In any year the building is not fully occupied, operating expenses are often “grossed up” as if the building had been fully or nearly fully occupied during the entire year. Confirm that the base year and adjustment year are treated consistently and that the “gross-up” calculations make sense.
- 25.4 Consistency.** For all operating expense definitions, references, and accounting procedures, the most important word is “consistently.” The landlord should not have the ability to change its calculation techniques after the base year.
- 25.5 Timing Of Operating Expense Statement.** The landlord should provide the annual operating expense statement within a reasonable time (90 to 180 days) after fiscal year-end. To give the landlord an incentive for promptness, the tenant might insist that monthly estimated operating expenses payments must stay the same (for the next year) until the landlord has completed its operating expense statement justifying an increase. And if the statement shows a decrease, then the tenant should immediately obtain the benefit of that decrease (with interest?) and a suitable rent credit.
- 25.6 New Expense Items.** Building management standards sometimes change over time, usually upwards (e.g., higher security standards or new types of insurance or new regulatory compliance costs). When that happens, the landlord may incur new categories of expense that the landlord did not incur during the base year, which would require the tenant to bear the entire cost of that new expense, not just increases above the base year. Therefore, if the landlord later incurs new categories or items of expense that were not being incurred when the lease was signed, the tenant may want to require the landlord to “gross up” the base year to reflect what this expense would have been if the landlord had already been incurring it the day the lease was signed.
- 25.7 Right To Review And Challenge.** The tenant should have the right to examine and question the landlord’s operating expense calculations. Require that any expense the landlord incurs be reasonable, ordinary and customary, not just actual. Allow the tenant to

challenge any expense as unreasonable. Those rights should survive any lease termination. The lease should give the tenant reasonable time to: (1) notify the landlord that it wants to audit expenses; (2) conduct and complete the audit; and (3) specify if, and how, it contests the landlord's calculations. Avoid any schedule that requires the tenant to provide more detail than is reasonable at any particular stage of the process. If the tenant discovers egregious errors, let the tenant reopen operating expenses from earlier years, even if the time to do so has otherwise expired.

- 25.8 Books And Records.** Require the landlord to keep books and records for a specified number of years in a single place under a unified system. In the likely event this information is stored electronically, give tenant the ability to access it in useful electronic form (e.g., spreadsheets rather than PDF files). Allow the tenant to copy those books and records for any audit of operating expenses.
- 25.9 Base Year.** The tenant's right to audit should also cover the base year, expiring no earlier than the expiration date for the right to audit the first operating year. The tenant may wish to audit the base year at the same time that it audits the first operating year.
- 25.10 Landlord's Responsibility For Audit Cost.** The landlord should pay the cost of audit (credit it against the next month's rent) if the audit discloses an overcharge of more than some stated low percentage. Beware of language that refers not to an overcharge but to an overstatement of operating expenses; that's a harder threshold to meet.
- 25.11 Most Favored Nation; Landlord's Discovery Of Error.** If some other tenant's audit discloses a discrepancy, the landlord should automatically give this tenant the benefit of any resulting adjustment to operating expenses, even if this tenant does not ask for it. If, on a particular issue, the landlord makes a better deal with any other tenant, this tenant should get the benefit. If the landlord fails to timely disclose any benefits of the types mentioned above, then the landlord should pay interest at a high rate and perhaps also an administrative fee. Don't call it a penalty, though.
- 25.12 Choice Of Auditing Firm.** The lease should not limit the tenant's right to engage a firm of its own choosing, such as a contingent fee lease auditor or someone engaged by other tenants, to examine the landlord's books and records.

- 25.13 Parking Lots.** Treat the cost of filling potholes and restriping as an operating expense, but resurfacing as a capital expense to be borne by the landlord without reimbursement. Require resurfacing at least once every ___ years. Exclude any parking lot maintenance costs for at least ___ years after the commencement date.
- 25.14 Cost Of Capital Improvements.** If the estimated cost of any capital improvement or replacement for which the tenant is responsible exceeds a specified amount, perhaps varying based on the remaining term of the lease, allow the tenant to terminate the lease or require the landlord to contribute to the cost. Base that contribution on the expected useful life of the improvement or replacement as compared against the remaining lease term. Beware of unrealistic limits on the amortization period for any capital or quasi-capital outlays by the landlord. Beware of capital costs masquerading as operating costs, or that should be handled as part of a capital project (for example, initial adjustments and repairs of a newly installed elevator).
- 25.15 Tenant-Specific Exemptions.** Look for justifications to support exemption from particular expenses (e.g., elevator expenses for a ground floor tenant).
- 25.16 Confidentiality.** If the landlord requires the tenant to sign a confidentiality agreement for any future lease audit, insist that the form of agreement be attached to the lease, or that the agreement be built into the lease. (Why do we need a separate agreement?) Either approach avoids the risk of extended delays in trying to negotiate a confidentiality agreement when the need arises.
- 25.17 Credit.** Try to get credit for any income the landlord derives from common areas (e.g., signage).
- 25.18 New Buildings.** Part of the business negotiation of a lease in a new building will relate to the negotiation of the base year for any escalations. The parties are both at greater risk here, because the building has no operating history. Initially, the base year should reflect regular base operating costs and should not include savings that result from new construction (for example, lack of maintenance costs because a contractor's warranty covers all problems). The tenant may want to adjust the base year to a year (or average of several years) in which the landlord has achieved a certain occupancy level (e.g., 100 percent).

- 25.19 General Comments.** The preceding discussion, and other comments on operating expenses in this checklist, amply demonstrate that operating expenses raise a wide variety of fascinating issues, giving landlords substantial discretion and opportunities and creating potential for many disputes based on characterization, measurement and conceptual issues. Operating expense clauses can sometimes amount to a reinvention of cost accounting and tax law by people who don't necessarily have expertise in either area. And if a particular lease includes creative protections for the tenant, will the landlord's actual accounting procedures adequately take those protections into account? Both landlords and tenants may favor replacing traditional operating expense escalations with fixed rent increases.
- 26. Operating Expenses—Exclusions.** The tenant may desire to exclude at least these items from operating expenses:
- 26.1 Above-Standard Cleaning.** Costs of cleaning portions of the building that have cleaning requirements higher than the tenant's (e.g., cleaning some other tenant's employee cafeteria or special mahogany conference rooms).
- 26.2 Americans with Disabilities Act.** Americans with Disabilities Act of 1990 ("ADA") compliance costs, particularly when triggered by operations of other tenants.
- 26.3 Advertising.** Advertising expenses, including the cost of maintaining any website.
- 26.4 Art.** The purchase, maintenance, or insurance of any artwork or sculpture.
- 26.5 Bad Acts.** Costs incurred as a result of the landlord's negligence or intentionally wrongful acts (good luck finding and proving either of those).
- 26.6 Breach of Lease.** Costs incurred because any party breaches any lease.
- 26.7 Capital.** Costs that under generally accepted accounting principles consistently applied would be considered capital outlays or are otherwise outside normal costs and expenses for operation, cleaning, management, security, maintenance and repair of similar

buildings. As an alternative, perhaps allow capital expenditures if: (1) the tenant approves any expenditure above a certain level; or (2) an expenditure is justified by the cost of repairs or undertaken to reduce operating expenses and then only to the extent that the landlord demonstrates actual cost reduction.

- 26.8 Collateral Source.** Any cost reimbursed by insurance proceeds (or that would have been reimbursed if the landlord had carried customary insurance), any condemnation award, or any indemnification from any third party.
- 26.9 Construction.** The cost to perform initial construction and to correct initial construction defects, as well as such costs for any future alterations, additions or upgrades.
- 26.10 Contributions.** Any charitable or political contributions the landlord might decide to make.
- 26.11 Development-Related Payments.** Exactions paid to any governmental body or community organization, including those for infrastructure, traffic improvements, curb cuts, roadway improvements, transit costs, “impact fees,” statues of government officials and so on. The tenant can reasonably treat these as land costs and irrelevant to the tenancy.
- 26.12 Environmental.** Costs of testing for, handling, remediating or abating asbestos and other hazardous materials or electromagnetic fields; the cost to remove chlorofluorocarbons or accomplish other future retrofitting driven by future environmental concerns not yet imagined; or the cost to purchase environmental insurance. If the landlord decides to make changes to achieve some level of LEED compliance, make that the landlord’s cost, not the tenant’s.
- 26.13 Excessive Management Fees.** Management fees beyond those charged in comparable buildings, particularly where the property manager is an affiliate of the landlord.
- 26.14 Executive Salaries.** Salaries for officers above the level of building manager, or that are overly generous.
- 26.15 Fines.** Fines and penalties the landlord must pay as a result of failure to comply with law, code, etc.

- 26.16 Food Court.** Costs related to food court tenants to the extent they exceed normal costs. As an alternative, allocate food seating area as tenant space (paid for by the food court tenants), perhaps with extra weighting because of the heavy cleaning requirements.
- 26.17 Holidays.** Any holiday decorations or gifts. As an alternative, impose a reasonable limit on these costs.
- 26.18 Mall Advertising.** Any mall advertising program. As an alternative, cap the tenant's contribution.
- 26.19 Other.** Next year's newest area of legal concern (for inspiration, check the latest carve-outs from "nonrecourse" treatment in mortgage finance transactions).
- 26.20 Other Tenants.** Any costs for a service not provided to this tenant and included in its rent (for example, the incremental cost of a higher level of service provided to office or retail tenants); costs reimbursed or reimbursable by specific tenants other than through pro rata rent escalations (e.g., fees for excessive use of utilities); or costs caused by the acts or omissions of particular other tenants.
- 26.21 Ownership-Related Costs.** Ground rent; mortgage interest, principal and transaction costs; build-out of tenant space; clean-up of any landlord's construction projects; and general and administrative expenses (overhead).
- 26.22 Payments to Affiliates.** Fees and expenses paid to the landlord's affiliates in excess of market rates. (But what's market and how do you know? The tenant may want preapproval rights.)
- 26.23 Professional Fees.** Brokerage fees and commissions; legal fees and expenses to negotiate and enforce leases; and accounting fees.
- 26.24 Telecom Installation.** Either exclude costs or offset them against the income the landlord receives.
- 27. Options**
- 27.1 Additional Space.** The tenant may want an option, right of first refusal or right of first offer for additional space.
- 27.2 Sublet Excess Space.** As a fallback, negotiate a wide-open right to sublet excess space until needed.

- 27.3 First Refusal Mechanics.** For a right of first refusal, seek a “second bite at the apple” if the landlord later decides to market the space in smaller pieces or on terms different from those originally contemplated. Also, scrutinize the conditions that trigger the right of first refusal. Landlords’ form leases often let the tenant exercise a first refusal right only if the space has become “vacant and available.” What does this mean? If the landlord negotiates a new lease for the space before an old lease expires, does that new lease mean the space is not “vacant and available”? The test should be whether an existing lease will (or has) expire(d) or terminate(d). The landlord should agree not to negotiate any extension or renewal that could impair the tenant’s claims to the space. Try to attach an exhibit to the lease identifying exactly when the tenant’s right of first refusal will arise, to the extent presently knowable. Rights of first refusal and their triggering events, exclusions and procedures are a fertile area for disputes and misunderstandings.
- 27.4 Excess Space Notices.** Whether or not the tenant has preemptive rights to extra space, the landlord should agree to advise the tenant regularly of any space that becomes available, giving as much notice as reasonably possible under the circumstances. As a practical matter, if the tenant wants the space, the parties may be able to negotiate something at that point.
- 27.5 Recapture From Other Tenants.** If the landlord can exercise its right to recapture space from another tenant, the tenant may want the authority to require the landlord to exercise its recapture right for the tenant’s benefit. The recaptured space would then become part of this tenant’s premises.
- 27.6 Early Termination Options.** The tenant may want early termination options, either complete or partial (“shed rights”). But what happens if the terminated space includes critical communications facilities serving the rest of the tenant’s space? The tenant will want the right to leave those in place. If a smaller tenant wants an option to terminate the entire lease, the landlord will sometimes offer instead a “good guy guaranty,” in which the tenant’s principal stands behind the lease obligations until the tenant actually moves out and surrenders the premises. That works fine only if the tenant has no other assets and no other activities, and does not want to be able to recommence business at some other location. If a tenant cares about those things, then the tenant should insist on a termination option rather than a good-guy guaranty.

- 27.7 Renewal Option.** Often tenants will seek a right to renew the lease term. In such cases, the tenant must scrutinize and confirm it can live with whatever conditions, requirements and procedures the landlord tries to attach to the renewal option. Landlords often require that rent can never go down in the renewal term and the renewal right can be exercised only by the initial tenant. Track renewal dates well in advance. Try to manage the process to give the tenant time to move if the rent, as finally determined, is unacceptable. Also, allow the tenant to assign any renewal options as part of a lease assignment.
- 27.8 Appraisal.** If rent during the option term depends on an appraisal, allow the tenant to withdraw its option exercise if the tenant disapproves of the new rent as finally determined. In practice, this may simply allow the tenant to re-negotiate the rent (a one-way downward negotiation opportunity), regardless of what the appraisal says. Set objective appraisal criteria. Does the definition of “fair market rental value” make sense? Does it give the landlord “credit” for value-enhancing measures (e.g., a tenant improvement allowance) that the landlord will not in fact deliver to the tenant? If the tenant won’t receive such an allowance upon renewal, the definition of “fair market rental value” should not pretend otherwise. And if the tenant paid for above-standard interior work, then “fair market rental value” should not reflect the value of that work. “Fair market rental value” should instead assume that the landlord delivered the space in the same condition as on the starting date. And does “fair market rental value” assume the lease allows any uses that the tenant is not allowed to, or will not, conduct? If there is a rent arbitration, require the landlord to disclose the terms of all recently signed leases. If the option term is “short” (less than 7 years) then what is the “fair market value” of that term? People don’t regularly sign 3 year leases. Maybe 3 year leases are cheap. Maybe they are expensive. Perhaps assume a more “standard” term and then price it as the first 3 years of a 10 year term. And, during any “fair market” renewal term, what rent increases should apply? Should the appraisers come up with a fixed rent for the whole period? Scheduled bumps? If not correctly handled, the tenant might end up with the worst of both worlds.
- 27.9 Purchase Option.** The tenant may want the right to purchase the building if the landlord intends to sell it or if the equity owners of the landlord intend to sell a substantial portion of their equity. If

the landlord converts the building into a condominium, the tenant may want a preferred right to purchase one or more units.

27.10 Reminder Notices. Require the landlord to send reminder notices of any upcoming option exercise deadline, but not more than ____ days, or less than ____ days, before the deadline. Extend the deadline and the lease expiration date if the landlord delays sending notice.

27.11 Short-Term Extension. Negotiate the right to a short-term lease extension, at the tenant's option, to avoid holdover problems if the tenant suffers delays in moving. The landlord will probably want some significant prior notice before the tenant exercises any such short-term extension right, but if the tenant agrees to too much time, then the short-term extension right becomes worthless, as it cannot deliver the flexibility that the tenant needs.

27.12 Base Years. For any lease renewal, reset the base years for escalations, or make sure the rent revaluation process assumes continuation of the old base years (nonstandard but theoretically a slight bit better for the tenant because it would give the tenant the benefit of future decreases in costs).

27.13 Rule Against Perpetuities. Think about the possible impact of the rule against perpetuities on any option rights in the lease or ancillary to the lease. This will vary by state.

27.14 Option Timing. Scrutinize and work through all the time periods for any option, and confirm that the tenant will be able to take the actions required within each time period. Do all the time periods work together? Do they give the tenant enough time for its internal review and approval processes in deciding whether to exercise a renewal option? If the tenant exercises an option defectively, require the landlord to notify the tenant promptly and allow some additional time to exercise the option correctly.

28. Parking

28.1 Specific Requirements. Define the location, number and pricing (or assurance of no fee) for parking spaces, reserved and unreserved. If any other tenant has the right to reserved parking, then this tenant should also have reserved parking equivalent in amount, proximity, type (covered, uncovered) and signage, adjusted for rel-

ative occupancy. Attach a parking diagram as an exhibit. Prohibit the landlord from changing the parking arrangements without the tenant's consent. In any case, the tenant may want to seek some number of reserved, covered, indoor or otherwise "premium" parking spaces.

- 28.2 Bicycles And Motorcycles.** The landlord should provide parking for bicycles, mopeds and motorcycles in a convenient location. If the tenant wants to allow bicycles, skateboards and the like into the tenant's space, make sure the lease allows it, without making special arrangements such as use of the freight elevator or giving advance notice.
- 28.3 Building Expansion.** If the landlord expands the building, the overall parking ratio shouldn't worsen.
- 28.4 High Parking Uses.** The tenant may wish to prohibit nearby high parking uses (e.g., movie theater, trade school, restaurant). Some of these uses are, however, regarded as less objectionable than they once were.
- 28.5 Location/Amount Of Employee Parking.** Insist that the landlord enforce employee parking restrictions against other tenants.
- 28.6 Snow/Maintenance.** Require the landlord to clear snow promptly from and otherwise maintain the parking area.
- 28.7 Lighting.** Set standards for lighting of common areas and parking decks—especially important to a 24-hour operation.
- 28.8 Patterns.** Prohibit the landlord from interfering with or changing traffic patterns in the parking lot areas.
- 28.9 Fences.** The tenant may want the right to require the landlord to install a fence to segregate parking areas from adjacent heavy-use facilities.
- 29. Percentage Rent**
- 29.1 Rent Abatements.** Rent abatements or other rent reductions should not reduce percentage rent breakpoints (to avoid an anomaly where the breakpoint drops because of negotiated rent abatements, resulting in percentage rent payments increasing by a like amount).

- 29.2 Partial Year Gross Sales.** Annualize first year and last year gross sales, with a seasonal adjustment, to prevent excessive percentage rent if the tenant opens or closes in its peak season.
- 29.3 No Partnership.** State that the parties do not intend to establish a partnership or joint venture.
- 29.4 Exclusions From “Gross Sales.”** Depending on the type of business, the lease should exclude or subtract certain items from “gross sales,” such as: sales made by concessionaires, sales not in the ordinary course of business, sales to employees up to a certain percentage or only if at a discount, sales taxes, refunds, returns, credit card fees, custom tailoring and monogramming. The tenant will want to avoid any suggestion that the landlord can collect percentage rent on the tenant’s catalog or Internet sales.
- 29.5 Time Limits.** Impose time limits on the landlord’s right to audit. Prohibit use of contingent fee auditors. If the landlord performs an audit, then the landlord should give the tenant a copy of the audit report even if it produces no adjustments.
- 29.6 Termination Right.** The tenant may want to request the right to terminate the lease if its sales fall below some specified threshold. If either party terminates because of a termination right like this, then the tenant may want the landlord to reimburse the tenant’s unamortized leasing and improvement costs, perhaps up to a cap.
- 29.7 Revenue Maximization.** The tenant should avoid any obligation to operate or to “maximize” revenues. The tenant should not make any representations on the volume of its business. Expressly negate any “implied” obligations along these lines. Also, a court may infer from a percentage rent clause that the tenant has agreed to keep its store open. If that’s not intended, say so.
- 29.8 Special Categories.** The tenant may wish to negotiate a lower percentage rate for particular low-margin activities or categories of sales.
- 29.9 Free Rent.** Any free rent period should abate percentage rent too.
- 29.10 Use.** Tie percentage rent to the tenant’s use of the premises. What happens if the tenant assigns to another operator with a different use? Request that the lease allow assignment even if this changes

the amount of percentage rent, provided the assignee agrees to pay at least the same total rent as the assignor did in its last year of operation.

30. Quiet Enjoyment

30.1 No Default. Beware of “quiet enjoyment” conditioned on no default. Condition quiet enjoyment instead only on the landlord’s not having terminated the lease.

30.2 Dumpsters, Staging Areas, Lay-Down Areas. Try to control where the landlord may install these items. Prohibit them in parking areas.

30.3 Sidewalk Sheds, Etc. If the landlord installs a sidewalk shed, scaffold, bridge, or temporary fence (a “construction installation”), it must achieve a prescribed minimum clearance above the retail windows and signage, and it must have an opening so pedestrians can walk from the street directly to the tenant’s front door. Allow the tenant to place advertisements on the construction installation, at the landlord’s expense, and prohibit any other advertising. Prohibit construction installations in the holiday season or other peak seasons. The landlord should pay the tenant a daily fee (or allow a daily rent credit) for maintenance of any of these structures regardless of the reason for them. For any construction installation: (1) try to set limits (duration; minimum clearance; cannot block windows; just posts for 30’ up, then roof above posts; frequency and purpose); (2) require the landlord to remove promptly all unauthorized postings or graffiti; and (3) require landlord to provide adequate lighting.

30.4 Remedies. If the landlord breaches the covenant of quiet enjoyment, the tenant cannot easily prove the amount of the injury or damages. Provide for liquidated damages or some other mechanism to quantify damages, ideally measured on a daily basis. Include the necessary recitations to validate any liquidated damages formula.

31. Radius Clauses

31.1 Physical Scope. Try to limit the physical scope of any radius clause, i.e., a clause that prohibits a retail tenant from competing

within a certain distance of the premises. Ideally, limit the radius to only a mile or two, depending on the site and the tenant's plans.

31.2 Exclusions. If the tenant must agree to a radius clause, carve out: (1) existing stores; (2) any new stores purchased in a future corporate transaction; (3) relocation of existing stores within any retail property where the tenant is already doing business; (4) any stores operated by any possible future acquirer of the tenant's business; and (5) any other brand names that the tenant operates.

31.3 Termination. Try to terminate the radius clause at a certain date; if the tenant has achieved a certain level of percentage rent; or if the landlord has achieved a certain occupancy level.

31.4 Near End Of Term. In the last few years of the lease term, the radius clause should terminate, to facilitate a graceful shift to a new location. In the alternative, allow the tenant to open a new store nearby provided that the tenant protects (or partly protects) the landlord from any decrease in percentage rent during the remaining lease term.

32. Real Estate Tax Escalations

32.1 Definition Of Property; Mixed-Use Projects. Confirm that the property to which the real estate tax escalation applies does not include other parcels or improvements; or, if it does, understand the likely future real estate taxes on those parcels or improvements. Will those taxes inevitably rise in ways that should not translate into higher escalations for this tenant? For example if the "other" parcels are now vacant and the landlord will improve them, this tenant should not participate in any resulting increases. Along similar lines, if a mixed-use building contains retail space, then an office tenant should worry that the landlord's income from the retail space will be higher and increase faster than the income on the office space. If the lease allows the landlord to allocate real estate taxes based on pure square footage, then the tenant may end up paying an unreasonable amount toward increases in real estate taxes attributable to the retail space. Especially in high-tax jurisdictions such as New York, a tenant signing a major lease should consider engaging special counsel just to advise on real estate taxes.

32.2 Substitute Or Additional Taxes. Devote close attention to how "substitute or additional taxes" are defined. Confirm that they are

truly appropriate for pass-through to the tenant. One might more appropriately treat some of them as equivalent to income taxes.

- 32.3 Landlord's Tax Protest.** For the base year, review any landlord tax protest filing to understand the landlord's theories for low value. Will those theories inevitably vanish next year, producing built-in increases? In the lease, express the base-year real estate taxes as a specified number of dollars per square foot. Avoid referring to the taxes payable in a particular tax year, because such a reference could increase escalations if the landlord successfully protests base-year taxes. It would mean that the base-year taxes never go up; they just go down if the landlord gets lucky. A tenant will not want to be at the receiving end of that crapshoot.
- 32.4 Installment Payments.** Require the landlord to pay real estate taxes in installments, as taxes are due. In any event, calculate tax pass-throughs as if the landlord were paying in installments over the longest period allowed.
- 32.5 Special Assessments.** The landlord should pay special assessments in installments and treat them as taxes only to the extent they fall within the lease term.
- 32.6 Right To Contest.** Require the landlord to contest taxes or, if the landlord does not, give the tenant the right to do so in the landlord's name or in the tenant's own name, as necessary. Check statutory and case law requirements as to who may contest taxes. For example, in New York a tenant that leases only part of a building lacks standing to contest taxes. The parties may need to make other arrangements, and the lease should provide for those. Whether the tenant leases all or only part of the building, any tax contest will still require cooperation and delivery of necessary information and signatures by the landlord. Require the landlord to contest taxes if a certain proportion of tenants so request. Require the landlord to warn the tenant of any tax contest deadline to give the tenant enough time to contest if the landlord does not wish to do so. Require the landlord to report to the tenant on status of pending certiorari proceedings on the tenant's request.
- 32.7 Tax Refunds.** Require the landlord to pay the tenant its share of tax refunds promptly, even if the lease has expired. The landlord should also notify the tenant of any such refunds promptly when received. If the landlord fails to do so, or the tenant needs to

remind the landlord, then the landlord should pay a default interest rate or some multiple of the amount due to the tenant. Landlords have been known to forget to give former tenants their share of any subsequent refunds of real estate taxes they paid. This can produce a nontrivial profit center for the landlord and a significant issue in negotiating a later purchase and sale of the building.

32.8 Tax Protest Costs. Any contingent fees paid to real estate tax counsel should be arm's length and commercially reasonable. What's "commercially reasonable"? The landlord should not collect a separate "management fee" for its services in contesting real estate taxes. That's a burden of ownership. The tenant should pay tax protest costs only for tax years in the lease term, with allocations for partial tax years.

32.9 Base-Year Reassessment. If the reassessment for the base year goes down, try to reduce base rent by the amount of the tax savings, to make up for the resulting increase in real estate tax escalations.

32.10 Abatement or Deferral Program. The landlord should agree to apply for any available tax abatement or deferral program. The risk of loss of tax abatements already granted (e.g., for failure to comply with governmental procedures) should belong to the landlord, not the tenant. For any future abatement or deferral programs, negotiate whether the benefits belong to the landlord or the tenant and, if the latter, identify exactly what cooperation the landlord must provide and when. How exactly does the application process work? Beware of repricing the base rent in a way that indirectly returns to the landlord any tax abatement/deferral benefits that the tenant expected to obtain. Some argue that the value of every geographically targeted tax abatement or deferral program will simply be negotiated into rents and hence land values within the targeted area and therefore have no effect except to increase local land values at the expense of the local taxing authority.

32.11 Artificially Low Assessments. If, under local assessment rules, the first year's free rent produces an artificially low tax assessment that year, then the assessment may automatically rise by the same amount in future years. The tenant may then, over the years, pay extra tax escalation payments far beyond the value of the free rent. This depends very much on local tax assessment procedures, but the tenant must understand them.

- 32.12 Exclusions.** Real estate tax escalations should exclude: penalties and/or interest; excise taxes on the landlord's gross or net rentals or other income; income, franchise, transfer, gift, estate, succession, inheritance and capital stock taxes; taxes on land held for future development ("outparcels"); increases in real estate taxes resulting from construction during the lease term if not done for the benefit of tenants generally, or if it does not create additional proportionate rentable area; termination of interim assessment; loss or phase-out (whether or not scheduled) of abatement or exemption; corrections of underpayments in previous periods; acquisition of development rights from other property; increases resulting from the landlord's failure to deliver required information to the taxing authority or other failure to comply with the taxing authority's requirements; and, if possible, sale of the property. If the landlord transfers unused development rights in a way that reduces the landlord's net real estate tax expense, confirm that the tenant will participate in any savings that result.
- 32.13 New Buildings.** Depending on when in the progress of the building project the lease is being negotiated, the tenant should confirm that the base year will reflect complete construction and full assessment of the building. This may require a retroactive adjustment of base taxes, depending on how the particular jurisdiction handles new construction.
- 33. Representations and Warranties.** The tenant may wish to ask the landlord to provide representations and warranties, including these:
- 33.1 Asbestos And Hazardous Materials.** The premises are free of mold, asbestos and other hazardous materials. The landlord should provide any document required to confirm that status for purposes of building permit applications, such as a New York City ACP-5 form, showing that the tenant's work will be a non-asbestos job. The landlord should indemnify the tenant against liability (and delay-based losses) arising out of any environmental conditions that existed before the tenant took possession, whether or not the landlord caused them. And the landlord should agree to clean up those conditions.
- 33.2 Certificate Of Occupancy.** Attach a true, correct and complete copy of the certificate of occupancy as an exhibit. The landlord should represent that the tenant's use as permitted under the lease

won't violate the certificate of occupancy or the landlord's other leases or agreements.

- 33.3 Commissions And Brokerage Fees.** The landlord has paid or will pay all brokerage fees and commissions for the lease. If the tenant cares about its relationship with the broker, the tenant may want the right to offset rent and pay the broker (particularly for any commissions due on future renewals or expansions) if the landlord does not.
- 33.4 Impact And Hookup Fees.** The landlord has paid or will pay all impact fees, hookup charges and other governmental exactions imposed on the project and will not recapture them through any escalation.
- 33.5 Rights Of Third Parties.** The landlord's entry into the lease does not violate any rights of third parties, such as the prior tenant that was evicted from the space or other tenants in the building. Although any such problem should be "just landlord's problem," tenant would inevitably be drawn into it and may like the idea of a clear line of responsibility pointing to landlord. Tenant may also want specific rights or remedies if, for example, tenant's exclusive isn't really as exclusive as tenant thought. For example, under that circumstance perhaps tenant should have the right to terminate its lease and landlord should reimburse tenant's leasing costs. Damages or a rent reduction may not suffice.
- 33.6 Submetering.** All equipment is in place and in good working order for any submetering of utilities the lease contemplates.
- 33.7 Utilities.** Adequate utility locations and capacity are available both within the building and at the premises.
- 33.8 Violations.** The premises are subject to no outstanding violation of any code, regulation, ordinance or law, and the landlord agrees to cure existing violations at the landlord's expense, not recaptured through any escalation.
- 33.9 Validity Of Lease.** Each party represents and warrants to the other that the lease has been duly authorized, executed and delivered, and is valid and binding.

33.10 Zoning. The property is properly zoned and the tenant's permitted use under the lease is legal.

33.11 Construction Plans. Landlord plans no construction at the property, except ordinary tenant improvements.

33.12 Notices; Plans. The landlord has received no notice of any condemnation, including any grade change of any street or any partial condemnation. The landlord plans no changes in parking or circulation. The landlord has no present plans to do anything that would require the tenant's approval or require entry into the tenant's premises.

33.13 Municipal Subsidies and Mandates. The landlord has not received any New York City subsidies (or made any agreement) that would trigger a requirement for the tenant to pay a "living wage" or comply with any requirements that would not apply but for those subsidies. This is also a due diligence item.

34. Requirements Of Law

34.1 Responsibility For Compliance. The landlord should be responsible for compliance with existing and new laws (including ADA) if the compliance applies generically to the property (e.g., "mere office use") or any noncompliance already existed before the lease was executed.

34.2 Regulatory Flexibility For Tenant. Allow the tenant to sell or assign the lease (or go dark) if required by law or through a settlement with any government agency.

34.3 Americans with Disabilities Act Of 1990. The tenant should have no duty to bring any elements of the existing building into ADA compliance (e.g., elevator buttons), unless (perhaps) the tenant actually alters that particular element of the building. Make the landlord responsible for ADA and all other baseline legal compliance.

34.4 New Requirements. The landlord should comply with any new legal requirement if the potential noncompliance did not result from the tenant's actions, and failure to comply may impair the tenant's alterations or use as the lease contemplates or otherwise adversely affect the tenant.

- 34.5 Permits.** The landlord should agree to cooperate with the tenant in obtaining permits and other governmental approvals that tenant may need, such as by signing permit applications (even before approving the tenant's work) and providing necessary existing information. Establish a tight turnaround time for any necessary landlord signatures. Don't allow the landlord to use the permit signing process as a back door technique to disapprove work that the lease otherwise obligates the landlord to allow.
- 34.6 Change in Zoning.** The landlord should allow the tenant to terminate if a change in zoning or other law (or inability to obtain or maintain necessary permits or adequate parking) prevents or impairs the tenant's operation of its business, in whole or in part.
- 35. Restrictions Affecting Other Premises**
- 35.1 Competing Stores.** Prohibit the landlord and its affiliates from renting to competing tenants within a certain area – not just in this property – particularly where the landlord operates its properties under an identifiable brand name. For a major tenant, prohibitions of this type may raise antitrust issues, which are beyond the scope of this checklist. New York law invalidates this type of prohibition in bank leases, allowing anyone damaged by such a prohibition to recover treble damages. New York Banking Law Section 674-a.
- 35.2 Use Of Building.** Prohibit the landlord from changing the use of the overall building or any part of it—such as turning the older and less rentable half of a regional mall into a call center or community college. Restrict the type of retail tenancies or other uses in the building (e.g., no fast food). Consider issues of density, traffic, parking, demographics, compatibility, likelihood of picketing or controversy, security concerns and other potential problems affecting building use and other tenants.
- 35.3 Prohibited Uses.** For retail properties, prohibit flea markets, carnivals, petting zoos, clothing drop-off boxes, kiosks (especially if competitive or within a certain distance of the entrance or windows of the premises), drive-up booths and the like elsewhere on the landlord's property, including common areas. For office buildings, prohibit uses that attract large volumes of people, particularly if incompatible with first-class business offices (e.g., poverty benefit or advocacy offices, drug rehabilitation or methadone clinics, welfare offices, certain types of auction houses, fast food restaurants).

For any building, prohibit psychics, drug paraphernalia sales, marijuana stores or clinics, abortion clinics, classrooms and other high traffic or controversial uses. More generally, a tenant will often want to prohibit the same list of “nuisance” uses that any landlord will want to prohibit.

- 35.4 Competitors.** Even for nonretail space, try to prohibit the landlord from leasing space in the building to the tenant’s competitors (creating a risk of a competitor's taking the tenant’s staff, customers or clients).
- 35.5 Additional Construction.** Limit the location and type of any additional construction the landlord can perform (e.g., on “outparcels”). If the landlord does anything to impair access to, or visibility of, the tenant’s space, give the tenant meaningful remedies, potentially including termination with a landlord reimbursement of the tenant’s leasing expenses.
- 35.6 Minimum Operating Hours.** Establish minimum operating hours for the property as a whole or for specific other tenants.
- 35.7 Scope of Restrictions.** To the extent that the lease restricts the landlord’s activities, consider how broadly those restrictions should apply. Ideally, they should affect both the existing structure and any future expansion in which the landlord has any interest, or for which the landlord or an affiliate presently controls the site. Try to have the landlord agree not to enter into a reciprocal easement agreement or otherwise facilitate any nearby construction by others unless the counterparty agrees to honor the same restrictions. The tenant may even want the right to approve any future reciprocal easement agreement or amendments to the existing agreement.
- 35.8 Public Areas.** The tenant should control (or have the right to require, within reason) future changes to public areas, lobbies, elevators, parking lots and other common areas. Require the landlord to renovate and update these areas periodically to keep them consistent with first-class standards as they change from time to time. Require the tenant’s approval for the plans for all such work, or at least the visible part (e.g., finishes) of the landlord’s work. The tenant may want the right to require the landlord to prohibit smoking in public areas even if governing law does not.

35.9 Exclusive Uses. The tenant may want exclusive rights for certain uses. As a fairly ordinary example, a coffee store may want the exclusive right to sell coffee within the landlord's shopping center. But the tenant's actual operating procedures may justify requests for other types of exclusives. For example, if a bakery tenant uses aromas as part of its marketing, it will want to limit competing aromas. A movie theater may want to prohibit not only competing movie theaters, but also any theater advertising. A careful landlord will push back and try to fine-tune any exclusives to assure they don't impair the landlord's overall leasing program. Every time the landlord chips away at the exclusive, this may make it less useful and valuable for the tenant. The tenant will want to make sure that any exclusive still serves its intended purpose and protects the tenant's investment.

35.10 Remedies for Violation of Exclusive Use. If another tenant violates the exclusive, will this tenant have direct rights to obtain injunctive relief against that other tenant? Not unless the exclusive is in a recorded document or the landlord and this tenant have carefully provided for such a right in this tenant's lease! Require the landlord to reimburse this tenant's costs of enforcement. Many exclusive use clauses give the tenant only limited remedies, such as the right to pay pure percentage rent with no minimum, or the right to terminate the lease in an extreme case (with or without a reimbursement of tenant's leasing costs). That's not as helpful as actually shutting down the violation of the exclusive use. In extreme cases, the landlord might be happy to see this tenant go away, so the tenant will not want to limit its remedies accordingly.

35.11 Adjacent Work. If a third party will pay compensation for inconvenience caused by work on an adjacent or nearby site, should the landlord or the tenant receive it?

35.12 Beware of Ownership Variations. To the extent the landlord agrees to any provisions suggested above, beware of limiting those provisions to any property "owned by the landlord and its affiliates." Third parties, often not even affiliates of the landlord, may own parts of what appears to be a single integrated building. In these cases, the tenant will need to focus on the governing easements and declaration documents for the building as a whole, triggering a level of investigation often reserved only for major tenants.

35.13 Use of Common Areas. Prohibit the landlord from allowing any tenant to use a common area in a manner specific to that tenant, such as for advertising, displays, nonstandard signage, or waiting area. In the alternative, allow this tenant to exclude the affected common space from any calculations of its rentable area.

35.14 Co-Tenancy. At least for retail leases, require the landlord to achieve and later maintain a certain level of other tenancies, such as 75% occupancy of the building as a whole and continued occupancy of anchor spaces by certain brands or types of anchor tenants. If the landlord fails to comply with co-tenancy requirements, then allow this tenant to pay only percentage rent for a certain period, and then eventually terminate. Should the landlord reimburse the tenant's unamortized leasing expenses in that case?

36. Rules And Regulations

36.1 Nondiscriminatory Enforcement. Require the landlord to impose and enforce its rules and regulations in a nondiscriminatory way. If the tenant so requests, the landlord should impose and enforce those rules and regulations against other tenants.

36.2 New Rules. New rules should be reasonable and of the type customarily imposed for similar buildings. New rules should require the tenant's approval. If the landlord wants to give the tenant a short period to object to any new rules, insist that the landlord give the tenant formal notice of any new rule, along with a reminder of the short period in which the tenant may object.

36.3 Interference With Permitted Use. The tenant should have no obligation to comply with any rule or regulation if such compliance would interfere with tenant's use permitted under the lease, or otherwise does not conform to the tenant's rights under the lease.

36.4 Third Party Enforcement. The lease should prohibit any other tenant from enforcing the lease against the tenant. Expressly negate any third-party beneficiaries of the lease, or anything in it.

37. Sale Of Property

37.1 Assumption Of Obligations. Upon any sale of the landlord's property, the purchaser should assume all obligations—including all existing undischarged obligations—of the landlord, including the

obligation to return the tenant's security deposit; refund any previous rent overcharges; and allow the tenant to conduct any permitted audits. The purchaser should also assume the landlord's insurance requirements and any net worth restrictions. Some landlord's lease forms say that the old landlord is not responsible, but neither is the new one. The tenant theoretically ends up with claims against no one. After a change of ownership, the new landlord should be responsible for maintaining records for all open operating years. If the new landlord doesn't have those records, then allow the tenant to estimate what the right numbers would have been.

37.2 Transfer Of Security Deposit. Require the landlord to transfer the security deposit to any purchaser of the property and assure that the purchaser gives the tenant a written confirmation of receipt. Insist that the tenant have the right to offset rent if the landlord does not comply with these requirements.

37.3 Rental Payments To Purchaser. The tenant should not be required to pay rent to a purchaser until the tenant has received notice of the sale and purchase and directions on where and how to pay.

37.4 Only One Landlord. If the landlord transfers its interest in the building, the tenant should never have two landlords -- even if they speak with one voice.

38. Security Deposit

38.1 Interest. Require the landlord to hold the security deposit in an interest-bearing account with all interest to be paid to the tenant. Many landlords require an administrative fee, like that contemplated by statute in New York (N.Y. GEN. OBLIG. LAW § 7-103(2) (McKinney 1963)). Although a landlord's form may not quantify such a fee, the tenant should insist on doing so, or eliminate the fee.

38.2 Letter Of Credit. Allow the tenant, at any time, to substitute a letter of credit or other alternative form of security. If the tenant thereafter fails to maintain the letter of credit, the landlord should be free to draw upon it. That failure should not, however, constitute a lease default. The tenant should retain the right to deliver a letter of credit. If the tenant delivers a letter of credit backed by a reimbursement agreement signed by a third party (e.g., the tenant's venture capitalist), then the landlord should also agree to give that

third party a copy of any notice from the landlord, or at least any notice of default or other notice that could result in a letter of credit draw. If the lease no longer requires a letter of credit at some point, require the landlord to sign whatever cancellation documents the letter of credit issuer requires.

38.3 Drawing Procedures. The tenant may wish to do what it reasonably can to make it hard to draw the letter of credit. For example, the tenant might require a prior notice before any draw. Or the letter of credit might require the landlord to deliver an affidavit of default, identifying all defaults in reasonable detail.

38.4 Return. The landlord should promptly return the security deposit after the lease expires. But what happens if landlord doesn't? Even if a letter of credit expires and is physically returned to the issuer, the issuer will often want landlord to sign a letter consenting to termination of the letter of credit. Landlord should agree to do that.

38.5 Reduction. Let the tenant reduce the security deposit over time, at least if the tenant is not in default. If the tenant has any concern about the landlord's creditworthiness, such reductions make particular sense in the last year or two of the lease term.

39. Signage And Identification

39.1 Signage Requirements. The lease should describe the signage requirements (for lobby, floor lobbies, elevators, exterior entry areas, driveways, roadway pylons, rooftop, common areas and other exterior locations) for the tenant and any subtenant(s). Allow the tenant to install temporary signage during construction and change its signage over time. If signage space is limited, the tenant should be given the right to use the next available signage space. Make the tenant's signage rights as transferable as any other rights under the lease. Also allow the tenant to use its logo or distinctive typeface or other graphic elements. If the tenant intends to illuminate its signage, the lease should allow that. Even if the tenant agrees to comply with the landlord's signage guidelines or obtain consent, the tenant should always have the right to match its national or regional signage program.

39.2 Other Parties' Signage. Establish requirements and other controls for other tenants' signage and the landlord's overall signage program, including future changes. The tenant may want to limit iden-

tifying signage for other tenants, particularly those competitive with the tenant. Provide that the landlord may not install advertising material, or any installations specific to any particular tenant, in common areas. This tenant is paying for its “share” of those common areas and they should be common and anonymous. Is there any type of signage or advertising that the tenant simply does not want the landlord to install anywhere in the property? What about political or other controversial signage?

- 39.3 Signage Position.** Does the tenant want the top position on any pylon sign? Second from top? Largest position on any other sign(s)?
- 39.4 Name Of Building.** Prohibit the landlord from naming the building after the tenant, any other tenant, or any competitor of the tenant. Make it clear that the landlord has no right to use the tenant’s name for anything. Does the tenant want affirmative naming rights? Prohibit the landlord from using the tenant’s name in any landlord advertising.
- 39.5 Directory Entries.** Require the landlord to provide building directory entries for the tenant and any subtenant or assignee. If the landlord tries to limit those entries, do those limitations make sense? Does the tenant contemplate needing directory entries for parties other than the tenant and its subtenants or assignees, such as joint ventures or other new entities? Prohibit any other tenant from being more visible or using its logo in the building directory unless this tenant has the same right. Don’t limit the number of the tenant’s directory listings at all if the landlord uses a computerized directory.
- 39.6 Flagpoles.** The tenant may want the exclusive right to use any flagpoles at the property. As an alternative, the tenant may want to limit the flags that the landlord or any other tenant may fly on those flagpoles.
- 39.7 Billboards.** Prohibit the landlord from installing billboards or other signs anywhere on the building or outside the windows of the building, even if such billboards or other signs are allegedly transparent from the interior of the building. Prohibit the landlord from blocking the tenant’s signage.

- 39.8 Pre-Opening And Post-Closing Signage.** The tenant may want the right to install signage announcing its imminent arrival, while the tenant's space is being constructed. This signage could be located at the space and elsewhere in the property. Once the lease is signed, the landlord must promptly delist the premises and remove "for rent" signs. Provide that after a retail tenant vacates (unless as the result of a default), it can leave reasonable signage in place to announce its new location.
- 40. Subordination And Landlord's Estate**
- 40.1 Proof Of Fee Estate.** The landlord should represent that it owns the fee estate. Perhaps attach a copy of the landlord's deed or title policy as an exhibit.
- 40.2 Nondisturbance Agreement From Mortgagees And Ground Lessors.** At the time of lease signing, the landlord should deliver a nondisturbance agreement from every mortgagee or ground lessor. Attach the form of nondisturbance agreement to the lease and require future mortgagees to sign it when they close their loans and future ground lessees to sign it when they come into the picture. Beware of allowing the landlord to deliver such an agreement after the lease has been signed, with a right for the tenant to terminate if it is not timely delivered. In practice, such a right will rarely be exercised. That may, of course, say something about the practical importance of these agreements. Any nondisturbance agreement will typically say that the lender (or a foreclosure sale purchaser) is not bound by any later lease amendment the lender did not approve. Try to narrow that concept, to avoid the need to get lender approval for minor lease amendments, or require the lender to promptly approve any lease amendments that meet a certain standard.
- 40.3 Timing After Foreclosure.** If a lender has the right to terminate a lease upon foreclosure, try to require the lender to make up its mind within a certain time. Typically, of course, any tenant without the clout to obtain nondisturbance protection will also lack the clout to obtain the protection just suggested.
- 40.4 Conditions For Subordination.** If the lease is "subordinate," condition that subordination on the landlord's having delivered specified nondisturbance protections from holders of senior estates, ideally in the form attached to the lease. Don't settle for "best efforts." The lease should not require the tenant to "subordinate" to

any mortgage if that mortgage is subordinate to any mortgage or any other lien that has not given the tenant nondisturbance protections. Foreclosure on that other, more senior, mortgage could wipe out both the more junior mortgage and the tenant's leasehold estate.

- 40.5 Debt Service Should Not Exceed Rent.** When the tenant leases all or most of the space or an entire building, the tenant may want the landlord to agree that the debt service payable under any fee mortgage will not exceed the rent under the lease. The tenant would also want to confirm that this is also true as of lease inception.
- 40.6 Negotiations Of Nondisturbance Agreements.** Require the landlord to reimburse the tenant for the tenant's reasonable legal fees for any future nondisturbance agreement negotiations.
- 40.7 Compliance With Mortgages.** Avoid any covenant by the tenant to be bound by and do nothing to violate any present or future mortgages. Such a provision may amount in part to an "end run" around negotiated nondisturbance rights and priorities as well as other lease provisions, starting with casualty, condemnation, restoration and use restrictions.
- 40.8 Rent Redirection Notice.** If the landlord's lender delivers a rent redirection notice to the tenant, state that the tenant may comply without liability even if the landlord disputes its lender's right to deliver the notice. The landlord should agree to reimburse the tenant's legal fees in reviewing, analyzing and figuring out how to respond to any such notice from a lender.
- 40.9 Landlord's Lender's Approval Rights.** Understand the approval rights of the landlord's lender under its loan documents (e.g., assignment, subletting, alterations, lease amendments, etc.) and try to trim back if excessive. Ask the lender to pre-approve as much as possible. Going forward, try to eliminate lender approval requirements. Ask the landlord to agree never to enter into any loan arrangements (or amendments to existing loan documents) that would prevent the landlord from agreeing to later minor or ministerial amendments of the lease, excluding any that could materially adversely affect the lender. Affirmatively state that no lender consent is needed for the tenant to exercise any option or pre-emptive right (e.g., right of first offer).

40.10 Definition of Landlord. Include successors and assigns in the definition of “Landlord.”

40.11 “Replacement” Mortgages. If the tenant agrees to be “subordinate” to mortgages—without nondisturbance protection—in any way that might come back to haunt the tenant (for example, casualty and condemnation issues), limit the “subordination” to refer only to any mortgages that are currently in place and not to any replacement or future mortgages.

41. Tenant's Remedies Against Landlord

41.1 Set-Off and Termination. The tenant may cure the landlord's defaults (after notice), set off the cost of cure (with interest at a high rate) against rent and terminate the lease. The tenant can set off against rent for claims against the landlord or any judgment against the landlord that is returned unsatisfied (or, if the landlord is in bankruptcy, then based upon the mere filing of a claim in the bankruptcy). The tenant may want similar remedies if any representation or warranty by the landlord is inaccurate. Review the assumptions that support the tenant's decision to enter into the lease. For example, let the tenant terminate if the nearby courthouse, train station, army base, university, or other business-driving installation moves or closes. Let the tenant terminate if the municipality enacts a minimum wage law and it affects a substantial portion of the tenant's employees.

41.2 Abatement. The tenant may want the right to abate rent if essential building services (access, electricity, other utilities, elevators, air-conditioning, etc.) are disrupted, or if the landlord is in default for longer than a specified period (after notice?). Trigger rent abatement rights based upon ____ or more days of problems during any ____ day period, rather than requiring that any single problem must continue for ____ days before the tenant may abate. If any such rent abatement continues for more than a certain period, then let the tenant terminate.

41.3 Self-Help. The tenant may want emergency self-help rights (including the right to install temporary equipment or service arrangements) if a water leak, power failure, or communications failure imperils the tenant's computer systems, communications systems, or other mission-critical equipment or operations. Allow only a very short period before this self-help right accrues for any

fundamentally important function of the tenant, such as the tenant's network control center or computer system. The landlord should reimburse the tenant's reasonable self-help expenses.

41.4 Payment Not A Waiver. The tenant's payment of rent with knowledge of a landlord default should not waive the default.

41.5 "Exculpation" Clause. When an "exculpation" clause limits the landlord's liability to the landlord's interest in the property, try to include the following within the definition of the landlord's interest in the property: rental income, insurance proceeds, escrow funds, condemnation awards, the landlord's interest in security deposits and sales and refinancing proceeds. For certain major landlord obligations — e.g., completion of buildout or return of a security deposit — consider whether "exculpation" makes sense or whether, to the contrary, the tenant should insist on some level of creditworthy assurances from someone beyond a single-asset landlord, or perhaps a letter of credit.

41.6 Other Tenants' Closure. The tenant may want the right to terminate the lease (or pay only percentage rent) if specified other retail tenants shut down or if the overall occupancy level drops below a certain level. Although such provisions are most common in retail leases, they could conceivably even apply to an office building if occupancy drops to a level where the tenant's staff feels uncomfortable working in the building even if the landlord continues to provide services.

41.7 Other Business Relationships. Do the landlord and the tenant have any other relationship (e.g., purchase and sale of a business) that might give rise to tenant claims against the landlord for which the tenant should be entitled to offset against rent if the landlord does not pay after some extended notice and warning period?

42. Use

42.1 Any Lawful Use. Try to allow "any lawful use" or at least "any lawful retail/office use" of the premises.

42.2 Permitted Uses. Describe permitted uses generically to avoid restricting future use by a subtenant or assignee (e.g., "medical or other health practitioner's offices" or "executive offices" rather than "podiatrist's offices" or "main headquarters of XYZ Corp.>").

If the tenant anticipates making unusual uses of the space (e.g., for basketball courts, pets, bicycles hanging from the ceiling, sleeping facilities, etc.), confirm that the lease and applicable law will not prohibit these uses.

- 42.3 Future Change Of Use.** Build in flexibility for future change of use if any possibility exists of a change in circumstances (e.g., likely technological obsolescence of the tenant's business). Prohibit the landlord from changing the use of the building.
- 42.4 Incidental Uses.** Obtain pre-approval for incidental uses, such as automated teller machines (ATM), food, training, duplicating, ancillary retail, gym, day care, other amenities, network control center, etc. If necessary, the tenant can usually agree that these facilities will be open only to the tenant's employees and invitees who are already on the premises to do business with tenant. If the tenant ever wants to hold an event requiring a liquor license (event permit), require the landlord to sign the permit application.
- 42.5 Duty To Operate; Recapture.** A tenant will prefer to have no duty to open or operate, implied or otherwise. If the landlord counters with a request for a recapture right if the tenant goes dark for a specified period, carve out permitted closures (e.g., for "force majeure event," alterations, inventory taking, other brief closings). Limit the time within which the landlord may decide to recapture. Require the landlord to reimburse the tenant's leasing and improvement costs if the landlord recaptures in these cases.
- 42.6 Satellite Dishes And Antennas.** The landlord should allow the tenant to install satellite dishes and antennas on the roof, either at no charge or for a defined or ascertainable charge. Allow the tenant to relocate this equipment if necessary to improve performance. The landlord should agree to prohibit future rooftop users from interfering with the tenant's use.
- 42.7 Rooftop, Generally.** The tenant may also want the right to install its own backup generators, supplemental air-conditioning and other equipment on the roof or elsewhere. If this will require structural reinforcement, the landlord should consent to it and ideally pay for it. For any rooftop or other off-premises equipment, the tenant will also want the landlord's consent, without charge, to the running of any wires, cables, connections and lines between the premises and the tenant's rooftop equipment. A tenant will prefer

not to be obligated to remove any equipment or connecting lines at the end of the lease term. A top floor tenant should try to restrict the landlord's further construction on the roof.

- 42.8 Use of Sidewalk.** A ground floor tenant may want the right to install awnings, canopies and crowd control barriers on the sidewalk. Will the tenant otherwise need to use the sidewalk or the exterior of the building for special events, temporary installations, or other purposes? Exterior loudspeakers? Exterior laser or light displays? Should there be any control/restriction on other tenants' ground floor uses?
- 42.9 Conflict with Other Leases.** The lease should not say that the tenant's use may not conflict with other leases or mortgages — unless this lease defines exactly what those other leases or mortgages prohibit. Any future leases or mortgages (or amendments to either) should be irrelevant to the discussion.
- 42.10 Common Facilities.** Allow the tenant to use building common facilities, such as cafeteria or health clubs, auditoriums, conference facilities and common lavatories if the leased premises do not include lavatories. The lease should state the minimum operating hours (24 hours in many cases) and maintenance and cleanliness standards for common facilities and any cost for such uses.
- 42.11 Outdoor Areas.** The lease should give the tenant the exclusive use of terraces or other identified outdoor space or facilities adjacent to the tenant's premises. The landlord should maintain and clean these areas according to specified standards. Terraces create a tremendous risk of roof leaks, which the landlord will try to shift to the tenant. The tenant can reasonably argue that it's up to the landlord to design terraces that don't create roof leaks.
- 42.12 24 Hour/365 Day Access.** The tenant should obtain 24-hour access, 365 days a year, via elevator or (if the elevator is broken) stairway. Unless the leased premises are on a very low floor, think about establishing consequences (monetary payments) if the elevators break down to the point where the tenant can't obtain access to the floor, though this level of breakdown rarely actually happens.
- 42.13 Reception, Security, Other Facilities.** Will the tenant want to install any reception, security, package handling, messenger, or other facilities in the lobby, basement, ground floor, or other com-

mon area of the building? If so, the lease should allow them and negate any obligation to pay rent for the affected space.

42.14 Storage Areas. In addition to the premises, the tenant may want to lease storage space available in the building. Any such arrangements should be coterminous with the lease and not, for example, a revocable license.

43. Utilities, Generally (Except Electricity)

43.1 Entry Point. The landlord should bring all utilities to a defined entry point on the perimeter of the premises, not just wherever the landlord decides to bring them. Decide what entry point works best for the tenant, for each utility service.

43.2 Special Requirements. Require the landlord to allow the tenant or its service providers to install T-1 and fiber optic lines, multiple points of entry and other telecommunications facilities, including cabling and connections from service providers to the premises. Recognize that these technologies and related tenant requirements will change over time.

43.3 Free Choice of Carrier. Allow the tenant to use any carriers or utilities it wishes for telecommunications and other services. The landlord must, without charge, cooperate as needed, such as by signing papers, providing closet space in the basement, providing pathways as needed and providing information. Requirements of federal law may actually mandate some of this. The tenant's counsel should check what law requires and what must be negotiated. Of course, law could change.

43.4 Excess Capacity. If generators or fuel systems in the building have excess capacity, require the landlord to preserve at least some of that excess capacity (without allocating it to other tenants) to maximize the backup value of those systems to this tenant.

43.5 Alternative Providers. Limit the landlord's right to change power or telecom providers.

44. Preliminary Arrangements And Considerations

44.1 Brokerage. Is a brokerage agreement in place? Are the commission negotiations completed? If the landlord will pay the broker, as

is typical, does the tenant want to discuss having the broker rebate part of the broker's commission to the tenant?

- 44.2 Term Sheets And Letters Of Intent.** Attorneys should deal with term sheets and letters of intent early in the lease negotiation process to raise and resolve major issues while it is relatively easy (and inexpensive) to do so. These preliminary documents should state they do not bind anyone, except relating to such matters as confidentiality.
- 44.3 Board Approval.** If the tenant will require its own internal board or other approval to ratify a contemplated transaction, provide for that condition in all letters of intent, term sheets, lease drafts and other preliminary documents.
- 44.4 Tax Incentives.** Can the tenant qualify for any tax incentives, abatements, deferrals, rebates, subsidies, or other governmental benefits? Check the timing requirements and pitfalls for any application. Often, a tenant must apply before “committing” to a new location.
- 44.5 Warranties.** If the landlord has the benefit of any warranties for the building, the tenant may want to be a beneficiary of those warranties and have the right to enforce them directly against the warrantor.
- 44.6 Premises Off Market.** During the lease negotiations, ask the landlord to agree to remove the space from the market and not to negotiate with other parties for a specified period. In particular, ask the landlord to remove any “for lease” signs at the premises, while the parties negotiate. Should the parties agree to a break-up fee? A reimbursement of expenses and attorneys' fees if the deal dies?
- 44.7 Tenant's Professionals.** Select, coordinate and negotiate the contracts of the tenant's other professionals: architect, broker, engineer, facilities consultant, signage designer, space planner and so forth. Try to get architects started early. Architects usually cost less than either lawyers or rent. The tenant's architect should review the lease while it is being negotiated.
- 44.8 Tenant's Procedures.** Understand the tenant's (and the landlord's) internal approval procedures, including any documentation requirements and likelihood for delay.

44.9 Backup Lease Negotiations. Consider negotiating multiple leases at the same time, though perhaps at various stages of negotiations, to be able to recover quickly if the lease negotiations for a particular premises break down or the landlord decides to lease to some other tenant.

45. Due Diligence

As noted above, no one should regard this checklist as exhaustive or complete. This is particularly true as it applies to the following list of “due diligence” investigation that the tenant’s counsel may wish to perform, or make sure other tenant advisers perform:

45.1 Existing Condition of Premises. Is the existing condition of the premises satisfactory? Does the tenant need to change the certificate of occupancy? Can it be changed? Are there open violations or permits? If so, require the landlord to correct them, at least if they delay the tenant’s construction. Does zoning law allow the tenant’s intended use of the new premises? What existing personal property is included? Should the landlord be required to remove—or be required to leave in place—any existing improvements or personal property? Does the landlord plan any major work affecting the building? If so, should the tenant try to limit the work in any way? If the lease covers the top floor of the building, does the landlord plan to construct additional space above, or do any major work on the roof? Is there anything about the space, or the building as a whole, that the tenant would not want the landlord to change? If so, the lease should prohibit the landlord from making such changes, or else the tenant won’t be able to stop them. Is the view from the premises critical to its perceived value? Could the view become obstructed during the lease term? In such event, should tenant have a right to terminate? Is there any risk of hazardous substances dripping from floors above? Unpleasant smells from other premises?

45.2 Title Search. Perform a title search and review, or an online search to confirm, ownership of the fee (easily available in many areas). Check any prior recorded documents that might affect this tenant. Review the landlord’s certificate of occupancy. Perform other municipal searches. Does the landlord have any outstanding violations that might impair the tenant’s ability to obtain necessary permits?

- 45.3 Square Footage.** Don't believe the landlord's or broker's numbers. Calculate the actual square footage and scope of the premises. Do all of the landlord's exclusions and inclusions of space make sense? For example, should the elevator lobby be part of the premises? Does the landlord propose that the premises include any mechanical space or equipment that the tenant won't really use? Don't assume "REBNY" or "BOMA" measurement standards make any practical sense. And compare the landlord's "rentable" square footage (sometimes rather creatively calculated) against the actual "usable" or "carpetable" square footage (as measured) of the premises. What space in the building does the landlord treat as "building common areas," thus increasing the rentable square footage of this tenant's premises? Do any of those "building common areas" really benefit only particular tenants rather than all tenants in the building? After adjusting for the "loss factor" (the percentage reduction from "rentable" to "usable" space), do the economics still make sense? Might the tenant be paying for any unusual spaces or installations that really should be entirely irrelevant to the leased premises? Perhaps none of this matters, as long as the tenant is satisfied with the space and the number of dollars the tenant is paying for the space, regardless of its square footage. But many tenants want to compare the "price per foot" of multiple options, and this requires measuring footage in a consistent way.
- 45.4 Special Permits.** Do any unusual uses require special permits or that special measures be taken to obtain necessary permits (e.g., liquor licenses, generators, sidewalk cafes)? If the tenant conducts business in a regulated industry, will the tenant need any regulatory approvals? How long will any permitting or approval process take, and what will it require? For example, the landlord may need to sign documents as part of the permit application, and should agree to do so. What other permits might the tenant need, such as public assembly? If the tenant anticipates delay or possible failure in obtaining one of these permits, the tenant should, at a certain point, have the right to terminate the lease.
- 45.5 Ventilation.** Does the space provide adequate ventilation, or adequate pathways for the tenant to install new ventilation? The tenant should either perform its own indoor air quality report or critically review the landlord's report.

- 45.6 Escalations.** The tenant, and particularly its accounting and leasing personnel, may want to consider at least these due diligence issues on escalations:
- (A) *Capital Projects.* What capital projects are underway or contemplated today? Does the tenant agree with how the landlord plans to treat them?
 - (B) *Historical Operating Expenses.* What are the historical amounts for operating expenses and taxes? Review the underlying financial information, presentation, characterization and documents, including sample escalation statements.
 - (C) *Pre-Programmed Increases in Assessment.* Investigate any built-in future increases in the tax assessment (e.g., termination of interim assessment, upcoming loss or phase-out of existing abatement or exemption). Is the building fully assessed? Does anything about the tax assessment for the building suggest future increases are unusually likely?
- 45.7 Telecommunications Capacity.** Investigate available capacity and pathways for telecommunications and other utilities. Is service available from more than one company?
- 45.8 Technological Requirements.** Check the tenant's network and other technological requirements.
- 45.9 Rooftop.** Check lines of sight for a rooftop satellite dish or antenna. Can the roof support any heavy equipment the tenant will install? Will the tenant be able to get the equipment up to the roof?
- 45.10 Present Occupancy.** What is the present occupancy of the premises to be leased? What is the practical likelihood of delays in possession?
- 45.11 Tenant's Existing Lease.** Review the existing tenant's lease for expiration date, holdover penalties, etc. If the tenant will need a short extension, ask for it early in the process, as the tenant's existing landlord may become less accommodating over time.
- 45.12 Disposition of Present Premises.** If the tenant has "too much" time remaining on the tenant's existing lease, how does the tenant plan to dispose of the premises it now occupies? Does the tenant understand any uncertainties and risks in that process?

- 45.13 Engineering.** If the tenant is taking the building systems as is, have an engineer check them--particularly the HVAC. The tenant's engineers should consider a range of issues, including the adequacy, directness and feasibility of pathways for utilities and services for the premises and more mundane issues such as floor load capacities. Does the building offer sufficient utility capacity for the tenant's needs? Multiple competing suppliers of, e.g., telecommunications services?
- 45.14 Security.** Does the landlord's security program meet the tenant's expectations?
- 45.15 Meter.** If the premises are metered or submetered, does any meter or submeter also serve any space outside the premises?
- 45.16 Taxes.** Any transaction might raise tax issues. Consider those during negotiations. Might the tenant qualify for any tax credits, abatements, subsidies, incentives, etc.? Usually, a tenant needs to apply for any of these measures before signing a lease. A careful tenant should investigate them early in the process.
- 45.17 Operating Requirements.** Does the tenant have any unusual operating requirements, procedures, or expectations? Specific expectations on usage of loading docks, freight elevators, security guards, or lobby operations? Anything outside the premises? Identify these and state them in the lease.
- 45.18 Environmental Concerns.** Consider whether the tenant should obtain an environmental review or perhaps a "baseline" to memorialize environmental conditions at lease inception. The tenant may want to take a look at the landlord's energy audit reports.
- 45.19 Special Governmental Requirements.** Does the landlord have any special subsidies, tax benefits, or other forms of governmental support? Do any of those things impose any nonstandard requirements on the tenant? Based on legislation enacted in 2015, those nonstandard requirements may arise outside the lease and the land records, as a result of governmental edicts. For example, New York City now says that whenever a landlord receives certain benefits, all tenants in the building must pay a "living wage" higher than would otherwise apply. This has nothing to do with the lease; it just applies. Tenants should look into this type of issue and, among other things, seek suitable assurances from the landlord.

- 45.20 Violations.** Check for any notices of violation filed against the property that could impair the tenant's ability to obtain necessary permits. Also, check for any litigation against the landlord.
- 45.21 Landlord's Credit Issues.** Should the tenant worry about the landlord's creditworthiness?
- 45.22 Tenant's Insurance.** Make sure the tenant's insurance program adequately covers the new location and the tenant's activities there.
- 45.23 Tenant Entity.** Determine which entity will enter into the lease and, if necessary, form that entity and figure out its ownership structure. Give the landlord this information early in this process to prevent surprises and last-minute suspicions.
- 45.24 Consents.** Determine and satisfy the tenant's internal corporate approval requirements to enter into the lease.
- 45.25 Design and Construction.** The tenant should start to think about design and construction of its new space – and the contracts necessary for that work – at the same time the tenant negotiates its lease. That thought process should include a critical examination of the likely cost of the tenant's work.

46. Lease-Related Closing Documents

At closing, any significant lease transaction may require a number of documents other than the lease itself. Counsel should resolve these documents as part of the lease negotiation process. They might include any of the following:

- 46.1 Memorandum of Lease.** Mention any “exclusive use” rights and other lease provisions that restrict the landlord's activities on other premises. Record the memorandum against all affected real property (e.g., “outparcels”).
- 46.2 Nondisturbance Agreement.** See the “lender's form” nondisturbance agreement as soon as possible, so it can be negotiated and signed along with the lease. Attach it as an exhibit as the standard for future nondisturbance agreements.
- 46.3 Reciprocal Easement Agreement.** For a new retail mall or mixed-use project, the tenant may want to have a role in establish-

ing and approving any reciprocal easement agreement that the landlord intends to record against the project.

- 46.4 Recognition Agreement And Estoppel from Ground Lessor.** If the landlord actually leases the building from a third party (a “ground lease”), any space tenant may want appropriate protections and assurances from the underlying fee owner. The tenant should generally insist on having that agreement in place at the same time the tenant signs its lease.
- 46.5 Written Authority For Agent.** If the landlord’s agent signs the lease (or any future amendment or estoppel certificate), the landlord should deliver a copy of a written authorization to sign.
- 46.6 Additional Consents.** Does the landlord need any consents or approvals? This is especially important if the landlord is a governmental entity or charity. Approvals could be internal or require cooperation from lenders, ground lessors, or other third parties. The landlord should represent and warrant that it needs no further consents or approvals and deliver copies of any necessary consents or approvals at closing.
- 46.7 Opinion Of Landlord’s Counsel.** One could limit such an opinion to authorization and execution and related issues, without entering the morass of issues—angels dancing on a pin—raised by “enforceability.”
- 46.8 Transfer Taxes.** Beware of transfer taxes generally. The calculation and allocation of any transfer taxes on the creation of the lease, including the treatment of any transfer of personal property, should be embodied in a closing document. In New York, some leases attract transfer tax, whether or not the parties record a memorandum of lease. Transfers of personalty may attract a sales tax. Prepare all necessary transfer tax returns, including required calculations and exhibits (e.g., copy of the entire lease, if required). Get them signed and filed.
- 46.9 Title Insurance.** Consider obtaining a policy of leasehold title insurance, or at a minimum an updated title search.
- 46.10 Unusual Security Arrangements.** Unusual security arrangements—letters of credit, delivery of marketable securities and the like—should be structured and documented. The landlord’s lender

and other conceivable third parties may also need to get involved in these discussions. Those third parties may ultimately become the “critical path” to signing the lease. They often have rigid documentation requirements applied by rigid people.

- 46.11 Leasehold Insurance.** Consider separate casualty insurance coverage for a valuable leasehold. If the lease requires insurance, comply with those requirements (e.g., insurer’s ratings, additional insureds, evidence of insurance).
- 46.12 Insurance Advice.** Send the insurance and casualty provisions of the lease to the tenant’s insurance advisor for review and comment. Confirm the tenant’s broker can actually issue the contemplated insurance coverages and in a timely manner.
- 46.13 Landlord’s Approvals.** Obtain and confirm the landlord’s approval of plans and specifications for initial work. Attach the plans and specifications as a schedule to the lease. If the tenant enters into any immediate subleases, have the landlord approve those at the time of lease signing.
- 46.14 Diagram of Premises.** Include an exhibit consisting of a precise diagram of the premises. Confirm that the tenant, the broker and other advisors reviewed and approved the diagram. Try to make this happen early in the process. The landlord may think it is “obvious” that certain spaces should be excluded or included, but the landlord may be wrong.
- 46.15 Guaranty.** Any guaranty of a lease will raise its own issues. A discussion of these issues lies beyond this checklist.
- 46.16 Internal Approvals.** Any documents necessary to evidence the tenant’s internal approval of the contemplated lease (resolutions, consents, or the like).
- 46.17 Rent Bill.** Instructions for how to pay rent under the lease, if not incorporated into the lease, and calculation of the first rent bill.
- 46.18 Brokerage Commission.** Evidence of payment of any brokerage commission.
- 46.19 Client Instructions.** If the client instructed counsel to do anything less than a full lease review and negotiation, counsel should maintain some written record of those instructions and a record that

counsel warned the client about the risks of “minimalism” in lease negotiations. Memories are short.

46.20 Exhibits. Focus on the exhibits early on. No one will be very happy if the lease is otherwise ready to sign but the parties have not worked out some items that were left for the exhibits.

47. Post-Closing Items

Like any other real estate transaction, a tenancy under a lease may require post-closing legal attention in order for the tenant to preserve its rights. The following are a few items that the tenant’s counsel may want to handle or at least mention to the tenant:

47.1 Advice And Administration Memo. The tenant may desire its counsel to prepare a memorandum to summarize any proactive and nonobvious actions that the tenant should take to protect its position under the lease. Such a memo might, for example, describe the deadlines and processes for objecting to the landlord’s delivery of the space; escalation statements; or provision of building services.

47.2 Ticklers For Deadlines. The tenant may want to make tickler file entries for tax protest deadlines, option and/or renewal exercise dates, letter of credit renewal dates and any other deadlines.

47.3 Future Filings. If the lease contemplates that the tenant will make any nonintuitive filings, or take any other nonstandard actions, the tenant’s counsel may wish to bring those matters formally to the tenant’s attention. This list might also include any necessary filings for available governmental incentives.

47.4 Escalation Audits. Note the deadlines to initiate any audit of the landlord’s operating expenses or other escalations. For the first year of operating expenses, audit the operating expenses not only for that year but also for the base year.

47.5 Tax Protests. The tenant should understand the deadlines for tax protests and any actions the tenant should take to preserve and exercise any rights to require the landlord to protest taxes.

47.6 Commencement Date Letter. When the commencement date has actually occurred, confirm it in writing and reconfirm the expiration date and any other dates keyed off the commencement date.

- 47.7 Options; Rent Adjustments.** The parties should memorialize all option terms and rent adjustments in writing.
- 47.8 Estoppel Certificates.** If the landlord asks the tenant to sign an estoppel certificate, the tenant should take it seriously, start researching the facts immediately and take advantage of the opportunity to put pressure on the landlord to solve any problems that the tenant identifies. Courts do take estoppel certificates seriously. The tenant should not simply “sign and return.” If the lease allows the tenant to require estoppel certificates of the landlord, the tenant may occasionally wish to do so, just to avoid future issues or surprises.
- 47.9 Future Lease Transactions.** Any future lease amendments (or negotiated termination of the lease) may require consent from the landlord’s mortgagee. Raise that issue early in the discussion. The landlord may otherwise think the tenant won’t really insist. Even if the landlord’s loan documents don’t expressly require lender consent to certain lease amendments, if the lender “granted” a nondisturbance agreement, that agreement will say the lender (or a foreclosure purchaser) won’t be bound by any lease amendments it did not approve.
- 47.10 Recordation.** If the parties signed a memorandum of lease, then the tenant should make sure it actually gets recorded and recorded correctly.
- 47.11 Effect Of Memorandum of Lease.** If the tenant recorded a memorandum of the original lease, then New York law in effect requires an amendment to the memorandum to be recorded (and accompanying transfer tax returns to be filed) whenever the parties amend the lease. Even if the amendment changes nothing that the recorded memorandum of lease disclosed, New York law requires the additional recording to give notice of the mere fact that the lease was amended. The tenant should insist on such an additional recording. For simplicity, both the landlord and the tenant may prefer to embody any future amendment in a single recorded document, assuming nothing in it must stay confidential.
- 47.12 Notices.** If the tenant has relocated its main office or legal department, then the tenant may need to notify all its contractual counterparties of the new address. This may require the tenant to do some digging in its contract files. If the tenant has filed any notice of

address for service of process with any Secretary of State's office (e.g., the tenant's state of formation and any state where the tenant has qualified to do business) or corporate service company, the tenant should update those filings as well. Who else needs to know about the tenant's change of address, and what level of formality will that change of address require? Taxing authorities? Don't assume an ordinary emailed or bulk-mailed announcement will do the job. Similarly, going forward, the tenant should watch for change of address notices from the landlord or a mortgagee (for example, every time the building is sold or refinanced). The tenant should update its records accordingly.

47.13 Nondisturbance Agreements. If a future mortgage lender requires the tenant to sign a nondisturbance agreement for a closing, insist that the agreement not become effective unless the lender signs and returns it to the tenant at closing or within a short time thereafter.

47.14 Landlord Relations. Maintain good relations with the landlord. Keep the landlord informed on anything relevant to the tenant's occupancy of the building. Have a communications channel. Use that channel before the need for any serious communications arise. That way when things arise, the tenant has someone to talk to, and the landlord knows who the tenant is. Pay the rent early every month. This is the single best way to maintain a good landlord-tenant relationship, and probably far more useful than any magic language the tenant can include in the lease.

CHAPTER SEVEN

LANDLORD'S CHECKLIST OF SILENT LEASE ISSUES (THIRD EDITION)

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* Earlier versions of this checklist appeared in the New York State Bar Association Real Property Law Journal, The Practical Real Estate Lawyer, and elsewhere. Please forward comments and corrections to the authors. Copyright © 2017 Joshua Stein, S.H. Spencer Compton, and New York State Bar Association. All rights reserved.

[7.0] I. INTRODUCTION

If you represent a landlord, do not assume a “standard” commercial lease says everything it should. Unexpected issues can lurk, sometimes silently, sometimes not. This checklist gives landlord’s counsel a tool to spot those issues and prepare or negotiate a better lease.

Any lawyer who handles commercial lease negotiations has lived through the same story a billion times: After much back and forth, often over an extended time, the landlord and the tenant have come to an agreement on the business terms of a lease. The landlord will then call or email its attorney (you) to put together a lease that covers the negotiated terms. Just this one time, the parties are really in a hurry. And the landlord, with a keen eye on the bottom line and prevention of delay, doesn’t want to break new ground in the world of commercial leasing. The landlord’s counsel, feeling the pressure to deliver what the landlord wants in the most cost-effective way possible, turns to one or some combination of the following:

- A standard form of lease, preferably one that someone updated and improved recently, but more likely one that no one has updated and improved for a very long time;
- A form of lease from some other similar recent transaction; or
- A similar lease between the same parties or their affiliates negotiated for a different deal.

In this checklist, a “Standard Form” refers to any of those possibilities.

What’s in a Standard Form lease anyway?

A Standard Form lease will probably do an adequate job of covering bread-and-butter leasing issues. But it almost certainly will not adequately consider recent developments in leasing law, recently reported cases, unreported litigation and disputes, newly discovered gaps and glitches in Standard Forms generally, advances in technology, or changes in the marketplace. If participants in other transactions have come up with better ways to handle landlord-tenant issues, or have identified new issues that nobody has thought about before, those things usually will not appear in a Standard Form.

[7.1] II. GETTING AROUND TO IT

Even if you know your Standard Form needs work—and almost all of them do—you probably will not have the time during any particular leasing transaction to give your Standard Form a tune-up, much less an overhaul. Yet clients expect (demand, actually) a suitable document, consistent with modern industry standards, immediately, if not yesterday. Even if the business negotiations moved like a glacier before you got involved, as soon as the landlord and the tenant reach a deal, they want the legal work done instantly. They know: (1) lawyers just push buttons to create documents, and (2) leases are pretty simple and standard documents, so after pushing the button it shouldn't take long to generate a lease. Does your landlord client want you to pause long enough to improve your Standard Form? Only in your spare time—and only after the deal has been signed—and not on their meter.

If you want to improve your Standard Form, though, you need to start somewhere. You might first gather up several other recent leases that seem particularly well done, thorough, and up-to-date. You might read each one and compare it against your Standard Form, improving the Standard Form as appropriate. This is a job that almost no particular transaction will ever support or even allow. And editing any Standard Form will probably never rise to the top of your to-do list, either. The job is just too big and squishy, to say nothing of being a bit painful. But you should, at least as an aspiration, try to do it once in a while anyway.

[7.2] III. HOW THIS CHECKLIST WAS BORN

To simplify that process, and to create a road map for any landlord's attorney who wants to update a Standard Form, in 2000 the New York State Bar Association Real Property Law Section Commercial Leasing Committee appointed a subcommittee to prepare the first edition of a Landlord's Checklist of Silent Lease Issues.

Looking at leasing transactions from a landlord's perspective, the subcommittee tried to identify issues that a typical Standard Form would probably cover inadequately, or not at all. These issues—the “landlord's silent lease issues”—might arise from any of the causes or trends described above. Many of them also reflect the reality that judges do not like to infer obligations or prohibitions in leases, particularly in New York, and particularly at the behest of a landlord or to the detriment of tenants, often a “protected class” in the New York courts even in commercial cases. Courts often say that if a landlord wanted to impose any partic-

ular obligation, burden, restriction, or prohibition on a tenant, then the landlord should have made it clear in the lease. If the landlord didn't do that, the courts usually will not do it for them. Courts routinely rule that if something is not in the documents that the parties signed, then it is not part of the deal. This checklist aims to help landlords assure that their leases contain whatever they may need to contain.

The Landlord's Checklist initially sought to suggest pro-landlord changes in a Standard Form that would apply in at least 15 percent of commercial leasing transactions. For an issue to make it on to the list, though, earlier editions required that the issue was also less than 50 percent likely to appear in a typical Standard Form, assuming the Standard Form was intended to cover transactions of the type for which the issue is relevant but had not been updated recently. The first and second editions of the Landlord's Checklist theoretically ignored any provision that the authors thought was 50 percent or more likely (when relevant) to appear in a typical Standard Form, or likely to apply in less than 15 percent of commercial leases. This sounds incredibly scientific and responsible, but is not really.

Both the "15 percent test" and the "50 percent test" were applied in an absolutely arbitrary, capricious, and subjective manner, with no evidence, data, or other empirical information, validation, confirmation, or corroboration of any kind whatsoever. Random exceptions were made with precisely the same level of analytical rigor. Thus, the inclusion or exclusion of any particular issue carries and continues to carry no weight. The checklist merely amounts to a reasonable reference point for anyone representing a landlord and looking for points to consider when improving a landlord's form of lease. Such imperfections and incompleteness are inevitable in any checklist like this one.

These imperfections only compounded themselves as the Landlord's Checklist grew over time to become something closer to a generic checklist for lease negotiations. The threshold for adding suggestions to the checklist eroded over time. Thus, many comments in this checklist no longer have the aura of mystery and intrigue that ran throughout the first (and to a lesser degree the second) edition of this checklist. One should, however, still not assume that this Landlord's Checklist offers a complete list of everything that a landlord's counsel should consider.

[7.3] A. What The Checklist Does

Any issues checklist like this one will probably cover both too much and too little at the same time. Nevertheless, this Landlord's Checklist valiantly seeks to deliver a summary of the latest issues that an author of a "state-of-the-art" Standard Form might wish to cover, all collected in one place, in a condensed manner, to help commercial leasing practitioners. That was true of both the first and second editions and is even more true of this third edition.

[7.4] B. Does The Checklist Give Landlords An Unfair Advantage?

Some might argue that Standard Forms are already landlord-oriented enough and no one benefits from piling on even more landlord rights and tenant burdens (also known as "gotcha" clauses). The landlord can counter that argument by stating that once in possession, the tenant has all the leverage and judicial sympathy, and the landlord just has the words of the lease on which to rely. A landlord would also argue that if the lease enforcement game were played on a level playing field, then perhaps Standard Forms would not need to be landlord-oriented; they could just be "balanced" and "fair." The use of landlord-oriented Standard Forms, the argument goes, merely represents some minimal effort to restore balance to the landlord-tenant relationship. Tenants' counsel would, of course, disagree.

As a variation on the theme of leveling the playing field, this Landlord's Checklist will also help a landlord's counsel respond when a major tenant insists on using its own form of lease. The points mentioned in this checklist will often correlate with the points that a tenant's form of lease somehow manages to omit, or perhaps covers in a way that does not adequately protect the landlord.

[7.5] C. Intended For Major Commercial Space Leases

This checklist is intended mainly for substantial commercial space leases, for both retail and office uses, and other commercial occupancies. This checklist does not apply to residential leasing transactions. They raise their own set of "consumer protection" issues that can be treacherous, much like the minefield of residential mortgage lending.

Most issues here will apply to some leases but not others. Every item in this checklist should be interpreted as if prefaced by the words: "if appli-

cable, appropriate, desired, possible, and realistic under the circumstances, taking into account the size and nature of the transaction, market conditions, the landlord's project, the tenant mix, the needs and negotiating positions of the parties, the history, the timing, governing law, and all other circumstances." Those words appear here once, but they could just as well appear as part of every suggestion made in the checklist.

Before adding anything from this list to a lease as part of a negotiation, first check to see if the lease under negotiation already covers it. If it does, only consider whether the suggestions here inspire some fine-tuning of the particular lease provision. Do not ask for something you do not need, because if it's already in the lease and you show the addition as a highlighted change, you may lead the tenant's counsel to focus on it and ask for concessions they might never have thought of otherwise.

This checklist does not try to suggest which issues apply to which types of leases, which issues matter most, or how a tenant might respond to any of these issues. Particularly given these limitations, this checklist will add more value for an experienced lease negotiator than for a novice. Even a novice, though, will find it useful. Any reader of this checklist should use it prudently and with judgment, and should not stop thinking just because something appears on this checklist. Do not just shovel words from this checklist into a lease.

Sometimes, a landlord will tell its lawyer to "just update the major issues, and do not bother with the minor stuff." In those cases, this checklist might help counsel raise a few "major" issues, but the client will probably not appreciate it if counsel makes extensive use of this list.

If your landlord client has directed you to focus only on the critical issues because of budgetary, transactional, or time constraints, you might focus on these as the "most important" lease sections for review and comment:

- Rent, including escalations and percentage rent;
- Operating expenses;
- Real estate tax and escalations;
- Use;
- Consents;

- Services by landlord;
- Utilities, including electricity;
- Assignment and subletting;
- Security deposit; and
- Defaults and remedies.

If relevant to the transaction, you will probably also want to consider provisions on Alterations, End of Term and, in a suburban building, Parking. This list is not exhaustive or complete. The authors recommend against using this short list at all, and instead considering all sections of any lease.

If a client insists on the limited approach suggested here, then you want to make it clear that you recommended a more careful and complete approach. This is especially important if it turns out that some “minor” item—something that counsel skipped—turns out to be important and expensive to fix.

[7.6] D. Caveats, Warnings, Disclosures

This checklist does not represent a position statement or recommendation by the New York State Bar Association or its Real Property Law Section, Commercial Leasing Committee, any of its subcommittees, any member of any of them, or either of the authors. This checklist is offered merely as a tool for leasing practitioners, in the hope that it might help. It creates no legal duties or obligations, and no standard of care. No representation or warranty is made on the enforceability, validity, or practical feasibility (or palatability to a tenant) of any provision suggested here. The checklist simply lists some issues landlord’s counsel might want to consider when updating a Standard Form or responding to a tenant’s lease form.

Although the authors of the checklist and the subcommittee members will be honored and pleased if anyone who reads this checklist mentions it in lease negotiations, this checklist does not estop any author or subcommittee member from taking any position in any lease negotiation. To the contrary, any reference to or quotation of this checklist in lease negotiations shall constitute an immediate and incurable event of default.

[7.7] E. Notes on Style

In the editing process, the authors decided to express some issues as affirmative recommendations, to achieve a more direct and lively presentation. Thus, the checklist sometimes says a landlord “should” consider some concept or even “should” add specific provisions to a lease. Take each such statement with a barrel of salt. The subcommittee and the authors do not purport to establish or define requirements for what any lease should or should not say or what any landlord’s counsel should think about or do. Every lease represents its own negotiation, depending largely on the considerations above. One-size-fits-all recommendations usually do not work.

This checklist mentions each issue only once, even if it might reasonably belong under more than one heading, but provides no cross-references, even in cases where this checklist breaks one topic into two related topics, both of which you should consider. Read this checklist from beginning to end.

[7.8] F. The Case Law

Although court decisions drive many landlord concerns suggested in this checklist, we do not cite a single case. Any effort to cite cases would change the character of the checklist. Case citations could go on almost without end, but would add little practical value for lease negotiators. If you want to find case law relevant to any issue, plenty of other resources exist for that purpose. For example, you might consider visiting a law library. They still exist. Many readers will fondly recall that a library is a room or other central physical facility that contains a range of “books,” which are objects consisting of multiple paper sheets, typically printed on both sides, in which people who claim (and often even have) expertise in a particular legal area share the benefit of that expertise. A book can sometimes be even more effective than Google as a legal research tool. Unfortunately, books are also more work to use, often requiring the user to leave his or her computer terminal and constant easy access to his or her email stream for well over five minutes. Books also create that the risk that the user will learn something about related legal issues not directly responsive to the user’s specific question, surely an inefficient and unnecessary use of time.

Likewise, you will need to develop lease language from sources outside this checklist (another visit to the library, perhaps?) or by thinking.

[7.9] G. Beyond The Four Corners of The Lease

This checklist considers primarily what goes into the lease itself. A successful leasing transaction also requires a landlord's counsel to consider many "silent" and other issues outside the leasing document. Those issues fall in three categories, collected at the end of this checklist: (1) due diligence; (2) additional lease-related documents and deliveries; and (3) administering and monitoring the lease after the parties sign it.

[7.10] H. Have At It

So, keeping in mind that this checklist is not perfect, that it offers an accumulation of issues with no scientific rigor whatsoever, that misusing this checklist can create problems not solve them, that the unanticipated and the unexpected are also the inevitable, and that, in the end, every lawyer must do his or her own thinking, we present for your perusal and, we hope, edification and practical value, the third edition of the Landlord's Checklist of Silent Lease Issues.

1. Alterations and Build-Out

1.1 Activities Outside Premises. If the lease lets the tenant perform alterations outside the premises (such as cable or riser installations, HVAC equipment installations, back-up generator, or fuel storage and transmission), the tenant should, at a minimum, meet all the same requirements (including removal/restoration) that would govern interior alterations. At the landlord's option, consider having the landlord, not the tenant, perform any alterations that affect space outside the premises, but at the tenant's expense.

1.2 Americans with Disabilities Act (and Similar Laws). Require the tenant's alterations to comply with not only the Americans with Disabilities Act (ADA), but also state and local laws, state and local codes, etc., on disabled/handicapped access. The latter can be more burdensome than federal law. Allow the landlord to block any alteration, even inside the leased premises, if it might require any significant changes to space outside the leased premises to comply with these laws. In any case, the landlord must understand those requirements, allocating their cost between the landlord and the tenant, before signing the lease. In the worst case, complying with these requirements may be so expensive that a particular building will not work for a particular tenant.

1.3 Artists' Rights. Prohibit the tenant from installing any artwork that could give the artist a right under federal law to prevent the artwork from being modified or removed. The law in question is the Visual Artists Rights Act of 1990. That was a busy year for federal landlord-tenant legislation, the same year Congress enacted the ADA. If the tenant has an agreement with the artist governing removal, the landlord needs to see and approve that agreement (and any amendments) and it must allow modification or removal of the installed artwork without cost to the landlord. Consider requiring a direct agreement between the artist and the landlord on these issues. Attach to the lease a copy of the artist's agreement.

1.4 Broker's Representations. State that any representations made by a broker, including representations on square footage, do not bind anyone and shall not be used to interpret the lease.

1.5 Building Security. Reserve the landlord's right to control building security. The landlord needs the right to install or change security cameras, scanning devices, and any other security technology—including future security technology—in common areas. Require the tenant to waive any right to object to such devices, and any right to sue the landlord over any privacy, labor, or workplace issues arising from their use. But the landlord should have no implied obligations on security, even if the landlord installs security equipment.

1.6 Completion of Alterations. Require the tenant to finish any construction job, close out all alteration permits, and deliver a final certificate of occupancy within a reasonable but determinable time after the tenant has obtained its first building permit, received possession or substantially completed its work. The tenant must also keep the landlord informed of tenant's schedule and progress.

1.7 Completion Bond. Before the tenant undertakes alterations expected to cost above a stated amount, require the tenant to deliver a bond or letter of credit in an amount equal to X percent of the estimated cost. (By the way, bonds sound great, but most bonds come from general contractors and don't necessarily backstop the tenant's payment and performance obligations.) If the landlord doesn't require bonds for construction work because the tenant has great credit, consider giving the landlord the right to rescind this concession if the tenant's credit deteriorates or the tenant assigns the lease.

1.8 Construction Protocols. During construction, require the tenant to fence or close off its premises. Prohibit the tenant's contractors from

entering the premises until the landlord has completed its work. If the tenant needs a staging area, the tenant should use only the area (if any) that the landlord designates.

1.9 Exterior Hoist. If the tenant wants to use a hoist outside the building, all lease provisions, rules, and regulations that govern alterations and activities within the premises should also apply to the hoist. Consider requiring that the landlord, rather than the tenant, control the hoist, although the landlord may not want the headaches or exposure. In the lease or a separate agreement, the parties should memorialize the terms of the tenant's use of the hoist, including priorities among the landlord and other tenants if the hoist will not belong exclusively to the tenant. Require the tenant to remove the hoist by a certain date. Should the landlord have the right to "free rides" on any hoist? If other tenants complain about the hoist or even try to claim rent offsets because of it, the tenant should indemnify the landlord. If the landlord has installed the hoist, provide for scheduling, charges and the right to remove it, particularly if the hoist has overstayed its welcome. In any agreement or lease provisions on the hoist, think about how the hoist is attached, use of walkie-talkies, the landlord's liability under scaffolding or other strict liability laws, permits, insurance and the landlord's liability to other tenants.

1.10 Filings. Consider requiring that the landlord's architect or expeditor supervise or handle all certificate of occupancy filings, and perhaps all other governmental filings for the tenant's work. Issues with the tenant's filing (and closing out of permits once issued) may impair the ability of the landlord or other tenants to pursue other work in the building. If the landlord signs permit applications, this should not waive any obligations of the tenant or make the landlord responsible for anything about the tenant's work.

1.11 Labor Harmony. The tenant's obligation to maintain labor harmony should relate not just to construction, but also to any other activities at the premises and in the building. Establish a specific monetary consequence if the tenant doesn't comply. Describe it as liquidated damages, and include the magic language necessary to make the liquidated damages enforceable. Also, prohibit the tenant from starting its work until the landlord has completed all "base building" and other landlord work. Simultaneous work creates greater risk of disharmony.

1.12 Landmarked Buildings. If the building is designated as an historical landmark (or lies within a similarly protected area), include whatever "magic language" the landmarks protection law requires. If the

building is not so designated, but might make an attractive target for designation, the tenant should agree: (i) not to file for historic designation, (ii) not to support any such designation without the landlord's consent; and (iii) to oppose any such designation if the landlord asks the tenant to do so.

1.13 Lender Consent. All alterations require approval by the landlord's lenders.

1.13. Liens. Try to say that the landlord's fee interest will not be subject to liens arising from the tenant's alterations, but do not assume the language will work. One could even argue that including such language is deceptive, because a non-lawyer on the landlord's staff might read it and think it solves any problem.

1.14 Modifications to Plans and Specifications. Limit the tenant's right to modify its plans and specifications, except as necessary to conform to field conditions. If the tenant modifies its plans and specifications after the landlord approves them, the alterations as modified should still be required to meet the original standards of the lease. To avoid dealing with a flood of change orders, the landlord might give the tenant some leeway, but subject to criteria to protect the landlord's interests.

1.15 Plans and Specifications. Require the tenant to deliver plans and specifications (initial, as-built, and as filed with the buildings department) in a specified (or more current) computer-aided design (CAD) format using naming conventions and other criteria as the landlord approves or requires. Also, require the tenant to deliver copies of its construction budget as well as all governmental approvals needed for the alterations, including a building permit and a temporary and final certificate of occupancy, as and when appropriate.

1.16 Removal. A strong tenant will often negotiate away any obligation to remove the tenant's alterations at the end of the lease term. As a more common alternative, the tenant will agree to remove only any unusual alterations that are difficult to remove, such as vaults, raised floors, and stairways between floors—but only if the landlord imposed the removal requirement when the landlord approved the tenant's plans. So the landlord must remember to think about this when reviewing plans. To protect the landlord from falling into a trap, perhaps the lease should require the tenant to provide an appropriate reminder when the tenant submits plans for the landlord's approval.

1.17 Responsibility for Contractors. The landlord has no responsibility for contractors, even if the landlord required or approved them. Sometimes the landlord will have an affiliate that the tenant may decide to engage for construction work. In those cases, the tenant and the contractor should still negotiate an ordinary contract, and the lease should negate any linkage between the lease and the construction contract.

1.18 Scope of Work. Even if the tenant will bear all construction risks and costs, the landlord should think twice before agreeing to tenant alterations that may require a major compliance effort or cost. Regardless of what the lease says, tenant construction projects that will raise major issues will often, one way or another, end up costing the landlord money and grief. If the building is landmarked, for example, then trivial work in one part of the building may focus municipal attention on other parts. Landlords should understand those problems before they undertake projects for the tenant or allow the tenant to undertake projects. Lease language should take into account these concerns. For example, if any tenant alterations would trigger an undesired level of scrutiny by the landmarking authorities, such as a “hearing” rather than a “staff action,” consider categorically prohibiting those alterations.

1.19 Supervisory Fee. Allow the landlord to charge a supervisory fee for any tenant alterations and for any landlord review of environmental and other conditions. The landlord’s wage schedule or standard rates in effect from time to time should constitute prima facie evidence of reasonableness.

1.20 Tenant’s Records. Require the tenant to maintain records of the costs of its improvements for six years. This information may help in real estate tax protest proceedings. If the tenant’s cost of any particular alteration exceeds a set amount, consider requiring the tenant to deliver its cost records within a certain short time after the tenant has completed construction. Otherwise, they will probably get lost, regardless of what the tenant has agreed to maintain.

1.21 Third-Party Fees. Require the tenant to reimburse the landlord for its architect’s fees, lender’s fees under any landlord loan documents and any other in-house and outside professional fees for review of plans and specifications. If a building is subject to a special regulatory regime such as landmarking, the tenant’s reimbursement obligation should also extend to any counsel or consultants the landlord engages to deal with that particular regime. The lease can express this idea broadly and generically. Always have the tenant reimburse the landlord’s legal

fees (inside and outside counsel) for practically anything the landlord does relating to the lease.

1.22 Warranties. Require the tenant to provide a warranty on completed alterations or at least an assignment of any warranty it receives from its contractor.

2. Assignment and Subletting: Consent Requirements

2.1 Assignment/Sublet of Other Tenants' Leases. Even if other leases allow assignment or subletting, prohibit this tenant from accepting an assignment of any other tenant's lease or from subletting any other tenant's premises in the building without the landlord's consent.

2.2 Change of Control. Treat a change of direct or indirect control of the tenant, unless a public company, as an assignment. To monitor, require the tenant to: (1) represent and warrant the tenant's current ownership structure, perhaps in an exhibit, when the parties sign the lease, to establish a baseline and define "change of control"; (2) deliver an annual (or upon request) certificate confirming the tenant's then-current ownership structure; and (3) report any change of control. The certificate described in (2) might, ideally, come from the tenant's attorney or accountant, but the landlord might settle for a certificate from the tenant. In prohibiting any equity transfers, do not limit the restriction to refer only to corporations, partnerships, and limited liability companies. The restriction on transferring equity should apply even to future entity types not yet known.

2.3 Collateral Assignment of Lease. Any prohibition against assignment and subletting should also prohibit any collateral assignment of the lease (such as mortgaging, encumbering or hypothecating).

2.4 Continuing Status as Affiliate. If the lease allows "free transfers" to the tenant's affiliates, require that the assignee or subtenant thereafter remain an affiliate throughout the lease term. If the affiliation ceases the tenant must notify the landlord, but the landlord should not assume the tenant will remember to do so. Once the affiliation ceases, the transaction must pass whatever test it would have needed to pass if the affiliation did not exist when the transaction occurred. That might require the landlord's consent and possibly a payment. At that point, if the landlord does not consent or the tenant does not pay, the transaction may become an event of default.

2.5 Fixture Financing. Prohibit the tenant from financing its fixtures, or impose appropriate protective conditions upon any such financing arrangements.

2.6 Future Sublease-Related Transactions. Even if the lease allows the tenant to sublet, think about future transactions that might arise from the subletting, such as further subleasing by subtenants. Try to limit the number of sublets, and consider demanding a recapture right if the tenant wants to sublet more than once. If the tenant sublets any space subject to a renewal option, that option should go away. Require the tenant to obtain the landlord's approval (or at least give notice) for any future modification or termination of a sublease, any recapture under a sublease, any sub-subletting or any expansion or assignment by the subtenant. If at any point the tenant sends or receives a commencement date notice (or any other material notice), the landlord should receive a copy. A landlord may regard at least some of these transactions as future opportunities worth preserving for the landlord. Any landlord rights regarding these transactions should appear not only in the lease, but also in the sublease, with the landlord identified as an intended third-party beneficiary. The lease needs to require all of that.

2.7 Government and Similar Tenants. A government tenant often burdens the elevator, HVAC, parking, lobby, rest rooms and security, by producing a higher occupant and visitor density than the typical private-sector tenant. This can quickly change a first-tier building into a second-tier building. Governmental occupancy, even by a subtenant, can in some cases lead to the unexpected imposition of governmental procurement regulations on the landlord. When drafting a sublease consent provision, consider limiting occupant density, power consumption, parking, operating hours and noise. If the landlord is generally willing to allow a particular government agency as tenant, state that only a particular agency (or its successor performing the same functions) can occupy the space. Any change of agency should be deemed an assignment. Conform the use clause accordingly. The comments in this paragraph about government tenants would also apply to schools, both public and private, as well as social service agencies and some non-profit organizations.

2.8 Lender Consent. Any lease assignment needs consent by the landlord's lenders.

2.9 Operation of Law. Confirm that the assignment restrictions extend to prohibit (or require the landlord's consent to) any assignments made by operation of law, such as mergers. Absent specific language to

that effect, an assignment clause will often not reach assignments made by operation of law.

2.10 Prohibit Competition with Landlord. Prohibit assignments or sublets: (i) to existing tenants in the building; (ii) for less than fair market rent or the present rent; or (iii) if the landlord has available space. Prohibit the tenant from subleasing to any entity: (i) that occupies any other building the landlord (or its affiliate) owns within a specified area; or (ii) with whom the landlord (or its affiliate) is actively negotiating or has recently negotiated.

2.11 Prohibit Other Landlord's Takeover. Any other landlord's takeover of the lease, perhaps as an inducement to relocate the tenant to that landlord's building, should be deemed a prohibited sublease. The same should apply if that other landlord, or someone else, directly or indirectly obtains the right to exercise control over the disposition of the lease (a variation on a lease takeover transaction).

2.12 Restriction. Consider prohibiting any assignment/sublet to: (1) any party with whom the landlord (or its affiliate) is in litigation (or an affiliate of any such adversary), or perhaps even any party with whom other landlords have had significant litigation; (2) a controversial entity such as a terrorist organization; (3) any party entitled to diplomatic immunity; or (4) specified entities or their affiliates, such as certain chain stores, parking lot operators, and multi-site/multi-brand restaurant operators that may have become notorious for their aggressive litigation programs against landlords. Also, prohibit assignments/sublets to any government, domestic or foreign; any government agency; a government contractor doing its contracted work in the space; or any other entity whose presence could subject the landlord to governmental procurement and affirmative action regulations. Federal procurement regulations sometimes make the landlord a deemed federal contractor under circumstances suggested in the previous sentence. State regulations vary, of course. The landlord may, however, prefer not to limit itself to any particular grounds for disapproval and rely instead on its right to "reasonably" reject proposed transactions, which might enable the landlord to reject a transaction on grounds like those suggested in this paragraph. This approach has the disadvantage, though, of creating an amorphous factual issue that may require litigation to resolve. Moreover, the cases indicate that if a landlord agrees to act "reasonably," this imposes a meaningful restriction on the landlord and could require it to show an objectively sound basis for its decision, such that a "reasonable person" in the landlord's position would

reach the same result — not a conversation that any landlord should relish having.

3. Assignment and Subletting: Implementation

3.1 ADA. Prohibit any assignment or subletting that triggers incremental ADA or other legal compliance requirements in the building or by the landlord in the premises.

3.2 Advertisements. The landlord should have the right to pre-approve any advertisements for assignment or subletting. Prohibit any advertisement that mentions price.

3.3 Assignor Guaranty. As a condition to any permitted assignment, consider requiring any unreleased assignor—and any guarantor of the lease—to deliver a guaranty with full suretyship waivers or at least an estoppel certificate or a reaffirmation of guaranty to confirm that the signer remains liable. In either case, state that any future changes in the lease obligations do not exonerate the guarantor, though perhaps the guarantor need not necessarily stand behind any incrementally greater obligations.

3.4 Breach of Anti-Assignment Covenant. A breach of the covenant not to assign the lease without the landlord’s consent should create an automatic event of default, not merely a generic default for which the tenant might have a cure period.

3.5 Confidentiality. The same confidentiality concerns that apply to the lease in general also apply to the tenant’s assignment and subletting transactions, especially if the landlord would consider those transactions to be “below market”—as the landlord typically will. The landlord would like to assure that the market does not know the terms of those transactions.

3.6 Contiguous Subleased Floors. If a tenant wants to sublet multiple floors, require those floors to be contiguous—ideally at the top or bottom of the tenant’s stack. Or require that any subleasing maximize contiguity (in some defined way), to facilitate future transactions and flexibility.

3.7 Documentation. If the tenant assigns or sublets, require the tenant to deliver unredacted copies of all documentation on the assign-

ment or sublet (including, e.g., commencement date letters, assignments, amendments and sub-subleases).

3.8 Leasing Agent. Require the tenant to designate the landlord's managing agent as leasing agent at market rate commissions for any contemplated assignment or sublet.

3.9 Partial Subleases. Wherever the lease refers to subletting, it should refer to a subletting of "all or any part of" the premises, because a bare reference to subletting may let the tenant argue that the provision relates to a sublet of the entire premises only. This is yet another example of how a literal reading, or the possibility of a literal reading, produces ever-longer legal documents.

3.10 Processing Fee. Charge a processing fee for any assignment/subletting, payable when the tenant submits an application. The tenant should pay the landlord's in-house and outside attorneys' fees and expenses for any assignment or sublease, whether or not the transaction requires the landlord's consent and whether or not the landlord grants consent.

3.11 Prohibited Use. Even if the tenant has rights to assign or sublet, the new occupant should remain bound by the use clause. Although that proposition may seem self-evident, courts may infer some unintended flexibility on use if the parties negotiate a right to assign or sublet. Retail landlords are particularly vulnerable. More generally, state that any permitted assignment or subletting does not modify anything in the lease, including negative covenants.

3.12 Recapture Right. If the tenant wants to sublease (or if the subtenant wants to sub-sublease) any space, give the landlord a right to recapture that space. Usually, the landlord must exercise or waive any recapture right early in the tenant's assignment or subletting process, before the landlord knows who the assignee or sublessee will be. A landlord may prefer to wait until the landlord has that information, as it may affect the landlord's decision. Define the recapture period window, and also the date when any recapture becomes effective. Avoid circularity, such as by saying the recapture becomes effective on the date of the sublease, but the sublease becomes effective upon the landlord's consent and, therefore, never becomes effective. If the tenant wants to sublease 50 percent or more of its space, allow the landlord to recapture the entire leased space. If the landlord exercises any recapture right, consider requiring the tenant to pay the landlord a brokerage commission equal to what the tenant

would have paid a third party to broker a comparable transaction. If the recapture right arises from a sublease, let the landlord decide whether to partially terminate the lease for the recapture space, or instead to require the tenant to sublease the same space back to the landlord, which might create another profit stream for the landlord. For any partial recapture right, require the tenant to pay for any demising wall or other space separation expenses. These could include code compliance expenses to establish a legally separate occupancy. And any switch from a full-tenant floor to a partial-tenant floor may trigger ADA and other code requirements. The tenant should pay for those too. If the landlord exercises any recapture right, allow the landlord to require the tenant to comply with whatever obligations would have arisen at the end of the term; otherwise a “recapture” might be deemed something less than a “termination” sufficient to trigger end-of-term obligations.

3.13 Rent Increase or Other Changes Upon Assignment. If the tenant assigns, let the landlord increase base rent to fair market rent. When assigning a lease with percentage rent, consider resetting the base for the rent calculation—either based on current market conditions or, in the case of retail space, the sum of existing base rent plus the average percentage rent for some specific period before the assignment. Anemic percentage rent will, however, often correlate with a tenant request to assign or sublet. Consider whether to reserve the right to require certain other changes in the lease (a higher security deposit?) upon assignment.

3.14 Tenant’s Profit. If the tenant must pay the landlord a share of the consideration or other profit the tenant receives from a subletting or assignment:

3.14.1 Allow the landlord to audit the tenant’s books and records;

3.14.2 Any tenant revenue arising from rent concessions the landlord made under the original lease belongs entirely to the landlord (a proposition that has a ring of fairness to it but may reverberate with a dull thud);

3.14.3 If the tenant does not furnish the necessary information for the landlord to calculate assignment/subletting profits, the landlord may estimate and the tenant must pay the estimated amount until a correct amount is established;

3.14.4 The landlord may condition the closing of any assignment/subletting transaction on the tenant’s acknowledging the amount of the

landlord's profit participation and making any payments due at the closing of that transaction;

3.14.5 The landlord may collect profit payments from the assignee or sublessee if the tenant fails to pay (which would imply failure to pay triggers a monetary default under the lease and the potential of lease termination).

3.14.6 For a sublease, amortize the tenant's transaction costs and other deductions over the term of the sublease; don't just subtract them from the first subrent payments;

3.14.7 Require the tenant to disclose all income derived from any subtenant, potentially backed by a certificate from the subtenant and from the tenant's principals;

3.14.8 Require the tenant to deliver copies of all assignment or sublease documents to the landlord for review before the landlord signs off on anything, as well as after the closing of the transaction;

3.14.9 Carefully define, limit, and scrutinize the scope and timing of all "offsets" or "credits" the tenant may claim in calculating its profits;

3.14.10 Consider requiring the tenant to pay the landlord's share of sublet profits in a present-valued lump sum at sublease execution;

3.14.11 Try to prevent the tenant from deducting any of the work allowance the tenant provided to the assignee or subtenant; and

3.14.12 Keep in mind that, even though the landlord might want to claim 100 percent of the sublet/assignment profit, this would vitiate the tenant's incentive to negotiate any sublease profit at all. The landlord might therefore prefer a somewhat lower percentage. In any case, the landlord might also want to require that the sublease be at market rent or higher.

3.15 Transactional Requirements. For any assignment/sublet, independent of any consent requirements, require the tenant to satisfy certain conditions (such as permitted use, reputation, net worth of assignee/subtenant, and no violation of exclusives) and delivery of certain documents satisfactory to the landlord (such as assignee/subtenant's certified financial statements, unconditional assumption of the lease, and reaffirmation of guaranties). The tenant should agree to report to the landlord, upon request, on how much space the tenant is marketing for sublease and

the asking terms of any such sublease(s). Any sublease should expressly benefit the landlord as a third-party beneficiary, so if the tenant defaults, the landlord can take over the sublease, if it wishes.

4. Bankruptcy

4.1 Characterize Tenant Improvement Contribution as Loan. To the extent that the tenant's rent reimburses the landlord for tenant improvements, consider restructuring such payments as payments on a loan, independent of the lease, evidenced by a note. Require the tenant to pledge (at least) its leasehold as security and perhaps supplement that security with a separate "tenant improvements loan letter of credit." This structure may give the landlord an argument to avoid Bankruptcy Code limitations on the landlord's claim for "rent." The landlord would then, of course, instead face all the perils of being a secured or unsecured lender in bankruptcy. The landlord's choice of poison will vary with circumstances, especially the ratio between the landlord's contribution and the annual rent. How best to handle these concerns will require full consideration of bankruptcy issues in the context of the particular transaction.

4.2 Letters of Credit. If the tenant delivers a letter of credit in place of a security deposit for more than a year's rent, consider the effect of Bankruptcy Code § 502(b)(6). Check the drawdown conditions of the letter of credit to confirm that the landlord has the right, though no obligation, to draw on the letter of credit if the tenant files bankruptcy, even if the tenant remains totally current in payments. Do not just rely on the proposition that a tenant bankruptcy would constitute an "event of default"; instead, the letter of credit should expressly allow the landlord to draw in that event. And, if the letter of credit exceeds a year's rent, instead of having the letter of credit backstop the tenant's obligations, have it backstop the guarantor's obligations. This may improve the landlord's position in a tenant bankruptcy. Don't assume that replacement of a large cash security deposit with a large letter of credit solves the landlord's problems in that context.

4.3 Multiple Leases. If the same tenant (or its affiliate(s)) leases multiple locations from the landlord, try to structure the transaction as a single combined lease for all locations to prevent the tenant from "cherry picking" in bankruptcy. If the landlord must use multiple leases, try to provide cross-defaults and give all the leases the same date. Try to avoid any language that would allocate particular rent or other economics to particular premises, an allocation that might invite or support selective lease rejection. Even a formulaic adjustment of rent based on casualty or

condemnation may create enough of a hook for a bankruptcy judge. Try not to create that hook.

4.4 Shopping Center Premises. Bankruptcy Code § 365 gives a landlord greater rights upon a tenant's bankruptcy if the landlord's building constitutes a "shopping center." But the statute does not define "shopping center." Within reason and the bounds of reality, the landlord can try to include favorable language in the lease to confirm that the landlord's project constitutes a "shopping center."

5. Bills and Notices

5.1 Change of Address/Notice Party. If the tenant relocates its main office or legal department, require the tenant to notify the landlord of the new address.

5.2 Date of Delivery Definitions. Confirm that every permitted means of notice also provides for the date when that particular notice will become effective. Try to make all notices effective as quickly as possible, even if the tenant refuses to accept the notice.

5.3 Emailed Notices. The co-authors disfavor the use of email as a means to give formal notices under a lease or other document. The market does, however, seem to be slowly moving toward accepting email notices. Any mechanism for email notices should include: (a) confirmation of receipt; (b) a generic address for incoming notices (e.g., legalnotices@landlord.com), with automatic forwarding to a handful of people; and (c) a reasonable way to deal with bounced messages.

5.4 Next Business Day Delivery. Define "overnight" delivery as "next business day" delivery, to avoid occasional case(s) saying "overnight" doesn't mean any particular number of nights—yet another example of bad cases producing ever-longer documents.

5.5 Routine Rent Invoices. Avoid any suggestion that the landlord cannot send routine rent or other invoices both: (1) by ordinary mail; and (2) only to the tenant, with no copies to counsel or the like. Negate any duty to send out base rent invoices unless they notify the tenant of an increase in base rent or an arrearage. The landlord should try to send only an annual invoice setting forth the year's base rent and known monthly escalation payments. The tenant should be able to pay monthly from that one invoice.

5.6 Service of Process. State that notice (or process) may be served on the tenant by serving the tenant's principal at his or her residence. Require the tenant to designate an agent for service of process and then maintain that designation.

5.7 Tenant's Notices. Copies of notices from the tenant (or perhaps just notices of alleged landlord defaults) should also go to the landlord's counsel.

5.8 Tenant's On-Site Contact. Require the tenant to provide a single on-site contact for operational issues who gives the landlord his or her current home and mobile numbers. If that person leaves the company, the tenant should notify the landlord and identify a replacement immediately.

5.9 Who May Give Notices

State that the landlord's counsel or managing agent (as engaged from time to time) may give notices for the landlord. Negate any suggestion that the party who gives the notice must provide any evidence of authority. If the tenant wants evidence of authority, allow them to ask for it, but without thereby diminishing the effectiveness of the notice.

6. Compliance With Laws

6.1 ADA. If the tenant uses the premises as "public accommodation" or for any other use that triggers extra ADA requirements in or out of the building (e.g., "path of travel" areas such as parking areas, entrances, lobbies, or public corridors), the tenant should pay for the work necessary to bring the premises into compliance with those legal requirements. Define the premises to include the restrooms and common areas of any full floor the tenant occupies.

6.2 Definition. Define "laws" broadly to include future enactments and amendments, insurance regulations and requirements, utility company requirements, administrative promulgations, governmental orders and recorded declarations, present and future.

6.3 Diplomatic Immunity. If applicable, obtain the tenant's waiver of diplomatic immunity. Ascertain under the specific circumstances whether this waiver will be enforceable. If it will not be enforceable, or if its enforceability raises interesting issues, find a different tenant. It is reasonable for a landlord to not rent to a consulate or foreign government or other entity entitled to diplomatic immunity.

6.4 Legally Required Improvements. Require the tenant to perform all improvements required by law. For any required improvements that relate to the building as a whole, the tenant should pay its proportionate share. Landlords often include such an obligation within the definition of operating costs for escalation purposes. That is fine, provided that the inclusion applies only during the adjustment years and not for any base year. If the tenant resists, consider limiting the tenant's obligation to apply only to laws enacted after the lease commences. The tenant will probably still resist and the parties will probably reach the following usual negotiated outcome in any space lease. The landlord will bear the risk of present and future laws that generally govern similar buildings and generic occupancies like the tenant's. The tenant will bear the risk of legal requirements that arise from tenant's particular use of the space, especially if unusual. Require the tenant to perform any improvements that are legally required as a result of any tenant alterations. Make the tenant financially responsible if it causes any part of the landlord's property to become non-compliant with the law or to lose a grandfathered status. For example, if code allows the landlord to maintain an antiquated fire alarm system, but requires the landlord to upgrade if anyone performs a certain amount of construction work anywhere in the building, and the tenant intends to undertake that amount of work, then the landlord may want to require the tenant to pay to upgrade the fire alarm system. Although that may sound like a desirable plan for the landlord, it may not conform to the best long-term asset management strategies.

6.5 Patriot Act. Require the tenant to certify that it is not a terrorist or someone with whom the landlord cannot legally do business, using language that refers to specific types of prohibited persons. For what it's worth, also have the tenant indemnify against any loss the landlord suffers (including, of course, the landlord's attorneys' fees) because the tenant really is a terrorist or falls within some other category of prohibited person. Consider similar anti-money-laundering provisions.

7. Consents

7.1 Conditions to Consent. Even if the landlord has agreed to be reasonable about a consent, require the tenant to satisfy certain conditions first. For example, the tenant must not be in default. The tenant must first deliver an estoppel certificate and copies of all relevant documents. Whenever the tenant requests any consent or future documentation, such as SNDA's and approvals, the tenant must reimburse the landlord's legal fees and other costs. Set other requirements tailored to the particular consent at issue. Remember that the landlord may forget to impose any such

requirements as a condition to the consent when issued. The lease should give the landlord a checklist of what to require, assuming that the landlord will think of opening up the lease and looking at it when the tenant actually seeks consent. And a one-time waiver should not be deemed a permanent waiver the next time the same situation arises.

7.2 Deemed Consent. If the landlord has agreed that failure to grant consent within a specified number of days will be deemed consent, try to: (i) have this concept apply only in particular areas, such as consents to transfers or alterations; (ii) require a reminder notice before the deemed consent arises; and (iii) require both the original notice and the reminder notice to state conspicuously in all capital boldface letters that the landlord must respond within that period or will be deemed to have granted its consent.

7.3 Discretionary Consents. If the business agreement between the parties does not require the landlord to be reasonable about any particular action or event, then simply ban that action or event—instead of requiring “consent in the landlord’s sole discretion”—to avoid possible claims of an implied obligation to act reasonably. Also, in this case, negate any implication that the landlord must at least consider whatever proposal the tenant presents. The tenant can always request the landlord’s consent to anything, and the landlord can always choose to grant it, at any time in the lease term. The lease doesn’t need to say that.

7.4 Limitation of Remedies. State that if the landlord wrongfully withholds consent (for example, the landlord acts unreasonably even though it agreed to act reasonably), then the tenant’s only remedy consists of specific performance—not monetary damages, and especially not consequential damages. As a backup position, the lease could require expedited arbitration, perhaps with the potential arbitrator(s) designated in the lease. This might particularly make sense for construction disputes, if the tenant anticipates performing substantial construction. In these cases, or any other case where issues seem likely to arise, confirm with the designated arbitrator (s) that they are willing to serve. Negate any potential tort or common law liability as a result of withholding consent unreasonably or in violation of the lease or applicable law. As a backup, allow the tenant to recover damages, but subject to a low cap.

7.5 No Representation. State that the landlord’s consent to anything is not a representation or warranty that the matter consented to complies with law or will meet the tenant’s needs or otherwise makes any sense at all. In the case of alterations, the landlord should not be responsible for

any contractors, architects, or engineers, even if the landlord approved or required them.

7.6 Reasonableness. Consider eliminating general references to “reasonableness” when describing a requirement for landlord consent. Instead, list specific permitted criteria, then agree that the landlord must act reasonably only once the tenant has met those criteria. Any present or future mortgagee’s disapproval of a matter should automatically constitute a “reasonable” basis for the landlord to withhold consent. Without some criteria or clear flexibility for the landlord, as a threshold before the landlord must act “reasonably,” the interpretation of “reasonableness” can result in litigation often stacked in favor of the tenant. Consider requiring arbitration on any issue of reasonableness.

7.7 Scope of Consent. Any consent applies only to the particular matter under consideration, and does not waive any future requirement to obtain the same consent if similar matters arise later.

7.8 Survival of Conditions to Consent. Whenever the tenant must satisfy certain conditions to obtain the landlord’s consent (or to take any action without obtaining the landlord’s consent), consider as a general conceptual proposition whether the lease should require the tenant to cause those conditions to remain satisfied even after the consent is granted or the action taken.

8. Default

8.1 All Rent Due at Signing. Consider requiring the tenant to pay all rent for the term of the lease at signing, but state that the landlord agrees to accept monthly installment payments only so long as no event of default exists. (Although this language sometimes appears in leases, it may be overly creative.)

8.2 Cross Defaults. Provide for cross defaults as against other leases with the landlord or its affiliates, or even against other obligations of the tenant or its affiliates, such as financial covenants under bank loans.

8.3 Default Notices. Provide that default notices need not specify cure periods; instead, the cure period will be whatever the lease provides for the particular default. (Does this work under governing landlord-tenant law?) Although any default notice will need to specify the default, give the landlord the right to supplement any default notice to include any additional defaults that were missed or correct any miscalculations, with-

out thereby extending the tenant's cure period, unless the change is substantial.

8.4 Discount for Timely Payment. Consider increasing "face rent" in the lease by some high percentage, but also state that if the tenant pays its rent by the first day of the month, then the tenant receives a discount equal to the increased part of the rent. Although this is a creative suggestion occasionally seen, it may create unintended and unexpected grief in such areas as brokerage commissions, commercial rent tax, and property tax assessments. Thus, before adopting this suggestion, counsel should consider its possible unintended consequences.

8.5 Impairment of Business. Define an event of default to include events (beyond the usual insolvency list) that may indicate the tenant is preparing to shut down. These might include the tenant's announcing that it will make substantial distributions, dividends or asset sales outside the ordinary course of business; shut down its operations elsewhere; suspend or terminate a substantial part of its business; or lay off staff above a certain threshold. At a minimum, require reporting of these matters.

8.6 No Right to Cure Event of Default. Once an event of default has occurred, should the tenant have a wide-open cure right even after the tenant's cure period has already lapsed? Whenever the landlord can exercise remedies "if an event of default shall have occurred and be continuing," this quoted language effectively gives the tenant an open-ended right to cure the event of default, provided the tenant does so before the landlord actually exercises its remedies. Does the landlord really want that? Consider providing that if the tenant defaults more than a certain number of times within a certain period, then the tenant will not have the right to notice and cure for any additional default. Also say that if the landlord accepts rent after giving a notice of termination of the lease, the rent constitutes merely a payment on account of sums due. It does not vitiate the notice of termination or any landlord right to terminate unless it brings current all arrearages. The landlord may want to state once that, if the landlord has actually given a valid notice of termination of the lease, then whatever cure rights the tenant previously had no longer exist, except as law requires.

8.7 Noncurable Defaults. State that certain defaults are noncurable, such as prohibited transfers.

9. Destruction, Fire and Other Casualty

9.1 Disaster. Consider drafting a clause to address loss of the tenant's ability to use the premises because of disaster conditions that go beyond the building, or arise entirely outside the building, such as flood or terrorist attack. Under these circumstances, a landlord will face pressure to forgive rent if the tenant cannot use the premises. It might make sense to insure the risk, if possible, and provide for a certain limited abatement right in the lease.

9.2 Insurance Coordination. Whatever the landlord does on rent abatement, make sure it matches the landlord's insurance coverage, to prevent surprises and problems.

9.3 Rent Abatement. If the landlord maintains rental income insurance, the lease should allow the tenant to abate rent for a casualty, and not obligate the tenant to maintain its own business interruption insurance. If, however, a casualty affects only part of the premises, then limit the abatement accordingly, so it applies only to the extent that the premises are not usable.

9.4 Tenant Waiver. Require the tenant to waive the provisions of New York Real Property Law § 227 (which allows a tenant to terminate a lease in the event of a casualty that renders the premises untenable), and comparable provisions in other states.

9.5 Termination Right; Limitation on Restoration. Provide no right (or a limited right) for the tenant to cancel upon casualty. To the extent the lease requires the landlord to restore, impose appropriate conditions, including completion of insurance adjustment and recovery of adequate insurance proceeds.

9.6 Time to Restore. If the landlord has the right or obligation to restore after a casualty, measure any deadline from the landlord's receipt of insurance proceeds—not from the date of casualty. Insurance policies require restoration "with due diligence and dispatch." If the lease defines an unrealistically short restoration period and allows the tenant to terminate the lease if the landlord misses the deadline, this could create a lender issue. Moreover, depending on policy language, any resulting lease termination may not constitute loss covered by the landlord's insurance program.

10. Development and Asset Management

10.1 Air and Development Rights. If the project includes development rights from other locations, should the landlord include them as part of the definition of the project? The answer may vary depending on state and municipal law, as well as the landlord's strategies for handling real estate taxes and related escalation clauses in leases. Have the tenant waive any right to object to any merger or transfer of development rights, and agree to sign any zoning lot merger if requested to do so. The tenant should have no right to limit any other uses within the project.

10.2 Building Identification. Allow the landlord to change the name or address of the building. Require the tenant to refer to the building only by whatever name or address the landlord gives it.

10.3 Building Standard Specifications. The landlord should reserve the right to modify building standard specifications. Consider the implications of any modification to building standards or specifications. For example, if the landlord wants to divide the building or shopping center into pieces, any CAM charges should continue to be calculated as if the landlord owned the entire property as one unit.

10.4 Condominium Conversion or Ground Lease. If the landlord considers condominium conversion at all likely, the lease should cover this possibility. Allow the landlord to delegate its responsibilities to the condominium board. Require the tenant to join in or consent to the condominium declaration, if governing law might require that. Adjust pass-throughs to include condominium fees as appropriate. Consider how condominiumization would affect building operations, the use clause, base years, escalations and everything else. What role should the condominium board have? The landlord should also retain the right to create a ground lease of the entire building, raising similar issues. Require the tenant to cooperate, as reasonably necessary, provided any new structure produces no material adverse impact on the tenant. If the new condominium association will take on any obligations that previously belonged to the landlord, then the landlord will want to avoid being "whipsawed" between a tenant demanding services and a condominium that might fail to competently provide them. In those cases the landlord may want to limit its obligations to trying to get the condominium to perform. At a certain point, the landlord should even agree to initiate litigation against the condominium. That's a reasonable price for the landlord to pay for its more general exculpation under these circumstances.

10.5 Construction Restrictions. State that nothing in the lease limits by implication the landlord's right to construct or alter any improve-

ments (including kiosks) anywhere on the landlord's property. If the lease does contain any such restrictions, state that they are limited to their express terms.

10.6 Demolition

Allow the landlord to terminate the lease after reasonable notice if the landlord intends to demolish the building or strip it down to structural steel and rebuild. Give the landlord a similar right if the landlord plans to redevelop the building, such as by changing its use or reconfiguring it. Set as low as possible a standard for the landlord to satisfy. For example, avoid any requirement that the landlord must be unalterably committed to demolition or must have terminated other leases or obtained a demolition permit or construction financing. It should suffice that the landlord has decided to redevelop the property or (more likely) has entered into a contract to sell the property to a developer. Give the tenant incentives to cooperate. Set up a process so the landlord will find out quickly whether the tenant will try to fight the early termination of the lease. For example, the lease can require the tenant (and any guarantors), promptly after receiving a termination notice, to deliver an appropriately tailored estoppel certificate and an increased security deposit. Pay the tenant a demolition fee only if the tenant vacates strictly on time. In certain cases, consider requiring the tenant to sign a stipulated judgment of eviction. The demolition clause should contain conditional limitation language.

10.7 Expansion Rights. If the landlord might want to expand the physical size of the building, such as by adding floors, build in enough flexibility so the landlord can prevent any issues that might arise from the expansion. More specifically: Consider resetting base years after the expansion.

10.7.1 Consider how the expansion would affect the tenant's proportionate share for escalations (after completion and lease-up).

10.7.2 Require the tenant to sign appropriate documents as needed.

10.7.3 Allow the landlord to expand the measure of real estate taxes by adding other tax lots to the project, though in that case the tenant's tax escalation share would need to drop.

10.7.4 Allow the landlord to reconfigure parking and the building as a whole.

10.7.5 Provide that the lease will be automatically subordinate to any future easements and other recorded documents the landlord signs to facilitate further development.

10.7.6 Review/revise/adjust the definition of “Building” as appropriate to take into account any possible future redevelopment of the project.

10.7.7 Give the landlord the right to enter the premises to install structural supports for any construction above the premises; to install new posts, pillars or supports as necessary; and to move walls around to accommodate any of this work. Allow the tenant an equitable rent adjustment for any significant interference or reduction of the premises, but have the tenant waive any right to an injunction, damages or claim of constructive eviction. Commentators raised their eyebrows when a case reached the result the previous sentence suggests, even in the face of silence in the lease. Despite the landlord-friendly outcome in that case, a careful landlord’s counsel will want to prevent the issue entirely.

10.7.8 The tenant should waive any rights to light or air, within limits.

10.7.9 Give the landlord the right to take back a limited amount of space to build more elevator cores or other necessary mechanical improvements.

10.8 Expiration Dates. The landlord may want to plan strategically so that all leases (or at least adjacent leases) end on the same date, to help the landlord put together large blocks of space for possible future tenants. Or the landlord may want to stagger multiple lease expirations over multiple years, so the landlord never faces “too many” lease expirations at once. This all depends on the landlord’s tastes and overall long-term strategy for the building. Might the landlord demolish or redevelop the building at a certain point?

10.9 Relocation. Give the landlord the right to relocate the tenant to comparable premises in the building or in some other specific building the landlord or its affiliate owns.

10.10 Remeasurement. If, over time, market conditions allow the landlord to nominally “expand” the building by remeasurement, make sure that will not produce any unpleasant surprises under this particular lease, e.g., an increase in the denominator for calculating this tenant’s share without a corresponding increase in the numerator.

11. Electricity

11.1 Additional Electrical Capacity and Riser Rights. If the tenant negotiates additional power and/or additional riser space, the landlord will want to preserve remaining electrical capacity and/or riser space for other tenants. Might the landlord want the tenant to remove any additional installations at the end of the lease term? Ordinarily no, but exceptions may arise.

11.2 Change of Provider. State that if the landlord changes the electricity provider for the building, the tenant must use the new provider, to the extent legally allowed, even if the tenant directly meters its own consumption.

11.3 Delivery of Electrical Service. The tenant should comply with electrical conservation measures and any limits on power grid availability, including required shutdowns that may arise. Allow the landlord to shut down electrical service to the premises when needed for alterations and other legitimate reasons so long as the landlord gives notice and the disruption is limited.

11.4 Electrical Service. If the tenant's space is directly metered, require the tenant to keep the landlord informed of the tenant's electrical consumption, with copies of bills. This may facilitate the landlord's long-term planning of electrical service for the building and future re-leasing of the space.

11.5 Electrical Measurement. In defining the electrical capacity that the landlord must provide, multiply the required watts per square foot by usable, not rentable, square feet. Then come up with a certain number of watts, because the lease should not use the words "rentable," "usable," or "square foot."

11.6 Post-Termination Electric Charges. To the extent any utility provider has the right to recalculate charges and bill the landlord later, expressly allow the landlord to bill the tenant for its share of such charges. If the electric utility has a certain time within which they can send such a bill, give the landlord at least the same time plus 60 days for processing.

12. End of Term

Some of the following comments on "end of term" issues also apply if the tenant has the right to prematurely or partially terminate the lease. The

lease should treat any such termination as the end of the term, at least for certain purposes relating to the affected part of the premises.

12.1 Abandoned Personalty. Upon lease termination, any personalty in the premises that the lease requires the tenant to remove, but the tenant does not remove, should be deemed abandoned. Require the tenant to pay to remove and store that personalty unless the landlord elects to retain or discard it.

12.2 Cables, Conduits. The landlord should retain ownership of all cables and other wiring in the building. Require the tenant to remove cables, conduits, wires, raised floors, and rooftop equipment at the end of the lease term either in all cases or at the landlord's request. (Some landlords like to require this. Others prefer to handle it themselves as part of preparing the space for the next tenant.) Require the tenant to indemnify the landlord from all liability in connection with that removal. To the extent that the lease allows any of these items to remain, require the tenant to properly cap and label them.

12.3 Consequential Damages. If the tenant holds over, require the tenant to pay all damages the landlord incurs, including consequential damages such as the loss of the next prospective tenant. If necessary, consider giving the tenant a window of up to 60 days before consequential damages apply. Holdover rent would apply as usual.

12.4 Holdover. Consider providing that if the tenant fails to vacate the premises at the end of the term, the tenant must pay a use and occupancy charge (not "rent") equal to the greater of: (1) some high percentage of the final adjusted rent (including escalations) under the lease; and (2) some high percentage of the then fair market rental value of the entire premises. Calculate the charge on a monthly basis for an entire month for every full (or partial) month the tenant holds over. Confirm what the maximum enforceable holdover rate may be. Describe this payment as liquidated damages and not a penalty. Consider simplifying matters by saying that during the final year of occupancy the tenant must pay either fair market appraised rent, or a very, very high rate. Give the tenant an option to terminate the lease effective just before that last year of the term begins, on at least a year's notice. This way, if the tenant stays, the landlord can try to collect very high rent. The landlord does not have to hold its breath to the last minute to see if the tenant will decide to default. The whole arrangement looks something like the "anticipated repayment date" and "hyper-amortization" provisions that sometimes appear in securitized loans.

12.5 Landlord's Property. At the landlord's option, the tenant should leave behind any improvements, fixtures, or personal property that the landlord paid for, including by rent abatement. Consider the tax implications of ownership. Consider to what extent the tenant can remove improvements and fixtures. Should the landlord be able to prohibit the tenant from removing these items?

12.6 Obligation to Restore. Require the tenant to restore the premises, including removing signage, at the end of the term. State that the landlord's consent to any alteration does not waive the tenant's obligation to remove it and restore the premises at the end of the term—particularly for major or difficult-to-restore alterations such as a slab cut for an internal staircase. To the extent that the landlord wants—or might want—the tenant to leave a major alteration in place, give the landlord that right. Where appropriate, specify by exhibit which alterations may remain, which must remain, and which the tenant must remove and restore. The restoration obligation should survive expiration or sooner termination of the lease. State that if the tenant does not complete restoration or other end of term activities (such as environmental remediation) by the expiration date, the tenant must pay holdover rent until completion.

12.7 Security Deposit. Consider requiring an incremental security deposit, a few years before the end of the term, to back the tenant's end-of-term obligations. Security deposits often “burn off” over time, with the result that little security deposit remains when it may most matter, at the end of the term.

12.8 Survival. The tenant's obligations and liabilities under the lease should survive the expiration or termination of the lease.

12.9 Tenant Waiver. Require the tenant to waive any civil procedure law or rule that would allow a court to issue a stay in connection with any holdover or other summary proceedings the landlord might institute.

12.10 Time of Essence. State that “time is of the essence” for the tenant's obligation to vacate the premises.

12.11 Timing. The landlord may prefer not to have leases expire during a holiday season or before or after a long weekend.

12.12 Warranties. If the tenant surrenders space (either at the end of the term or because the tenant reduces its occupancy), require the tenant

to assign to the landlord any warranties the tenant received for any improvements or equipment surrendered.

13. Environmental

13.1 Copies of Notices. Require the tenant to promptly deliver copies of all notices it receives from any state or federal environmental agency relating to the property.

13.2 End-of-Term Assessment. Where applicable, allow the landlord to require an environmental assessment at the tenant's expense at the end of the term. Require the tenant to remediate any conditions that would have been the tenant's responsibility under the lease.

13.3 High Risk Uses. For a gas station or other high-risk use: (1) establish an environmental baseline by undertaking a sampling plan or environmental assessment before occupancy (to define what problems, if any, already exist); (2) require periodic monitoring, especially where groundwater might be readily affected, and along perimeter areas where migrating oil can be detected; (3) obtain an indemnification that is both very broad (all environmental risks) and very specific (particular environmental issues arising from the tenant's particular business); and (4) require the tenant to post a bond if the tenant cannot obtain environmental liability insurance. If underground tanks already exist, require the tenant to: (1) accept them "as-is"; (2) comply with laws, including obtaining all permits (as well as annual registration and recertification); (3) post all required financial assurances; (4) maintain, repair and replace, if required, all tanks; (5) maintain all required records and inventory controls; (6) deliver evidence of compliance (e.g., copies of recertifications) according to a reasonable schedule; and (7) comply with any present or future lender requirements.

13.4 Interior Air Quality. Disclaim any landlord liability for mold, bad air or "sick building syndrome." Also allow the landlord to prohibit smoking anywhere in the building or nearby such as on sidewalks and terraces.

13.5 Landlord Indemnification. If the landlord agrees to indemnify the tenant for past environmental problems, limit this indemnification to any liability that exists under present law based on present violations. Exclude any liability arising from the act of a third party, future laws, amendments of existing laws or any action (or failure to act) of the tenant that exacerbates any existing condition or increases any existing liability.

13.6 LEED Compliance. If the landlord seeks to comply with LEED, the landlord may need to include suitable language in the lease and modify some typical lease provisions. As one element of green leasing, the landlord may require in every relevant context that the tenant comply with the landlord's environmental requirements or guidelines and perhaps anything necessary to preserve the landlord's LEED or other certification. This all works very well until it starts to cost the tenant an undefined and unknowable amount of money. If the landlord has agreed with other tenants to maintain LEED certification, then the landlord may not have much flexibility on these issues. Therefore, the landlord should try to avoid making any ironclad LEED commitments to any tenants.

13.7 Mold. The tenant must promptly report any mold infiltration. Make the tenant responsible for all mold in the premises unless it can affirmatively show the mold originated in a part of the building for which the landlord is responsible.

13.8 Notice of Hazardous Conditions. Require the tenant to promptly notify the landlord of any leaking or other hazardous or potentially adverse condition on the premises, including mold, leaks and other conditions that could cause mold. Require the tenant to abate any such circumstances promptly, except any that are the landlord's responsibility.

13.9 Reports; Inspections. The tenant should agree to deliver, or reimburse the landlord's cost to obtain, updated environmental reports. Give the landlord and its environmental consultant the right to enter, inspect and photograph the premises and perform environmental assessments, including invasive assessments, if the landlord reasonably believes that a violation of environmental law exists, all at the tenant's expense.

13.10 Tank Removal. The landlord might want the right to perform a further environmental assessment at the end of the term, and require the tenant to remove any underground storage tanks (especially but not only if the environmental assessment discloses problems) and perform any required remediation. Condition the return of the tenant's security deposit on the tenant's completing any such removal and remediation.

13.11 Tenant Indemnification. Require the tenant to indemnify the landlord against all harm arising from the tenant's use and occupancy of the premises and the property. The tenant's indemnity should cover all environmental matters and anything the tenant installs anywhere. The indemnity should survive the expiration or termination of the lease.

14. Escalations

14.1 Audit Issues (Operating Costs)

14.1.1 Auditors. Prohibit contingent fee auditors or auditors that have worked for other tenants in the building. If the landlord agrees to reimburse audit costs, e.g., if the tenant's audit reveals a certain level of mistakes, then negate any reimbursement to contingent fee auditors. Consider requiring a national CPA firm, billing on an hourly basis. Insist that such firm agree to notify the landlord of any undercharges or errors in the tenant's favor that the audit discloses, and to give the landlord a copy of the auditor's full report. If the auditor does not, the tenant should agree to do so. If the tenant engages any particular lease auditor, require that lease auditor to agree not to represent other tenants in the building. The tenant must keep audit results confidential.

14.1.2 Claims. Require specificity, completeness, and finality in any tenant claim of discrepancy or error.

14.1.3 Condition for Audit. Allow the tenant to audit operating costs only if those costs increase more than a specified percentage over a specified prior year or base year.

14.1.4 Confidentiality. Require the tenant and its auditor to sign a confidentiality agreement satisfactory to the landlord for any audit and its results before disclosing any records or information to the tenant or its auditor. The agreement should, among other things, prohibit the tenant and its advisors from disclosing the existence of any audit or any of its results, including any settlement, particularly to other tenants in the building. The tenant's breach of the confidentiality agreement should constitute an incurable default under the lease or at a minimum preclude the tenant from initiating further audits for several years.

14.1.5 Costs of Audit. Ask the tenant to pay for the landlord's out-of-pocket costs for any audit (such as photocopying, staff time, document retrieval, accountants' time spent answering inquiries, etc.), at least if the audit fails to disclose any issues serious enough that they would make the landlord responsible for the audit costs.

14.1.6 Dispute Resolution. Provide a private and final mechanism (such as arbitration) to resolve any dispute about operating costs.

14.1.7 Inspection Restrictions. Allow the tenant (or its representative) to examine specified books and records only, and only for a specified period, but prohibit copying. Require that any audit comply with the landlord's reasonable requirements and instructions. On assignment, prohibit the new tenant from auditing for any period before the date of the assignment.

14.1.8 Limits. Limit the timing, frequency and duration of audits. Require the tenant to complete the audit within a stated time after notifying the landlord of the audit. Consider requiring the tenant to audit multiple years at once, or requiring that the notice of audit specify the specific issues the tenant intends to raise (difficult or impossible if the tenant has not yet seen any of the underlying records).

14.1.9 Threshold for Payment. If overcharges (net of undercharges) total three percent or less of total annual operating costs (a generally accepted definition of "materiality"), then the tenant should receive no adjustment or reimbursement of its audit costs. Define carefully the variable against which the three percent test will apply. Try to use a variable that will be large rather than small. For example, refer to three percent of gross annual operating costs rather than three percent of the tenant's escalation payment. Try to use a higher percentage.

14.2 Generally

14.2.1 Base Year. Consider whether anything might make the current base year for operating costs unusually high, such as a spike in insurance costs, energy cost spikes, a change in management, or extraordinary repairs. Normalize the base year for operating costs to adjust for such unusual spikes. Or, instead, consider a fixed dollar amount to define the base.

14.2.2 Brokers' Commissions. Exclude all escalations from the calculation of broker's commissions in the brokerage agreement.

14.2.3 Ease of Proof. Make operating costs easy to prove. The landlord does not want to have to prove all the underlying facts. How would a judge respond to the definition of "operating costs" in the lease, and all the various definitions and exclusions? Ask a litigator. Perhaps the calculation should come from the landlord's outside accountant, and not be subject to challenge except based on manifest error.

14.2.4 Examples. For any complex or intricate escalation formula, consider adding an example, but do not make the numbers dramatic or shocking. Keep in mind, though, that the formula should speak for itself. By adding an example, one says the same thing twice, introducing the risk of inconsistencies. The example should add nothing. If it adds anything at all, then it also adds risk.

14.2.5 Fixed Fee. Consider replacing escalations based on operating costs or CAM with a fixed formula.

14.2.6 Implied Covenants. State that the landlord has no obligation to use operating cost escalations to pay operating costs; they merely constitute additional compensation to the landlord under the lease.

14.2.7 Liability for Refunds or Rent Credits. The landlord's liability for any refund (or credit) of overpaid escalations should terminate after a specified number of years. It should also terminate automatically upon any sale, receivership, or foreclosure of the building. Otherwise, the possible overpayment may create open-ended obligations or issues for the landlord, particularly at the time of sale. Consider whether the landlord should have the right to pay in installments any refund that the landlord might owe, or limit the tenant's relief to a future offset against rent, unless the lease expires before the tenant fully recovers what's due.

14.2.8 No Decrease. Escalation formulas should never allow rent to go down.

14.2.9 Reimbursements. What happens if the landlord can require other tenants to reimbursement some piece of the landlord's operating expenses? Those reimbursements may include a profit component to the landlord (e.g., for cleaning "extras"). If the tenant can require subtraction of the entire reimbursement payment, the tenant effectively participates in that profit. Instead, the lease should merely exclude from operating expenses the landlord's costs of providing whatever services trigger reimbursement payments.

14.2.10 Survival; Timing. Limit the time during which the tenant may challenge any escalation or demand a refund that the landlord "forgot" to pay. Be careful, though. The tenant may try to make this reciprocal for the landlord's billings. All the tenant's obligations on escalations should survive the expiration or termination of the lease.

14.3 Operating Costs

14.3.1 Broad Definition. Consider any special characteristics of the property that could cause the landlord to incur costs outside the typical operating cost definitions in a generic lease. For example, if a reciprocal easement agreement or a ground lease imposes costs similar to real estate taxes or operating costs, expand the appropriate definition to include them. State that any characterization of an expenditure in the landlord's tax returns (e.g., as a capital expenditure) has no effect on interpretation of the definition of operating costs in the lease.

14.3.2 CAM. Avoid the term "CAM" (common area maintenance) because operating cost escalations cover far more than common area maintenance. A tenant may argue that the phrase "CAM" is somehow deceptive or restrictive. At a minimum it might create confusion. Where do "common areas" end?

14.3.3 Capital Expenditures. Ideally, the base year would disregard any contribution to capital expenditures—even their partial amortization. Amortize capital improvements only in the comparison years, not the base year, for operating costs. In that case, unusual capital expenditures in the base year would not raise an issue. Only the adjustment years would include amortization of capital expenditures as part of operating expenses. Try to tack on an interest factor on the landlord's unreimbursed capital outlay.

14.3.4 "Gross Up" Clause. The landlord should have the right to "gross up." For example, if the building has an occupancy level under 95 percent, increase the amount of operating costs to the amount that the landlord would have incurred for full occupancy. The tenant will expect to see a gross-up in the base year operating costs as well.

14.3.5 Major Repairs. Do not necessarily limit multi-year amortization of large repair costs to "capital" items. Particularly if leases limit escalations or if the landlord worries about base years for new leases, the landlord may want the ability to spread major noncapital repair costs, and new costs of legal compliance, over multiple years.

14.3.6 No Fiduciary Duty. Negate any fiduciary duty regarding operating cost escalations and their administration, and any other lease provisions.

14.3.7 Off-Site Costs. Avoid limiting "operating costs" to those incurred physically within the particular building. The landlord may incur off-site operating costs, such as in a multi-use project (such as holiday

decorations in a central plaza) or for off-site equipment, installations, or shuttle bus service for the benefit of the building. Likewise, if municipal approvals for development of the building required the landlord to incur continuing off-site expenses, treat those as additional operating costs. Examples might include maintenance of traffic improvements, a day care facility or a sculpture park containing statues of the Mayor and City Council.

14.3.8 Reality Connection. When negotiating the operating cost escalation clause, confirm that the clause, particularly as negotiated, matches the landlord's current practices in operating the building, so the landlord can actually make the necessary calculations and adjustments without experiencing a long, slow descent into accountancy hell. Consider consulting with the landlord's accountant and the building manager, or even someone in the business of auditing lease escalations for tenants. They should look at the definition of operating costs and any exclusions. Try to keep these definitions consistent across multiple leases.

14.3.9 Reserve Charge. Operating expenses should include repair and replacement reserves. To avoid common arguments about how to treat "capital" items, consider establishing an annual per-square-foot capital reserve charge. The landlord would not need to account for these funds and the lease would define categories of "capital type" costs to which tenants need not contribute. If, however, this reserve charge stays constant from year to year, including the base year, then the reserve charge on its own will not allow the landlord to recover a penny under the typical pass-through of only increases in operating costs. Therefore, make the reserve charge a separate additional charge.

14.3.10 Timing. Try not to agree to tight time limits (or, worse, a "time is of the essence" provision) for the landlord's obligation to provide operating statements. The landlord should, of course, try to be timely, based on cases that have required such timeliness based in part on an inferred "fiduciary duty" because the landlord controls the information.

14.3.11 Use of Generally Accepted Accounting Principles (GAAP). In defining operating "costs" (not "expenses," perhaps an accounting term of art), try not to refer to GAAP. The term often arises in two places: (1) when defining what the landlord can pass through to tenants; and (2) when excluding "capital" items. GAAP may unintentionally skew the calculation of operating costs in ways the landlord would regard as a surprise. Again, coordinate with the landlord's accountant.

14.4 Other Escalations

14.4.1 Consumer Price Index. Use the Consumer Price Index for all Urban Areas (CPI-U) index. Many believe that this index has historically increased faster than the Consumer Price Index for Urban Wage Earners and Clerical Workers (CPI-W) index.

14.4.2 Fixed Percentage Increase. Neutral, predictable, and easy to administer, though the landlord must still remember to do it.

14.4.3 Porter's Wage. Include fringe benefits and all other labor costs. The wage rate used should not reflect "new hire" or other transitional wage rates.

15. Estoppel Certificates

15.1 Additional Requirements. In defining the scope of an estoppel certificate, allow the landlord to require any additional information the landlord reasonably requests. Think about uncertainties that, at some later date, a lender might want the tenant to confirm —such as whether the tenant exercised an option, the dollar amount of base operating costs or any nonstandard dates that might help define either party's obligations.

15.2 Attach Documents. Require the tenant (if asked) to attach to any estoppel certificate a copy of the lease and all amendments, option exercise letters and other documents that define the landlord-tenant relationship.

15.3 Exhibit. Attach a form of estoppel certificate as a lease exhibit (conform to typical lender requirements), but build in flexibility for future lender requests. Include a certification of the tenant's current ownership structure.

15.4 Failure to Respond. Establish specific, meaningful remedies for failure to sign an estoppel certificate within a short period. These might include a deemed estoppel, a power of attorney to execute it for the tenant or a daily nuisance fee.

15.5 Future Estoppels. Require the tenant to deliver future estoppel certificates at any time on the landlord's request. If the tenant negotiates restrictions on the frequency of estoppel certificates, then think about other specific occasions when the landlord might want an estoppel certificate, and perhaps provide for those (e.g., completion of improvements, exercise of renewal option).

15.6 Ratify Guaranty. Allow the landlord to require a confirmation and ratification of any guaranty, and an estoppel certificate from the guarantor, not merely an estoppel certificate from the tenant. Lenders and purchasers will often care more about the guarantor and the guaranty than the tenant and the lease. As an alternative, require the guarantor to sign any estoppel certificate along with the tenant.

15.7 Reliance. Allow reliance by prospective purchasers, mortgagees or any participant in a future securitization, including rating agencies, servicers, trustees, and certificate holders. What about the landlord? If the landlord cannot demonstrate detrimental reliance, a court might conclude that an estoppel certificate does not estop the tenant as against the landlord. Thus, the lease should say that an estoppel certificate binds the tenant as against the landlord, even if the landlord cannot demonstrate detrimental reliance.

16. Failure to Deliver Possession

16.1 Condition of Premises. Substantial completion should suffice (for example, temporary certificate of occupancy) for the landlord's delivery of the premises. Try to maintain some record of the condition of the premises at delivery.

16.2 Delivery Dispute. Provide for a short deadline for the tenant to report any issue or problem about the premises or the landlord's work. If possible, state that taking of possession constitutes acceptance for all purposes.

16.3 Delivery Procedure. Try to tie the "commencement date" to an objective event—preferably within the landlord's control—or a date, rather than to any notice from the landlord. Notices are often not as easy or quick to give as they often seem to attorneys drafting leases. Any delay in giving a commencement date notice will mean lost revenue for the landlord. Allow the landlord to give notice of the commencement date promptly after it has occurred, not as a condition to its occurrence.

16.4 No Liability. The landlord should incur no liability for failing to deliver possession on the commencement date for any reason, including holdover or construction delays. The lease should expressly waive any applicable law that may provide otherwise. The tenant's obligation to pay rent should start on possession. Perhaps extend the term by the duration of any landlord delay in delivering the premises, especially if the delay exceeds a certain amount of time. Depending on state law, though, with-

out an outside deadline for delivery, the lease may be subject to attack under the rule against perpetuities.

16.5 Rent Abatement. To the extent the landlord agrees to give the tenant a rent abatement for late delivery, limit the duration of the abatement (for example, if the rent abatement exceeds a set number of days, thereafter the tenant must either terminate or wait, but cannot continue to abate). Try to defer any such abatement (for example, spread it out in equal annual installments over the remaining term of the lease, rather than front-load it). This will reduce immediate damage to the landlord's cash flow at a time when the landlord may face financial stress.

16.6 Termination Right. The landlord (not just the tenant) may want the right to terminate the lease if the landlord ultimately cannot deliver possession by a date certain.

17. Fees and Expenses

17.1 Attorneys' Fees and Expenses. The tenant should reimburse the landlord's attorneys' fees and expenses both broadly and with specificity (for example, for actions and proceedings, including appeals, and in-house counsel fees and expenses). The reimbursement obligation should cover attorneys' fees and expenses incurred in connection with: (1) any litigation the tenant commences against the landlord (including any declaratory judgment action or any action to interpret or apply the lease), unless the tenant obtains a final favorable judgment; (2) any litigation or arbitration the landlord commences against the tenant whether for default or specific performance; (3) negotiating a lender protection agreement for the tenant's asset-based lender; (4) the landlord's (or its employee's) acting as a witness in any proceeding involving the lease or the tenant; (5) reviewing anything that the tenant asks the landlord to review or sign; (6) any lien filing arising from the tenant's work, even if the lien filing does not constitute a default; (7) bankruptcy proceedings; and (8) delivering an estoppel or a subordination, non-disturbance and attornment agreement (SNDA).

17.2 Fees and Expenses. Require the tenant to pay any fees or expenses the landlord incurs, including legal costs, in connection with any consent or waiver, or request for one, even if denied. Try to make the reimbursement obligation broad enough so it even applies if the tenant initiates discussions with the landlord for a totally discretionary lease amendment or waiver, as opposed to a consent already contemplated within the four corners of the lease. The tenant should also pay a fee (and

expenses) for the landlord's review of any plans and/or specifications. Avoid a flat fee. Set the fee according to a formula based on the size of the job or hours necessary, with a floor.

18. Future Documents, Deliveries, Events, and Information

18.1 Confidentiality. The tenant should keep confidential the fact of the lease signing and the terms of the lease, particularly if the tenant's pricing is below current market value (or the landlord's conception of current market value) or the landlord's asking price for direct space. If the landlord provides the form of lease, require the tenant to acknowledge that the form is confidential. Require the tenant and its counsel to agree not to use the landlord's form of lease for other transactions, and not to disclose any concessions to this particular tenant that the landlord made.

18.2 Further Assurances and Cooperation. Require the tenant to enter into any amendments that the landlord reasonably requests to correct errors or otherwise achieve the intentions of the parties, subject to reasonable limitations. Provide that if a party is legally required to do anything, the other party will reasonably cooperate.

18.3 Future Events. The parties should agree to memorialize any commencement date, rent adjustment, or option exercise in a lease amendment or confirmation letter. If the parties do not actually do that, though, the lease should say such failure does not affect either party's obligations. If the parties recorded a memorandum of lease, they will often need to record the confirmation of dates.

18.4 Governmental Benefits, Generally. Require the tenant to cooperate in a timely manner, as necessary, to help the landlord qualify for any available tax or governmental benefits, such as tax abatements.

18.5 Landlord's Accommodations. To the extent that the landlord agrees to provide future deliveries or take certain actions for the tenant's benefit, require the tenant to reimburse all costs and expenses the landlord incurs, including reasonable attorneys' fees.

18.6 Limits on Tenant Rights. To the extent that the landlord gives the tenant any special "right" or "privilege," condition it as appropriate. Certain minimum occupancy? No default? Other criteria or conditions? Maintenance of a certain financial strength? When the landlord agreed to the concession, what assumptions did the landlord make? What happens if those assumptions stop being true? For example, if the tenant's good

credit eliminates any requirement for bonds or other landlord protections, undo this concession if the tenant's good credit turns bad. Can the tenant exercise any privilege or right only once or only within a certain period? Or does it apply throughout the lease term? Can the tenant assign any particular special privilege if the tenant assigns the lease? Or does the special privilege go away upon assignment? Can the tenant assign that privilege or right separately from the lease? If the tenant exercises any privilege or right, should the lease require the tenant to deliver an estoppel certificate, any documents the tenant entered into in exercising the privilege or right or any other documents? These issues potentially arise for every tenant "right" or "privilege," including permitted assignments, releases from liability, options and exclusive uses.

18.7 Original Lease Document. The landlord may scan and destroy its original lease in the ordinary course of business. The landlord need never produce an original counterpart. Make sure this will not raise any problems in litigation in the particular jurisdiction.

18.8 Permitted Disclosure. If the landlord agrees to any confidentiality restrictions, or if governing law automatically infers such restrictions, then the landlord should exclude from such restrictions the right to disclose any information to actual or prospective mortgagees, equity investors, purchasers, or where required by law or legal process.

18.9 Reporting. Require the tenant to immediately report if the tenant or any guarantor experiences: (1) any adverse change in financial position; or (2) any litigation that could adversely affect the tenant's or guarantor's ability to perform. For an individual guarantor, require the tenant to notify the landlord of the guarantor's death or disability. If the landlord receives such a notice, the landlord may need to file a claim with the guarantor's estate, or lose the benefit of the guaranty.

18.10 Sales Reports. Even if the tenant does not pay percentage rent, a retail tenant should still deliver monthly sales reports and sales tax records. This helps assess the tenant's profitability, the long-term prospects of this tenant and the project, and how to approach future rent negotiations. Although such provisions are standard in mall leases, they probably make sense in all retail leases. If the landlord operates a property-wide promotional program and needs to know the tenant's current sales levels, try to connect the tenant's cash registers to the landlord's computers to track spending and promotions in real time. If the tenant uses tablets in place of cash registers, confirm that any percentage rent formula captures those sales.

18.11 Tenant's Financial Condition. Require the tenant to deliver annual financial statements for itself and any guarantor. Negotiate the right to require a security deposit, rent adjustment or other consequences to protect the landlord if the financial condition of either deteriorates.

18.12 Tenant's SEC Filing. A publicly held tenant whose lease is a "material obligation" must file a copy of the lease with the tenant's publicly available SEC filing. Therefore, consider having the tenant: (1) represent that the lease is not a "material obligation"; (2) agree to notify the landlord if the tenant ever must publicly file the lease; and (3) agree to try to have rental information and other economic terms redacted or given "confidential" treatment. If the lease is "material," however, the last suggestion might not be realistic, because if the lease was material then presumably its rent and economic terms are the most material part of the lease and hence the whole point of the exercise.

18.13 Tenants Representations, Warranties, and Status. The tenant should agree to update its representations and warranties from time to time and to stay in good standing throughout the lease term.

18.14 Termination of Lease Memo. If the tenant obtains a memorandum of lease: (1) the tenant should agree to execute and deliver a termination of memorandum of lease in recordable form if the lease terminates early; and (2) consider requiring the tenant to sign such a termination at lease execution, to be held in escrow.

19. Guaranty

19.1 Estoppel Certificate. Any guarantor should agree, in the guaranty, to issue estoppel certificates promptly upon request. Any failure should constitute a lease default.

19.2 Foreign Guarantor. In the case of any foreign or out-of-state guarantor, require appointment of an in-state agent for service of process and a consent to jurisdiction. Check into enforcement procedures for judgments in the guarantor's home country. Consider providing for arbitration as a means of enforcing the guaranty; arbitration awards can often be more readily enforced in foreign countries than U.S. judgments.

19.3 "Good Guy" Guaranty. If a tenant is not creditworthy, consider obtaining a "good guy" guaranty. This guaranty would cover all rent and certain other obligations under the lease, starting with mechanics' liens. Like "carveout guaranties" for loans, the scope of these guaranties

has metastasized over time, potentially covering a wide variety of obligations under the lease. Any “good guy” guaranty would end when the guarantied obligations have all been performed (by the tenant or the guarantor) and the tenant surrenders the premises vacant, in satisfactory physical condition, and free of any occupancy rights, provided the guarantor gives X months notice of surrender and pays X months rent. Upon the tenant’s surrender, and as a condition to release of the guaranty, the tenant should release the landlord in writing from all lease obligations. The “good guy guaranty” should remain in force until the guarantor has paid all sums due under the guaranty.

19.4 Guarantor Consents. Tailor the guarantor’s consent/waiver boilerplate to reflect circumstances of the lease. For example, the guarantor should consent in advance to any future assignment of the lease. The guaranty should also contain any state-specific language necessary or helpful for a guaranty.

19.5 Guarantor Consideration. In any guaranty, recite the relationship between the guarantor and the tenant to confirm the guarantor will receive some benefit from the lease.

19.6 Guarantor’s Financial Condition. Require the guarantor to provide financial statements at lease execution. Require regular reporting of each guarantor’s net worth. State that a material decline in a guarantor’s net worth or a guarantor’s death, disability, or bankruptcy constitutes an event of default unless the tenant promptly furnishes additional collateral or a new guarantor satisfactory to the landlord or meeting an agreed financial test, such as a net worth equal to some multiple of the annual rent. If a guarantor enters bankruptcy but the tenant does not, then any lease remedies triggered by the guarantor’s bankruptcy should be perfectly enforceable against a tenant.

19.7 Lease Assignment. If the landlord sells the property, then the guaranty should, by its terms, automatically travel to the purchaser, whether or not the transfer documents say so.

19.8 Social Security/EIN Number/Address. State the Social Security or employer identification number (and, perhaps, driver’s license and passport) number and home address of any guarantor beneath its signature line. This underscores the fact that the guaranty is intended to constitute a personal obligation of the guarantor and may facilitate enforcement.

19.9 Springing Guaranty. Consider a springing guaranty if certain adverse events occur, such as a material reduction in the tenant's or a guarantor's net worth.

19.10 Tenant Bankruptcy. Any guarantor and any unreleased assignor should acknowledge that its liability will not decrease if a tenant bankruptcy "caps" the landlord's claim for "rent."

19.11 Unreleased Assignors. If the tenant assigns the lease, then unless the landlord has released the assignor, recognize that the assignor remains functionally a guarantor of the lease. Any reference to a guarantor of the lease should include any unreleased assignor, and the lease should treat them the same way.

20. Inability to Perform

20.1 Exception to Force Majeure. Force majeure should never limit any monetary obligation of the tenant, or any obligation to maintain insurance.

20.2 Force Majeure. For the landlord, force majeure should include a failure to obtain governmental consents or permits and acts of government, war, terrorism and insurrection.

20.3 Triggering Event. If the tenant negotiates a force majeure clause, require the tenant to notify the landlord promptly of any "force majeure" event. If the tenant doesn't notify the landlord quickly, then the tenant cannot claim force majeure. The tenant's extension of time to perform should continue only so long as the triggering event actually causes the tenant delay.

21. Initial Alterations

21.1 Completion of Landlord's Work. When the landlord completes any work it agreed to perform for the tenant, require the tenant to deliver an estoppel certificate confirming satisfactory completion. The lease will probably already allow the landlord to request an estoppel certificate at any time. The landlord just needs to remember to exercise that right.

21.2 Minimum Tenant Payment. Require the tenant to spend some minimum amount on its initial build-out, either generally or as a condition to satisfy before the landlord must make any contribution.

21.3 Landlord's Work. Because rent commencement will probably hinge on the landlord's completion of any work the landlord agreed to perform, scrutinize the scope and process for that work to assure that the landlord can accomplish it in a timely way without any need for cooperation from the tenant. As a small example, if anything requires the tenant's approval, even reasonable approval, the landlord can lose time if the tenant disapproves or delays its approval. Minimize any such requirements, and think about possible measures to mitigate the effect of consent requirements. Some are described in other sections of this checklist. The process of defining and completing any initial build-out requirements raises a huge number of issues large and small, which this checklist does not further address.

21.4 Punchlist Waiver. If the landlord has delivered the premises to the tenant, and the tenant starts alterations (or takes occupancy to conduct business) in any area, then the tenant waives any claims about the landlord's work in that area, unless previously included in a punchlist notice to the landlord.

21.5 Tenant Improvement Allowance. Coordinate the landlord's payment of any tenant improvement allowance with the terms of the landlord's construction loan or other financing. Make sure the requisition and funding schedules and conditions align. For example, avoid any obligation for the landlord to lay out its own cash for the tenant improvement allowance and then seek reimbursement. Instead, the lender should advance the funds when needed for the tenant.

21.6 Tenant Work Letter. The tenant work letter will become part of the lease. Give it the same legal scrutiny as the rest of the lease, or more. The landlord should confer with its architect and construction personnel to make sure the landlord can reasonably deliver what the work letter requires.

21.7 Use of Funds. Allow the landlord to keep any portion of the tenant improvement allowance not used by a specific date. Limit the tenant's ability to use its improvement allowance for anything that does not directly improve the landlord's real property. For example, exclude "soft costs," furniture, moving costs and network wiring.

22. Insurance

22.1 Additional Insureds. Require the tenant's insurance to name the landlord and its managing agent and mortgagee as "additional

insureds,” not “named insureds.” The latter designation may lead to liability for premiums and may prevent the landlord from seeking indemnification against the tenant for claims. Bear in mind that nobody is an additional insured under a policy unless the policy is endorsed to say so. Two kinds of “additional insured” endorsement exist. One purports to cover anyone who is required by contract to be so covered. The other actually identifies the additional insured by name. The latter is preferable as a matter of practice. It requires less proof in court. In contrast, a so-called “blanket” or “automatic” endorsement forces the additional insured to prove that the contract was executed before the loss occurred and that the contract is between the additional insured and the named insured. Carriers successfully reject a significant number of additional insured claims because the claimant failed to meet the technical details of the endorsement. Require that coverage for the additional insured parties be primary. Any other insurance available to an additional insured party should not contribute to a loss until the tenant’s coverage (primary, umbrella and excess) is exhausted.

22.2 Approval Rights. Allow the landlord to approve the identity and financial condition of the tenant’s insurance carriers. Set minimum financial rating standards for any insurance carrier (typically a minimum A:X by AM Best or A by Standard & Poors).

22.3 Coordination with Loan Documents. Conform the insurance requirements in the lease to those in the landlord’s current loan documents. Allow the landlord to change the insurance requirements in the lease as needed to comply with the landlord’s and any mortgagee’s future reasonable requirements.

22.4 Evidence of Insurance. In the case of first party property insurance that tenant must maintain, call for delivery of “evidence” of insurance through one of the “ACORD” forms. “ACORD” is the universally used acronym for Association for Cooperative Operations Research and Development, a nonprofit standard-setting body for the worldwide insurance industry. (For more information, visit www.acord.org.) The forms would include the “ACORD 28” form, formerly “ACORD 27”) or a copy of the tenant’s insurance policy at lease signing, not a “certificate” of insurance (the “ACORD 25” form), which is a worthless piece of paper that may not lawfully be modified. For liability insurance, mandate the delivery of the policy itself and examine it for the endorsements that are necessary to make anyone at all an additional insured. The lease should require the tenant to deliver evidence of insurance whenever necessary to facilitate the landlord’s refinancing of the property, with a nuisance fee for

late delivery. State that the landlord's failure to demand evidence of full compliance with the insurance requirements or to identify a deficiency in whatever documents the tenant does provide does not waive the tenant's insurance obligations.

22.5 Improvements and Betterments. Have the tenant insure any improvements and betterments it makes to its space, not just its personal property.

22.6 Insurance Advice. Work with the landlord's risk management team to check, update, and improve—and above all confirm compliance with—the insurance requirements of the lease as appropriate. Try to get an insurance broker (engaged by either the landlord or the tenant) or consultant to confirm in a letter, directed to the landlord, that the tenant's insurance coverage complies with the lease. Keep an eye on TRIA/TRIPRA/terrorism-related legislation; it has typically always had a sunset date, triggering a periodic crisis in the commercial real estate industry as each sunset date approaches.

22.7 Insurance Broker. Allow the landlord (at its option) to deal directly with the tenant's insurance broker to obtain any insurance documents the lease requires. The tenant should expressly authorize the tenant's broker to release the requested documents. The lease should state that doing so imposes no liability or obligation on the landlord, and doesn't excuse any tenant obligations. Absent special agreements, a broker owes no duty to anyone who is not the broker's "customer," so in an important enough case, ensure that the requisite special agreement is in place with the broker. In such a case, also consider checking the broker's errors and omissions insurance. Absent privity of contract, the landlord may find itself without any remedy against the tenant's adviser, at least absent fraud.

22.8 Limits on Liability Insurance. A well-drawn liability insurance clause should specify the limit of liability by requiring per-event coverage and aggregate coverage. As its name suggests, a "per-event coverage" limit would apply per occurrence, per accident or per claim. An "aggregate coverage" limit would apply to all occurrences, accidents or claims that take place in a policy period, typically a year. Specify when the aggregate limit should reset. For tenants with multiple locations, require a per-project or per-location aggregate limit. Require the tenant to submit "loss runs" to show how much insurance remains available after taking into account the claims filed to date. Establish a threshold for claims that will require the tenant to reset or increase its insurance cover-

age. Specify the maximum permitted deductible and self-insured retention amounts. Specify whether the policy is “claims made” or “occurrence”-based.

22.9 No Fault Liability. Resist the inclination to state that the tenant gets no rental abatement after a casualty if the tenant caused the casualty. Though this may sound “fair,” remember that the tenant has paid for its share of insurance coverage through operating cost escalations or otherwise. Fault may not be easily determined. Also, if rent does not abate upon a casualty, then the landlord cannot make a claim under its rental income insurance. Try to say that if the landlord cannot collect insurance proceeds, the tenant’s rent abatement ceases. Any tenant waivers of liability should expressly cover negligence and should benefit not only the landlord, but also the usual list of landlord-related parties, the property manager, and so on.

22.10 Plate Glass Insurance. Require any retail tenant to carry plate glass insurance. This coverage relates only to glass on the first floor of a building.

22.11 Rent Coverage. A landlord will usually prefer to maintain rental income insurance, as part of a larger property insurance package. In that case, it probably makes no sense to require the tenant to maintain business interruption insurance. Any rental/business interruption insurance should cover additional rent (such as escalations or tax pass-throughs) and percentage rent as well as base rent. The landlord should try to carry rental income insurance coverage for at least 12 months, more for buildings that would take longer to rebuild. The landlord will typically want to supplement the coverage with 12 months of an “extended period of indemnity” to cover the re-leasing period. Rental/business interruption insurance is usually written with an “exclusionary period,” which means the insurance does not respond until the loss continues for some period, typically 30 days.

22.12 Self-Insurance. If the tenant self-insures, work with an insurance adviser to understand the interaction between self-insurance and the waiver of liability addressed in a typical “waiver of subrogation” clause in an insurance policy. The landlord still needs to obtain the benefit of those waivers, even if the tenant (or its affiliate) acts as its own insurer. And the waivers should not preclude the landlord from making claims against the tenant in the tenant’s role as self-insurer.

22.13 Should Landlord Insure? Consider having the landlord insure the tenant's improvements, with the tenant reimbursing the allocable insurance cost—premium, co-insurance and all other insurance costs—either directly as additional rent or as an operating cost without a base year. Then have the landlord agree to restore, or give the landlord the right to require the tenant to restore, using any available insurance proceeds. If the landlord insures, have the tenant agree not to do anything that will void the landlord's insurance, increase the landlord's insurance risk or cause disallowance of sprinkler credits, if applicable.

22.14 Tenant Failure to Insure. If the tenant fails to insure and a fire occurs, then make the tenant liable for the entire loss and not merely the unpaid insurance premiums—even if the landlord knew about the failure to insure. Such a provision responds to cases that limit the tenant's liability to the amount of the unpaid premiums. For net-leased properties where the tenant is responsible for buying the insurance, give the landlord the right (but not the obligation) to buy the required insurance and obtain reimbursement from the tenant. Some landlords prefer or even insist on this arrangement as it gives them more control over insurance.

22.15 Tenant's Right to Proceeds. Make any right of the tenant to receive insurance proceeds subject to the rights of the landlord's mortgagee and to fulfillment of any tenant restoration duties under the lease.

22.16 Tenant's Special Use. Consider the tenant's specific use and whether the lease should require any particular insurance. For instance, if the tenant sells liquor on the premises require the tenant to purchase liquor liability insurance and dram shop coverage. If the tenant gives away liquor without charge, then the lease should require host liquor liability insurance. Art poses special issues, as do high-risk activities. More generally, if the tenant's use and occupancy of the premises presents an unusual situation or risk of loss, consult an insurance adviser. If the tenant keeps the premises vacant, it might trigger a higher insurance premium for the landlord. Therefore, if the tenant decides to do that, the tenant should pay any resulting insurance premium increase.

22.17 Waiver of Subrogation. Understand “waiver of subrogation.” This is a tricky topic, often handled badly. Do not provide that landlord and tenant waive their subrogation rights. They have no subrogation rights. Only the insurance carrier has subrogation rights. Provide instead that the landlord and the tenant waive any right to recover from the other for property damage to the extent covered by property insurance (and sometimes also liability insurance). These clauses should be mutual, cov-

ering all losses caused by any insured risk (even negligence of the landlord or the tenant), provided the insurance carrier has consented to the waiver. Such consents (the actual waivers of subrogation) appear in the standard insurance policies published by the Insurance Services Office and used by insurance carriers in the vast majority of the market. But confirm this each time. State that the landlord's waiver does not apply if the tenant does something that invalidates the insurance.

23. Landlord's Access

23.1 Communications with Third Parties. Require the tenant to provide the name, telephone number and email address of its consultants, insurance brokers and other third parties. Allow the landlord to communicate directly with these parties. The tenant should agree to authorize and require those people to cooperate.

23.2 Emergency Contact. Require the tenant to provide the name, telephone number and email address of an emergency contact and state it in the lease, subject to change by proper notice.

23.3 Keys. Leases usually require the tenant to give the landlord copies of all keys and access codes. The landlord should note that liability may travel with those keys and access codes, especially if the tenant has unusually valuable personal property. The landlord may want to be selective about requiring keys and access codes or limit the landlord's liability, if the lease does not already do that. Prohibit the tenant from placing chains or padlocks on any doors.

23.4 Landlord's Right to Enter. Give the landlord the right to enter to perform repairs, to take photographs in the premises and to facilitate the landlord's ability to perform repairs and do work in other tenants' premises.

23.5 No Eviction. Make clear in the lease that the landlord's entry onto or inspection of the premises does not constitute an actual or constructive eviction and does not entitle the tenant to any rights or remedies, or any claim, offset, deduction, or abatement of rent. It also does not increase the landlord's responsibility for any conditions in the premises.

23.6 Notice Requirements. The lease should state that the landlord may enter without notice in an emergency. Even absent an emergency, oral notice to someone on site should suffice. This is yet another example of an area where a requirement for "written notice" may sound perfectly

reasonable, but in the real world such a requirement is completely impractical.

23.7 Reconfiguration. Reserve the right for the landlord to reconfigure or change the means of access to the premises.

23.8 Secure Areas. Limit the tenant's right to create secure areas (areas the landlord may not enter without the tenant's permission) by identifying those areas in an exhibit. If the tenant wants the right to move those areas around, limit them to their original overall size, and require some level of reasonableness.

23.9 Signs and Showings. The landlord should have the rights to: (i) show the premises to prospective purchasers, mortgagees, or appraisers and post "for sale" signs; and (ii) in the last six to 18 months of the term (longer for longer terms), show the premises to prospective tenants and post "for rent" signs. If the landlord has a commitment to "green leasing," the landlord may need to be able to show the premises to any consultants or organizations issuing or maintaining LEED or similar certifications, or want to be able to show the premises to interested persons seeking to learn about environmentally sound construction.

24. Landlord's Liability

24.1 Exculpation. Limit the landlord's liability to its interest in the property or, better, to whatever equity the landlord would have if it had entered into a mortgage securing financing equal to 80 percent of the value of the property. Negate any personal liability of the landlord and its partners, members, managers, officers, directors, affiliates, and the like. Recent cases have applied the "implied covenant of good faith and fair dealing"—a tort theory of liability—to sidestep exculpation clauses in leases. To avoid the possible effect of such cases, state that the landlord's exculpation 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.

24.2 Landlord Default. Give the landlord at least the same open-ended cure periods for nonmonetary defaults that tenants typically obtain. So long as the landlord has commenced and is diligently prosecuting the cure of its default, the tenant should have no rights or remedies against the landlord. Consider giving the landlord's mortgagees some additional cure period.

24.3 Liability. Any liability of the landlord should end if the landlord transfers its interest in the premises.

24.4 Liability for Prior Owners' Act. As a rather aggressive position, say that after any conveyance of the property (even outside foreclosure), the new owner is not liable for (and the tenant may not assert any credit, claim or counterclaim because of) any claims the tenant might have had against the former owner, such as for overcharges and refunds of escalations. Perhaps the liability should cut off as soon as a mortgagee takes over control of the property, whether through a receiver or as a mortgagee in possession.

24.5 Statute of Limitations. Require the tenant to assert any claim against the landlord within a certain short period after the tenant first became aware of the facts supporting the claim.

25. Landlord's Representations

25.1 Express Not Implied. State that the landlord makes no implied covenants, representations or warranties. Limit the landlord's responsibilities to those expressly stated in the lease (i.e., hopefully, none). As a practical matter, the landlord's continuing obligations under the lease matter much more than any representations and warranties.

25.2 Independence of Covenants; No Termination Right. The tenant should acknowledge that all covenants of the landlord are independent. The tenant should waive any right to terminate or suspend rent based on the landlord's default.

25.3 Merger. State that any agreements, written or otherwise, pre-dating the lease (including prior lease drafts) merge into (i.e., are totally superseded by) the lease. Indicate that any statements or representations on the landlord's website or in the landlord's advertising are not part of the lease.

25.4 Other Leases. State that the landlord makes no representations, warranties or covenants, about other tenants (past, present or future) or the terms of their leases.

26. Maintenance and Repairs

26.1 Broad Repair Obligations. When the tenant has broad repair obligations, expressly include "ordinary or extraordinary, structural or nonstructural, foreseen or unforeseen" repairs.

26.2 Landlord's Repair Obligations. If the landlord must make any repair, it should have no duty to replace or repair the tenant's finishes above plain vanilla building standard.

26.3 No Overtime. The landlord should have no obligation to do any work at overtime or premium rates.

26.4 Periodic Upgrades. Beyond maintaining the premises "as is," the lease could require the tenant to upgrade and renovate every specified number of years, to keep the premises exciting and new, particularly for retail space. Perhaps the tenant must have invested a certain additional amount in the premises within a certain period as a condition to exercising any lease renewal rights.

26.5 Right to Perform. If the tenant's acts or omissions cause damage to another tenant's premises, the landlord can repair them at this tenant's expense.

26.6 Specify Repair Obligations. Try not to refer categorically to repairs as "structural" (the landlord's responsibility) and "nonstructural" (the tenant's responsibility). Draw these lines specifically and in detail, saying exactly who repairs what. Otherwise, a court may decide what the parties intended and the landlord may not like what the court decides. The lines between "structural" and "nonstructural" may vary between whole-building leases and leases of only part of a building.

26.7 Tenant's Obligations. The tenant must maintain, repair and replace any parts of the building—including storefronts and sidewalks—that exclusively serve or abut the premises. Prohibit the tenant from placing anything on the sidewalks that might violate a local ordinance (e.g., a pickup box for FedEx). Should the tenant be allowed to display merchandise on the sidewalk? Or place vending machines on the sidewalk? If the tenant is allowed to place any "lucrative" vending devices on the sidewalk, then consider entitling the landlord to a percentage of the revenues. Require the tenant to obtain and maintain any related permits and insurance.

26.8 Wireless Internet. If the tenant's wireless internet service causes interference, the tenant must resolve. The landlord may require the tenant to password-protect its Wi-Fi service. The tenant cannot resell those services to other tenants.

27. Occupancy

27.1 “As Is” Condition. The tenant should represent and acknowledge that it takes possession of the premises and the building and common areas in their as-is, where-is condition as of the commencement date. Consider including specific language to negate landlord liability for any latent defect.

27.2 Minimum Operating Covenant. The tenant should agree to open for business by a certain date. The tenant should then agree to operate for at least a certain minimum period. For a retail tenant, the lease should set minimum days and hours of operation, and consequences if the tenant “goes dark.”

27.3 No Obligation Except Specific Work. Confirm that the landlord has no obligation to perform any work or make any installations to prepare for the tenant’s occupancy, except as the lease expressly states.

27.4 Service Contracts. Consider whether the tenant should agree to reimburse the landlord for some share of the cost of all applicable service contracts (such as HVAC, boiler, sprinklers, alarms and security) or to maintain such contracts for the premises at the tenant’s expense. If the tenant maintains such contracts, stipulate quality standards for the service provider; minimum maintenance frequency; and recordkeeping and reporting requirements, both during the lease term and when it ends.

27.5 Tenant’s Name. If the tenant operates under any name other than the tenant’s name as stated on the lease, confirm that this does not give the other entity any rights or require the landlord to name or serve them in any action. In some cases, if the name on the door does not match the respondent’s name on the warrant of eviction, the marshal may not evict. Careful landlord-tenant counsel can probably prevent the problem, but any variation in names could create a spurious issue. This will vary among states. In some cases, the lease should require that the tenant operate and identify itself only under a particular name consistent with the lease.

28. Options (Expansion/Renewal/Reduction/Termination)

28.1 Conditions. Although tenants like options, they limit a landlord’s flexibility and create the risk of mistakes and dropped balls, with potential exposure. Even if the landlord is willing to grant them, the landlord should do whatever it can to limit them and try to make them go away under circumstances that suggest the tenant does not really need them, or no longer deserves them. For example, do not allow the tenant to exercise

an option if the tenant is in default on the exercise date or on the effective date of any exercise. The landlord could even require that no defaults have occurred within a specific period before the exercise date. A tenant's option rights should terminate if the tenant has: (1) assigned the lease; (2) sublet more than a certain amount of space; (3) dropped below a certain minimum occupancy; (4) stopped operating in the space; (5) recently exercised any "giveback" right; (6) recently failed to exercise any available "first refusal" or expansion right; (7) not invested a certain dollar amount in the space in a certain period; or (8) suffered a deterioration in its financial condition.

28.2 Consequences. If the tenant exercises any option right of any kind, think about whether any lease terms should change as a result. For example, if the tenant received special signage rights because of the tenant's large occupancy, those rights should perhaps go away if the tenant exercises a right to substantially reduce the size of the leased premises.

28.3 Multiple Bites at Apple. If the landlord offers "first refusal" space and the tenant does not take it (or if the tenant declines to exercise an option), then for a specified number of months the tenant should be deemed to have waived any first refusal rights (and any options that would otherwise apply), at least where they relate to comparable space, broadly defined.

28.4 Option Maintenance Fee. Require the tenant to pay a nominal annual fee to preserve future options. This gives the tenant an incentive to give up any option right it does not truly need and will never use.

28.5 Option Subject To Other Rights. Make any expansion option subject to existing exclusives and renewal clauses of other tenants. To preserve tenant diversity, the landlord may even want the right to negotiate a renewal with an existing tenant before making that tenant's space available to a new tenant negotiating its own option or right of first refusal.

28.6 Option Term Rent. Set a floor for rent in any renewal option term equal to the previous rent under the lease.

28.7 Overlapping Options. Try to limit the landlord's liability if the landlord inadvertently allows overlapping or inconsistent options, or forgets to notify the tenant of potentially available space.

28.8 Purchase Right Carveouts. If a tenant somehow manages to negotiate an option or right of first refusal to purchase the landlord's building, exclude: (1) foreclosure or its equivalent; (2) any subsequent transaction; (3) transactions between the landlord and affiliates or family members; (4) other permitted transactions, such as transfers of passive interests or creation of preferred equity for mezzanine lenders; (5) any exercise of remedies under one of those permitted transactions; and (6) if the tenant "passes" on its preemptive right, then all subsequent transactions. If the tenant does exercise a purchase option, state that the lease remains in effect, and the tenant must continue to pay rent, until the closing under the purchase. Otherwise, courts have been known to conclude that the lease vanished when the tenant became a contract vendee.

28.9 Reduction Options. If the tenant negotiates an option to "give back" space, this raises many of the same issues as expansion or renewal options, as well as lease expirations. In addition, think about the practical issues that any space reduction might create. Will the tenant need or want to leave any installations in place to service their remaining space in the building? If the tenant gives back a partial floor, who will construct—and pay for the construction—of any new demising walls or any incremental costs to comply with building code requirements for a separate occupancy? How will the landlord need to change its operations if a floor previously occupied by one tenant becomes a multiple-tenant floor? Will the tenant's elevator lobby signage need to change? Exclusive elevator banks? How will the parties handle submetering and other reconfiguration of utilities? What happens if the tenant gives a notice of reduction but then can't move out on time? If the tenant reduces its occupancy, should it lose some of the concessions it otherwise negotiated in the lease? If the tenant gives back multiple floors, the lease might require contiguity among those floors, and require them to consist of the highest (or possibly lowest) floors in the tenant's stack. One basically must think through and reverse-engineer all the practical issues that arose in the original lease structuring and negotiations.

28.10 Termination Options. If the tenant has a termination option, require the tenant to make any termination payment when the tenant exercises the option. Adjust any brokerage agreement to assure that if the tenant terminates, then the landlord will not have to pay a commission for the terminated/canceled part of the lease term. This is typically done by deferring the corresponding commission until the termination option has lapsed without exercise. The broker may expect to receive a commission on the termination fee.

28.11 Time of the Essence. Make time of the essence for exercising any option or right of first refusal. Say that timely notice constitutes an agreed and material condition of exercise. Recognize that the courts sometimes validate late exercise. Perhaps provide for a protective rent adjustment in this case, e.g., to fair market rental value if the lease would not otherwise provide for it.

28.12 Timing. Make the exercise deadline early enough to give the landlord time to relet if the tenant does not exercise. Allow the landlord to immediately start showing the option space if the tenant does not exercise. Coordinate the timing with other leases to facilitate assembling large blocks of space in the future if the landlord wants to do so. A landlord usually wants plenty of lead time and notice, but may want to give the tenant as little lead time and notice as possible, to maximize the landlord's flexibility in dealing with unexpected changes in occupancy. If some other lease ends earlier than anticipated, give the landlord the right to accelerate any future option or first refusal right that the tenant may have on the affected space.

29. Percentage Rent and Radius Clause

29.1 Audit Right. Let the landlord audit the tenant's gross sales. The tenant should deliver point of sales data as well as sales tax returns. If the tenant underpaid percentage rent (or underreported gross sales) by more than three percent, the tenant should pay interest and the costs of the audit.

29.2 Effect of Casualty. If the premises are closed for parts of the year because of a casualty or condemnation, the "breakpoint" for percentage rent should drop. This assumes the lease expresses the breakpoint as a fixed dollar amount, and not a formula referring to actual fixed rent payable from time to time. The latter would be more common, so this problem usually does not arise.

29.3 Fixed Rent Increases. Increase fixed minimum rent (and the percentage rent breakpoint) periodically, based on actual or projected increases in gross sales.

29.4 Gross Sales. Define gross sales to include sales by subtenants and concessionaires.

29.5 Inclusions/Exclusions. Consider whether to include any catalog or internet sales that the tenant makes through the store. Take into

account the mechanics of the tenant's business. Prohibit the tenant from claiming any credit for goods that a customer bought through a catalog or over the internet, unless previously included in store sales. Exclude sales to the tenant's employees only if the tenant makes those sales at a discount or, better (but less "standard"), include those sales based on their actual discounted prices.

29.6 Increases. Provide for an increase in percentage rent upon any change of use or change of the tenant. If the lease provides for multiple increases in percentage rent over time, think about the interaction of those multiple increases, and whether any uncertainty exists about their possible "compounded" effect.

29.7 Kick-Out Right. Allow the landlord to terminate the lease if percentage rent does not reach a certain level by a certain date or if the tenant goes dark. Upon any such termination, require the tenant to reimburse the landlord for all its unamortized leasing costs, including the cost of tenant improvements, brokerage commissions, negative rent, inducement payments, free rent, and cash allowances. Try to continue any kick-out right over the entire lease term. If a retail landlord only has a one-shot kick-out right, this may concern future lenders. As a compromise, the kick-out right could recur periodically.

29.8 Limit Any Percentage Rent Penalty Period. If any co-tenancy or other problem arises, the lease may allow the tenant to pay "percentage rent only." In those cases, if the landlord ever solves the problem, regular rent should once again apply. After a certain time, allow the landlord to require the tenant to either terminate or resume paying regular rent (fish or cut bait).

29.9 Non-Compete Clause. Any non-compete clause should expressly benefit only the named tenant, not any successor or assignee. If the tenant assigns or sublets, the restriction should go away.

29.10 Radius Clause. Include a radius clause in any lease requiring percentage rent, i.e., the tenant (and affiliates) may not compete with itself within a restricted area without the landlord's consent.

29.11 Recordkeeping. Require the tenant to maintain records, in accordance with GAAP or any other generally accepted accounting standard, sufficient to make any audit meaningful. The tenant should keep its records at an accessible and reasonable location, specified in the lease. If the tenant moves its records, it should agree to promptly notify the land-

lord. The tenant should keep its records for at least three years. For any audit, the tenant should provide its record in electronic form such as a spreadsheet, so the landlord can easily work with them.

29.12 Violation. If the tenant violates the radius clause, then consider requiring the tenant to include as “gross sales” (for percentage rent purposes) the greater of: (1) a specified percentage of gross sales at the premises; or (2) the gross sales of the tenant’s store in the prohibited area.

30. Quiet Enjoyment

30.1 Conditions. New York law (and probably the law of other states) implies a covenant of quiet enjoyment if the lease says nothing. Indicate that quiet enjoyment is subject to the rights of mortgagees, ground lessors, other tenants, matters of record and all other terms of the lease. Condition the covenant of quiet enjoyment upon the tenant’s not being in default, or at least not being in default beyond cure periods.

30.2 Limit Services. Expressly limit the landlord’s obligation to provide services and other obligations to only whatever the lease expressly requires. Try to prevent the courts from using the “covenant of quiet enjoyment” as the basis to infer possible landlord obligations to provide services beyond those the lease requires. But also consider whether modifying the covenant of quiet enjoyment at all justifies the controversy and negotiations it may cause.

31. Real Estate Taxes.

31.1 Allocation of Tax Liability. The landlord might not always want to allocate real estate taxes by square footage. For example, retail space may increase taxes more and faster than residential or office space. Try to require each tenant to pay for any real estate tax increases that result from that particular tenant’s installation. If one tenant receives a tax abatement, the other tenants should typically contribute to real estate taxes based on the pre-abatement taxes.

31.2 Base Year Real Estate Taxes. Define “Base Year Real Estate Taxes” to include water and sewer charges; as “net of any special assessments”; and “as finally determined.” Consider the impact of varying tax years for varying tax jurisdictions, such as school district, water district, municipal, and county.

31.3 Business Improvement District (BID) Charges and Special Assessments. Include any BID charges and special assessments in the definition of “Real Estate Taxes,” even if no BID presently exists.

31.4 Estimated Tax Payments. Require the tenant to make monthly estimated tax payments, especially if the landlord’s mortgage requires tax escrow payments. Time the tenant’s payments to precede the mortgagee’s required tax escrow payments by at least a few days.

31.5 Further Assurances. The tenant should agree to assist the landlord, as reasonably necessary, to qualify for tax abatements and benefits (such as the Industrial and Commercial Abatement Program, or ICAP, in New York City). Allow the landlord to amend the lease to qualify for any tax benefits or abatements. If the landlord obtains such benefits, the lease should say whether the landlord or the tenant will ultimately receive the economic benefits of the program and how those benefits interact with real estate tax escalations. If an ICAP reduction arises from a particular tenant, all parties will typically expect it to be allocated just to that tenant.

31.6 Imperiled Abatement. If the property benefits from any tax abatement, deferral, subsidy or the like, think about the risk that someone might challenge the validity of such a benefit. If any such challenge arises or someone threatens such a challenge, allow the landlord to require the tenant to pay monthly (just like a regular payment of real estate taxes) an appropriate contribution toward whatever incremental taxes, with interest, the landlord owes or might owe if the challenge succeeds. The landlord would refund these payments with interest if the challenge failed. Without a structure like this, the landlord will bear much of the risk of any challenge and, in practice, may not be able to shift much of that risk to tenants.

31.7 Management Fee. If the landlord protests real estate taxes, impose a reasonable management fee to compensate for the landlord’s time, trouble and effort. Such a fee might apply generally or, if appropriate, only to particular tenant(s) requesting the tax contest.

31.8 Payments in Lieu of Taxes (PILOT). Include PILOT payments in real estate taxes.

31.9 Successful Contest. If a tax contest succeeds, the tenant will not necessarily be entitled to its share of the full refund. Instead, subtract the refund from actual real estate taxes for the year in question, and then ask whether this would have reduced the tenant’s tax escalation, after con-

sidering base years. The tenant's refund should not exceed that hypothetical reduction.

31.10 Tax Contests. Prohibit the tenant from contesting taxes without the landlord's consent. If the landlord does consent, the landlord may want the right to require the tenant to post a bond or letter of credit equal to any contested taxes, if the tenant did not need to pay the taxes first, as a condition to the contest. The landlord may also want to control choice of counsel. The tenant should indemnify the landlord against all losses that arise from any tax contest the tenant initiates. The landlord will almost always prefer to handle the contest.

31.11 Transfer Taxes. Consider possible transfer taxes on the lease. New York, for example, imposes a transfer tax on certain leases that extend beyond 49 years (including options) or contain a purchase option. New York City taxes any consideration ("key money") paid for a lease, regardless of term.

32. Recognition of Subtenants

32.1 Clear and Objective Standards. Any landlord that agrees to deliver recognition protections to subtenants should insist that any "recognized" sublease must satisfy clear and objective standards. (In the context of protecting subtenants, these agreements are often called "recognition agreements." They are very similar to, and also sometimes called, "non-disturbance agreements." This checklist reserves the latter term, abbreviated as SNDA, for the agreements between a tenant and a landlord's mortgagee.) Before agreeing to recognize any actual or potential sublease, the landlord must ask whether it wants to be stuck with that sublease and all of its terms if the main lease terminates. The landlord may want to require minimum rents, a certain form of sublease, an unrelated subtenant, arm's-length negotiations, a reasonable configuration (such as multiple contiguous full floors), subrent that does not decline over time, and other characteristics. And the tenant should not be in default.

32.2 Multiple Subleases. If the lease terminates, a landlord that has entered into recognition agreements could conceivably end up inheriting any one or more, or some random selection, of the tenant's subleases. Subtenant recognition agreements can create issues similar to partial release clauses in mortgages (concern about "cherry picking" and/or destruction of expected value).

32.3 Multiple-Floor Subtenants. If the tenant occupies multiple floors, try to limit the recognized space to full floor(s) at the top or bottom of the tenant's stack.

32.4 Negotiations. The tenant should agree to reimburse the landlord's legal fees to review the sublease and negotiate the recognition agreement. To short-circuit those negotiations, attach a form of recognition agreement to the lease as an exhibit. Those recognition agreements often give a landlord protections that exceed those a mortgagee expects in an SNDA. The agreement needs to assure, generally, that the landlord has no greater obligations under the "recognized" sublease than the landlord would have had under the terminated lease. Beyond that, the landlord will want to negate liability for a litany of possible unappealing sublandlord obligations, such as representations, warranties, confidentiality, space preparation and provision of incidental services. The landlord will also want protection against the risk (likelihood) that the subrent will fall short of the agreed rent under the main lease for the same space. If the landlord's counsel uses a mortgage SNDA as the template for a subtenant recognition agreement, counsel should check it against other subtenant recognition agreements. Failure to do that could result in important omissions from the subtenant SNDA.

32.5 Sale of Building. If a lease obligates the landlord to "recognize" subtenants and the landlord later decides to sell the building, how can a purchaser obtain comfort about the scope of "recognition" obligations the purchaser will inherit? Insist that only a recorded document will bind any future landlord. And try to say that any successor landlord – particularly one that acquires the property through foreclosure – has no liability for rent overcharges, escalation refunds or other financial obligations of the former landlord.

32.6 Security Deposit. If the landlord does agree to enter into a recognition agreement with any subtenant, the landlord may want to hold the subtenant's security deposit, but beware of becoming involved in sublandlord/subtenant disputes.

33. Remedies

33.1 Abandonment. The landlord's seizure and re-entry into the premises based on abandonment can create risk, because of uncertainty about what abandonment means. Try to define abandonment in the lease, such as nonpayment of rent and physical absence from the premises for a certain time. State that if the tenant defaults beyond cure periods and also

removes a significant amount of fixtures and equipment, that would constitute an abandonment and a surrender of the premises, entitling the landlord to repossess. Thus, the landlord need not bring summary proceedings or give the tenant further cure rights. Expressly allow self-help for abandonment. But before actually doing it, check local landlord-tenant law.

33.2 Arbitration. If the tenant can invoke arbitration of disputes, condition this right on the absence of any rent default. Expressly exclude any rent dispute from arbitration. If the landlord cares about quick resolution of any arbitrated dispute, agree in the arbitration clause on possible arbitrators (and the number of arbitrators), the arbitration authority and the rules that will apply. Do not leave these matters until a dispute arises. Specify arbitrators (and confirm they are willing to serve), or arbitrator qualifications, so that the arbitrators will understand the landlord's business and position, or even favor the landlord. Specify a limited and short list of issues for which arbitration will apply, such as escalation charges; disputes about repairs; and assignment and subletting if the landlord has agreed to be reasonable. If, however, one draws lines between disputes to be arbitrated and disputes to be litigated, this creates the risk of disputes about how to characterize a dispute. Thus, if one must go down that road one should make the lines crystal clear and perhaps state that any disputes on characterization of a dispute shall be arbitrated. Some landlords think tenants are more willing to arbitrate than to litigate. Arbitration should not apply to nonpayment, dispossession or conditional limitation proceedings. Require any arbitrator to issue a written explanation of its decision. Most attorneys writing arbitration clauses prefer to require "baseball arbitration," in which the arbitrator must choose one party's proposed resolution of the dispute or the other party's proposed resolution of the dispute—nothing in between. It is believed this approach promotes reasonableness and settlements.

33.3 Default Rate. Require the tenant to pay interest at the default rate on amounts past due even after judgment, when the statutory judgment rate would otherwise apply. This assumes, of course, a default rate in excess of the judgment rate (9% in New York).

33.4 Equitable Relief. Try to state that the landlord can obtain injunctive, declaratory and specific performance-type relief regarding all nonmonetary covenants—both negative and affirmative—supervised and monitored by a special master if necessary.

33.5 Inducement Repayments. State that if the lease terminates early because of default, the tenant must repay with interest the unamor-

tized balance of the landlord's rent concessions, brokerage commissions, contribution to the tenant's work and work the landlord performed for the tenant. The tenant will argue that this gives the landlord double compensation. That may be true, but only if the tenant actually pays both (1) the damages the lease or governing law requires the tenant to pay; and (2) the refund of the landlord's inducement costs. The landlord can agree to offset any liquidated damages provided for in the lease by the damages suggested in this paragraph if the tenant actually pays the latter damages. But in that case, why bother?

33.6 Interest and Late Charge. Require the tenant to pay interest on late payments, in addition to a late charge. Make the tenant responsible for any charges the landlord incurs due to a bounced check. Multiple defaults or bounced checks within a specified period should trigger special consequences up to and including termination of the lease. For example, the landlord can require a higher late fee; a larger security deposit; that the next default be incurable; or that future payments—or at least all payments for the next specified number of months—be made by bank checks or wire transfer.

33.7 Intermediate Remedies. Deal with the fact that courts typically refuse to terminate leases based on “minor” defaults such as failure to deliver financial information or an estoppel certificate. For these defaults, establish intermediate remedies, something less than terminating the lease. Make them meaningful, but not draconian, such as liquidated damages (e.g., \$500/day) or an administrative fee, a temporary rent adjustment or a suspension or deferral of some privilege or benefit. If the tenant's “minor” default continues for a specified period, at some point it should constitute an event of default. Consider the degree of reasonableness necessary for any such payment remedy to qualify as liquidated damages.

33.8 No Mitigation. Provide that the landlord has no obligation to mitigate damages. If the landlord agrees to mitigate, the lease should define exactly what the landlord must do. It should not be much.

33.9 Nonpayment. If the tenant fails to pay rent, expressly allow the landlord to exercise a “conditional limitation” right and terminate the lease, not just commence nonpayment proceedings. Watch out: many Standard Forms establish a “conditional limitation” for all defaults except failure to pay rent. Expressly allow the landlord to exercise a “conditional limitation” right to terminate the lease and also prosecute simultaneously a proceeding for nonpayment of rent. Try to negate the usual rule that

requires the landlord to elect between the two—although of course the landlord cannot actually obtain both forms of relief, and judges may do what they want.

33.10 Ownership or Succession. Consider asking the tenant to excuse the landlord from any obligation to prove ownership or succession in any eviction proceeding. The landlord would need to prove only tenant default. The tenant would then bear the burden of proving that the party claiming to be the landlord is really just an impostor without rights. If enforceable, this would eliminate a sideshow that merely gives any tenant an opportunity to trip up the landlord and delay the proceedings, with no practical benefit in the real world. As a variation, state that if the landlord shows a recorded deed to the court, then this constitutes prima facie proof of ownership sufficient to prosecute eviction proceedings, and the tenant bears the burden of proving the landlord doesn't actually own the building, i.e., has commenced the eviction proceeding just for fun.

33.11 Right to Cure. Allow the landlord to cure the tenant's defaults and bill the tenant for the landlord's expenses, with interest at the default rate, as additional rent.

33.12 Waiver of Jury Trial. The waiver should apply to all matters arising out of the landlord/tenant relationship and the property, not merely the lease, so as to reach tort claims between the parties.

33.13 Yellowstone Injunction. Consider whether the landlord can proactively add language to the lease to limit the availability and potential burden of so-called "Yellowstone" injunctions under New York law. For example, consider some or all of the following, each of which responds to one or more of the issues that arise in Yellowstone proceedings:

33.13.1 Cure Period Extension Rights. State that the tenant may obtain an open-ended cure period, and as much time as the tenant wants to litigate an alleged default, by depositing with the landlord as security an amount equal to the landlord's estimate of the cost to cure the alleged default. State that such a deposit constitutes the only way the tenant can evidence its ability and desire to cure the default.

33.13.2 Final Cure Period Before Eviction. State that if the landlord obtains a warrant of eviction, the tenant will automatically have—or the landlord can agree at any time to grant the tenant—a short final cure period before the landlord proceeds with actual eviction. A "last clear opportunity to cure" at the end of the eviction proceedings substantially

undercuts the basis for a Yellowstone injunction. State that the landlord may offer the tenant any such “last clear chance” either in the notice to cure or at any later point before the lease has actually terminated.

33.13.3 Financial Defaults. Require the tenant to acknowledge that it cannot obtain a Yellowstone injunction for any financial default, even if uncertainty or disagreement exists about the tenant’s obligations. Uncertainty or disagreement will always exist in these cases. The tenant must pay first, fight later. At one time, it was thought that Yellowstone injunctions were never available for financial disputes, but that is no longer always true.

33.13.4 Landlord Court Victory. State that if the landlord prevails in litigation, the lease will be deemed to have terminated on the date the landlord delivered notice of default, and the hold-over rent rate applies from that date forward. Require the tenant to deposit this amount in escrow during any Yellowstone injunction.

33.13.5 Other Rights and Remedies. State that a Yellowstone injunction, if granted, limits only the landlord’s right to terminate the lease and does not limit any other rights or remedies, such as late charges, default interest, and reimbursement of the landlord’s expenses.

33.13.6 Waiver. Require the tenant to waive its right to bring a Yellowstone injunction, but recognize that existing law probably makes such a waiver unenforceable. Perhaps consider limiting the duration of any Yellowstone injunction to a short number of days, so that if the litigation is not fully resolved in that time the landlord is free to pursue remedies, or perhaps the rent automatically rises.

Although any or all of the above Yellowstone prevention measures may be creative and might even work, New York judges often regard Yellowstone injunctions as both automatic and a quasi-constitutional element of New York law. Thus, judges may disregard or laugh at any of the measures just suggested.

33.14 Assignment of Remedies. Allow the landlord to assign any of its enforcement rights under the lease to a third party. For example, if the lease restricts certain uses, the landlord may assign to another tenant the right to enforce that restriction.

33.15 Liquidated Damages. If the tenant violates a radius clause, operating covenant, or other similar prohibition, establish a simple for-

mula for liquidated damages. Otherwise the landlord will have no meaningful remedy.

34. Rent

34.1 All Payments Are “Additional Rent.” Define “additional rent” to include all payments the lease requires of the tenant. This will support the use of “summary dispossession” rights for nonpayment of all these amounts. The same characterization may have unfavorable consequences in bankruptcy, though. The landlord may wish to be strategic about this issue.

34.2 Commercial Rent Control. Standard Forms already often require the tenant to make a corrective payment when rent control terminates. Consider requiring the tenant to escrow the shortfall amount with the landlord each month during any rent control period, and pay interest on the shortfall, with credit for any interest earned on the escrow account. Any such measure will almost certainly not be enforceable, though, once the Legislature establishes commercial rent control, hence might not be worth the effort.

34.3 Finalizing Dates. Where important dates remain to be determined after lease signing, such as the delivery date, commencement date or rent commencement date, state that the landlord can later deliver a commencement date letter to the tenant, memorializing all relevant dates. The lease could include a form of that letter as an exhibit. The letter should automatically become effective unless the tenant delivers a written objection to the landlord within 10 days after receipt.

34.4 Free Rent. Define the free rent period as ending on a particular date (defined in the term sheet), not a certain number of months after an event (such as lease signing or delivery of premises). Consider including a rent schedule for clarity. This approach shifts to the tenant the financial risk of protracted lease negotiations. Free rent periods should apply only to fixed rent. As a compromise in “free rent” negotiations, consider allowing a retail tenant to pay rent in gift certificates for a certain period.

34.5 Lockbox. If the tenant pays rent into a lockbox, consider how to handle the risk that the lockbox administrator will deposit a check that the landlord would have wanted to reject. For example, the lease might say that any such deposit does not waive the landlord's rights, as long as the landlord refunds the amount of the incorrectly deposited check within some short time after the lockbox administrator deposited it. Thus, the

landlord can correct the lockbox administrator's mistakes and preserve the landlord's rights. The landlord will also need to make sure that any such corrections do not create issues under the landlord's loan documents.

34.6 Payment. The lease should include an express covenant to pay rent, not just a schedule of rental amounts. Allow the landlord to require the tenant to pay all rent by wire transfer. If an affiliate pays the rent, the landlord can reject the payment or require that all future payments be made by the actual tenant. The lease should say that an affiliate's payment of rent does not give the affiliate any rights. Any such payment is merely for the tenant's convenience.

34.7 Remeasurement. Negate any possible remeasurement of the space or the common areas. If the tenant insists on the right to remeasure, define the formula for remeasurement. For example, one might refer to the Building Owners and Managers Association (BOMA) standards. In that case, however, make sure the landlord and its counsel understand exactly how BOMA works. The authors of the BOMA standards almost by definition favor larger measurements rather than smaller measurements of any given space. Have the landlord's architect/space planner certify any space measurement to the landlord. If the tenant later brings an action against the landlord for bad measurement, the landlord may have a claim against the design professional. Any restriction on remeasuring the space should not preclude the landlord from remeasuring the entire building with no effect on the tenant's overall percentage.

34.8 Rent Concessions. Allow the landlord to undo or recapture a rent concession and any other inducement if the tenant defaults before fully applying the concession. Consider extending a rent concession for a longer time, such as six months of 50 percent free rent rather than three months of 100 percent free rent. Perhaps allow free rent in stages over the lease term, such as one month free after every 24 months rather than several months free at the beginning. Condition any rent concession on the tenant's having finished its initial alterations by a certain date or having met other conditions. Consider any accounting implications for the landlord.

34.9 Rent Not Per Square Foot. State rent as a flat amount rather than basing it on the square footage of the premises. This can prevent controversy about square footage and remeasurement. Avoid any statement about the square footage or rentable square footage of the premises.

34.10 Stock Options. For tenants with initial public offering (IPO) potential, consider whether to require stock, options, or warrants in lieu of, or in addition to, rent.

34.11 Waiver. Consider requiring the tenant to waive legal principles that can automatically convert a terminated lease into a month-to-month tenancy, with notice requirements for termination. Some subcommittee members reject such a waiver, arguing the automatic conversion makes sense.

35. Rules and Regulations

35.1 Compliance. Require the tenant to comply strictly with the rules and regulations attached as an exhibit to the lease, and also with any changes (or perhaps only just “reasonable” changes) that the landlord makes later. Consider whether the landlord’s rules and regulations correctly reflect present circumstances and building operations. They often do not. In that case, update them.

35.2 Lease Incorporation. If the rules and regulations contain anything unusually important, move it to the body of the lease. Courts may ignore rules and regulations. State that if any conflict exists between the rules and regulations and the lease, the lease governs.

35.3 No Liability. If the landlord does not enforce the rules or regulations against other tenants, or if other tenants violate them with impunity, this should impose no obligation on the landlord. A landlord often wants to have the freedom to enforce rules and regulations against some tenants but not others. Often the landlord has a good reason for that.

35.4 Recycling. Consider requiring the tenant to separate its waste. The landlord’s requirements may exceed those of applicable law. Consider adding a provision governing medical waste or other tenant-specific recycling or waste disposal requirements.

36. Security Deposit

36.1 Amount. Although the amount of any security deposit is a business issue, counsel may wish to suggest a declining letter of credit (initially in the amount of the tenant improvement allowance, or the landlord’s cost of build-out) to protect the landlord if the tenant defaults after the landlord incurs significant expense for front-end leasing costs.

36.2 End-of-Term Issues. Expressly allow the landlord to apply the security deposit to, among other things, costs to restore the demised premises and remove the tenant's abandoned personal property and signs. Give the landlord a reasonable time to return the security deposit after the end of the lease term, so the landlord can fully process and calculate any escalations, reimbursements, damages, and other amounts the tenant may owe.

36.3 Increased Security. Require the tenant to increase the security deposit if (1) the rent rises; (2) the tenant defaults more than x times; or (3) the tenant's or guarantor's financial rating drops below a certain point. Should any other circumstances trigger such a requirement?

36.4 Letter of Credit. Depending on the jurisdiction, consider requiring the tenant to deliver a letter of credit in place of a cash security deposit to try to reduce the impact of any possible tenant bankruptcy. To minimize administrative complexity, require the tenant to elect at lease signing whether it will post cash or deliver a letter of credit. Try not to allow either/or. Only if the landlord insists on the promptest possible closing, allow the tenant to deliver a letter of credit after signing. Close with a cash security deposit. This avoids delays in dealing with banks' letter of credit departments. Require the tenant to reimburse the landlord's costs of handling, renewing, accepting a replacement of or drawing on any letter of credit.

36.5 Letter of Credit Requirements. If the tenant delivers a letter of credit, require that: (1) the issuing bank be (a) reasonably acceptable to the landlord and (b) a New York Clearinghouse bank; (2) the landlord can draw the letter of credit at a bank branch in the same city as the landlord upon presentation of merely a sight draft (no drawing certificate or other documentary conditions); (3) the letter of credit be an "evergreen" (i.e., providing for automatic renewal unless the issuer gives ample notice of nonrenewal) or the bank must notify the landlord (at least X days before expiry) of any failure to renew and the landlord may draw (or better, shall be deemed automatically to have drawn) the letter of credit; (4) even if the letter of credit is an "evergreen," the issuer must confirm the current expiry date upon request (and then remember to request); (5) the letter of credit will not expire until at least a specified period after lease expiration (at least 30 days); (6) the landlord can transfer the letter of credit without charge to any lender or purchaser (or, if there is a charge, the tenant must pay it); and (7) the tenant must reimburse the landlord's out of pocket costs, including attorneys' fees, in dealing with the letter of credit.

36.6 Lien on Personalty. In states where the common law does not give a landlord an automatic lien on the tenant's personal property, the landlord should consider taking such a lien. File a UCC-1 financing statement if the landlord obtains a security interest in the tenant's personal property. Any security interest should by its terms survive lease termination; otherwise it might terminate with the lease. Note that the tenant may (legitimately) resist granting such a lien because it violates or will interfere with its financing arrangements.

36.7 Mortgage Requirements. Accommodate future mortgagee requirements (for example, allow the landlord to pledge the landlord's interest in the security deposit or to transfer any letter of credit to the mortgagee). If the tenant ultimately needs to cooperate with these measures, establish a tight time frame for cooperation. Allocate any resulting costs, including attorneys' fees and bank fees to reissue or transfer a letter of credit.

36.8 Replenishment. Require the tenant to replenish promptly the amount of any security that the landlord draws, or restore the letter of credit accordingly.

36.9 Segregated Account. The landlord and the lease should comply with any state-specific requirements on holding security deposits. When these provisions require notices to the tenant about the security deposit, try to build those notices into the lease, if possible and permissible. Well before the landlord disburses any interest to the tenant, the tenant should execute and deliver a W-9 form to the landlord.

36.10 Security for Guaranty, not Lease. Consider securing a lease guaranty obligation with a letter of credit or other security. By tying such a letter of credit or other security to a guaranty rather than to the lease, the landlord may reduce the likelihood that the tenant's bankruptcy estate could "claw back" any proceeds that exceed the landlord's permitted claim for rent in the tenant's bankruptcy. This becomes a potential problem only if the security deposit or letter of credit exceeds one year's rent.

36.11 Waiver. Require the tenant to waive any damages claim against the landlord for any wrongful drawing on the letter of credit, and any right to enjoin or otherwise interfere with a drawing. Replenishment of an incorrect drawing should make the tenant whole.

37. Services

37.1 Additional Services. If the landlord agrees to make available additional electricity or HVAC services, allow the landlord to set aside capacity for future needs, as the landlord estimates them. State that the landlord will furnish building services only during “building standard” hours, with some flexibility to (re)define what that means.

37.2 Changes in Building Operation. Allow the landlord to change how the building operates and the services the landlord provides, such as the number of elevators and security levels and procedures, subject to reasonable standards. To the extent that the landlord agrees to particular performance standards, build in flexibility if usage levels change, such as if the long-term storage area for old files on the third floor becomes a cafeteria.

37.3 HVAC. Define any HVAC standards as design criteria, not as performance specifications. The landlord’s only obligation should be to operate HVAC in conformance with design criteria. Prohibit the tenant from changing the HVAC system without the landlord’s consent. The tenant should be responsible for any distribution problems within the premises.

37.4 Off-Season Air-Conditioning. If the landlord provides air-conditioning before or after the regular air-conditioning season, because of hot weather or tenant requests, allow the landlord to charge tenants for that extra service, even if the lease does not yet require air-conditioning.

37.5 Resale. Prohibit the tenant from reselling to other tenants any telecommunication services, satellite capacity, electricity, or other utility or service.

37.6 Safety Measures. Require the tenant to cooperate with the landlord’s present and future safety measures for the building. For example, the tenant should participate in fire drills.

37.7 Specifications. To the extent the landlord agrees to meet specifications for any landlord services, consider the assumptions that underlie those specifications. For example, elevator specifications assume a certain level and distribution of occupancy and type of usage. If the tenant installs a cafeteria, this may alter traffic patterns so much that the landlord should have the right to change the elevator performance specifications.

37.8 Sprinklers. Charge the tenant for sprinkler maintenance and upgrades. Consider charging a monthly fee for static water.

37.9 Telecommunications/Fiber Optics Cable Provider. Consider requiring the tenant to use the landlord's telecommunications/fiber optics cable provider. Give the landlord the right to change providers. Negate any landlord obligation to continue to use any particular provider. The Federal Communications Commission constantly reviews and revises the rules in this area, which often supersede lease language.

37.10 Tenant Complaints. Limit who can complain about building services. Require a written notice of any such complaint, signed by specified officers of the tenant. Excuse the landlord from any liability for utility service failures.

37.11 Tenant-Provided Services. Prohibit the tenant from providing its services of types that the lease contemplates the landlord will provide, such as cleaning, especially if this might create labor problems.

37.12 Utilities. Require the tenant to pay for temporary utilities during construction. If the tenant's business will consume unusual amounts of utilities or services (such as a hairdresser, restaurant, or trading floor), try to require a separate (sub)meter. If not, make sure the allocation formulas will adequately capture the tenant's usage.

38. Subordination and Landlord's Estate

38.1 Expenses. Require the tenant to reimburse the landlord's expenses for obtaining any SNDA from the landlord's mortgagee, including the landlord's reasonable attorneys' fees. (All comments in this section on the landlord's mortgagee also presumptively apply to possible future ground lessors.)

38.2 "Financeability" Provisions. To avoid negotiating a separate SNDA, include directly in the lease all mortgagee protections and benefits that an SNDA would typically give a mortgagee. Require the tenant to confirm these protections if a mortgagee so requests, with the form of confirmation attached as an exhibit, perhaps within the form of estoppel certificate. Build in flexibility to add any other SNDA protections that some future mortgagee might (reasonably?) require. Tightly limit any cure period for any default arising from the tenant's failure to sign an SNDA. Any attornment or other lender protection provision should: (a) survive any (claimed) termination of the lease in foreclosure; and (b) expressly benefit present and future lenders. Review all loan documents affecting the building to ensure that any lease requirements (e.g. nondisturbance) have been satisfied.

38.3 Lease Subordinate. Make the lease automatically subject and subordinate to the landlord's existing or any future fee mortgage, easement agreements, condominium declaration, ground lease, and similar future documents. Try not to condition subordination on delivery or filing of these documents, or any confirmation or countersignature by anyone.

38.4 Mortgagee Modifications. Require the tenant to agree to any reasonable modification of the lease that a mortgagee or prospective mortgagee requests, if it does not materially reduce the tenant's rights or materially increase its obligations.

38.5 Mortgagee Right to Subordinate. State that any mortgagee can unilaterally subordinate its mortgage to the lease, in whole or in part, at any time, including after commencement of a foreclosure action. Any such subordination should bind the tenant automatically, whether or not the tenant has been notified of it.

38.6 SNDA Form. Require the tenant to execute any SNDA form that the landlord's lender requires or attach an industry standard model SNDA, such as the one the New York State Bar Association promulgated in 1994 (New York State Bar Association Real Property Law Section Newsletter, Spring 1994, 42). Edit the form of SNDA to make it nonrecordable, and prohibit recordation. State that if the landlord delivers a conforming SNDA and the tenant does not sign and return it within a specified period, then the landlord has fully performed its obligations on obtaining an SNDA from that mortgagee. Any SNDA should have an expiration date so that it will not cloud title after lease expiration. If the tenant wants to negotiate the form of SNDA, it must pay the landlord's lender's legal fees.

38.7 Zoning Lot Mergers. Require the tenant to cooperate and timely execute documents as necessary.

39 Tenant's Equipment and Installations

39.1 Conduits and Risers. The landlord should control and coordinate use of conduits and risers that run through or next to the premises. The landlord should have no liability for claims arising out of the tenant's use of conduits and risers. The tenant should label all cables and communications lines. Allow the landlord to relocate conduits; to recapture unused conduit or riser space; and (at the landlord's option) to require the tenant to remove cables, conduits, and risers no longer in use. Provide that the tenant may not install telecom or data cable outside the premises; the

tenant must use one of the existing distribution cables. The landlord may have to commit in exchange to have at least two or three different telecom or data transmission providers in the building, with diverse points of entry.

39.2 Ducts and Ventilation. Require the tenant to pay for any alterations or upgrades. Require the tenant to solve at its expense any venting or odor problems, all to the landlord's reasonable satisfaction.

39.3 Electromagnetic Fields (EMF). The tenant should agree not to cause any EMF interference. If the tenant generates EMF interference, the tenant should agree to solve the problem. Negate any landlord liability. Allow the landlord to limit placement of machines that may cause EMF, even within the premises.

39.4 Rooftop Equipment. The landlord should control roof rights, including penetrations, fuel supplies, ancillary equipment, relocation, and size and weight of any rooftop dish or other equipment. Require the tenant to remove its equipment, including any connecting cables, and restore (or pay for the landlord to restore) the roof at the end of the term. The tenant should agree to indemnify the landlord against all liability and roof damage that arises from the tenant's rooftop equipment. Charge for the tenant's use of rooftop space. State that the landlord may require the tenant to relocate equipment elsewhere on the roof, and to provide screening or walkways, all at the tenant's expense. State that any use rights granted to the tenant do not limit the landlord's use rights. Describe the tenant's rooftop rights as a "nonexclusive license." Try to limit the tenant's roof usage as much as possible, recognizing that future installations, including installations as yet unknown, can produce substantial additional income for the landlord.

39.5 Signage and Identity. The landlord should control all rights to exterior signage (including the name of the building, any flagpole, and rights to install plaques or other identification), even if exterior signage affects light and air. Prohibit digital, flashing, or video signs, or establish criteria for such signs, such as how often they may change. Signage can only advertise this tenant's operation at this location; it cannot advertise the tenant's products or services generally, or anyone other than the tenant. If the landlord installs any signs for the tenant, the tenant should pay for them. As an alternative, state that the tenant's signs must comply with signage criteria attached as a lease exhibit, which the landlord may modify or update from time to time. The landlord should think about consistency and future needs in the signage program for the entire building.

For future changes in signage criteria, give the landlord an express right to upgrade the tenant's signs, at the tenant's expense. Require the tenant to cooperate and execute all necessary documents. Give the landlord the right to remove signage temporarily for repair or compliance with law. If the tenant's sign is worn, stained, unattractive or broken, require the tenant to repair or replace it quickly. In drafting lease provisions, think of signage as a profit center, which the landlord should preserve and protect. The landlord should also control interior signage visible from outside the space.

39.6 Supplemental HVAC, Backup Generator, and Fuel Tank.

The tenant must maintain its equipment in compliance with law and good practices (such as monthly inspections), and keep written maintenance records. These installations become the property of the landlord at the end of the term. The tenant must deliver the equipment in good working order with all permits, warranties, and maintenance history documents. Restrict testing of backup generators, which are very loud.

39.7 Uniform Elevator Lobbies, Signage, Entrance Doors and Window Shades. Require all tenants to maintain uniform elevator lobbies, signage, entrance doors and window shades. As an alternative, consider giving the landlord the right to require future uniformity. Give the landlord the right to install thermal film on the inside surfaces of any windows.

39.8 Temporary Signage. Require a retail tenant to install temporary promotional signage during construction and before opening. Does the landlord want the right to approve that signage? Require uniform signage for space under construction?

40. Use

40.1 Advertising. In a retail lease, consider requiring the tenant to include the name and address of the premises, as appropriate, in all regional and internet advertising. Or, in the alternative, prohibit the tenant from using the name, image, or likeness of the building in its advertising, or control the manner in which the tenant does so. If the landlord has trademarks, service marks, or other intellectual property, which the landlord will allow or want the tenant to use under certain circumstances, including appropriate provisions in the lease. At a minimum, the tenant will need to disclaim any interest in the landlord's intellectual property and the landlord will need to approve each usage.

40.2 Basement Use. If the building contains a basement with tenant access, describe the basement and indicate what permitted uses the tenant may conduct there. For example, is it a “selling basement”? If so, then the rent is generally higher. Is it a “storage basement”? If so, what can be stored there? And, in that case, prohibit use as selling space. If there are meters inside the basement, require that the utility companies have the right of access even if they have remote reading capabilities. Over time, basement usages tend to expand into any available and visible unused space. Allow the landlord to adjust the rent accordingly.

40.3 Certificate of Occupancy. State that the landlord does not represent or warrant that the tenant may use the premises for the permitted use. Even delivery of a certificate of occupancy does not create such a representation or warranty.

40.4 Continuous Operation. Require a retail tenant to open and stay open during certain prescribed hours with sufficient personnel and inventory and all required licenses. If the tenant breaches, try to define the landlord’s measure of damages. Also, provide for remedies other than an injunction or a lease termination, such as higher rent. A court may not grant an injunction and the landlord would probably not want to terminate the lease.

40.5 Co-Tenancy. Build in flexibility in co-tenancy requirements to accommodate possible future changes in the retail marketplace. Avoid requirements that over time may become impossible to satisfy (for example, because of multiple name changes). Define co-tenancy requirements broadly enough so the landlord can meet them not just by maintaining occupancy by the named co-tenants, but also by substitute or replacement cotenants, or even other categories of retail tenant. Terminate the co-tenancy requirements at some point (for example, based on the passage of time or the achievement of sales thresholds).

40.6 Density. Limit density in the premises, i.e., how many people in how much space.

40.7 Exclusive Uses. Track exclusive uses to avoid conflict. The landlord would ideally have no liability for conflicting exclusive use clauses or enforcement of exclusive use clauses. Consider limiting the tenant’s remedies if the landlord violates any exclusivity clause. For example, allow the tenant to pay “percentage rent” only—but have no other remedy—if the landlord violates the clause. After a certain amount of time, require the tenant to revert to full rent or terminate the lease. If

some other tenant operates a prohibited use, allow the landlord to assign to this tenant, as this tenant's sole right and remedy, any right to enforce the prohibitions in the other tenant's lease. Carve out from any "exclusive use" existing tenants and expanded or new anchors, and/or any store that operates the same use as one of multiple uses, but not its primary use. Limit this tenant's exclusive use right so it refers only to this tenant's primary business. Consider measuring limited permitted excluded use by square footage, time of day, or percentage of sales. Allow other tenants a limited right to sell exclusive use items (so-called "incidental sales"), but limit the right to sell the exclusive use item to a certain percentage of sales floor area or restrict the percentage of sales that may come from the exclusive use item.

40.8 Franchises. If the tenant operates a franchise, the tenant should agree to comply with its obligations under the franchise agreement. The landlord may also want to receive copies of any material notices from the franchisor and have the right to communicate with the franchisor to confirm the tenant's good standing and identify any issues.

40.9 Limited Hours of Operation. Consider limiting hours of operation as appropriate, e.g., in a mixed-use building with security concerns.

40.10 Loss of Exclusive. Provide that if the tenant does not use its exclusive use right, or goes dark for a certain period, then any exclusive use rights terminate. These terminations need to be permanent. Temporary terminations do not help the landlord much.

40.11 Medical Use. Disclaim any right or obligation on any medically sensitive information in the tenant's space. The tenant should agree to remove all that information at the end of the term. As an administrative matter, the landlord will want to assure it never takes control of or touches that information, and may even want to say that in the lease.

40.12 Narrow Use. Draft the use clause narrowly (for example, not general office use, but office use for a computer consulting company operating under a specific business name). Then say: "and for no other use."

40.13 Noise and Odors. If the tenant's operation emits noise or odors (such as a bar, a restaurant, or a donut store), define in the lease specific noise and odor mitigation measures. Do not just impose a general obligation for the tenant to control or prevent noise and odors. Allow the landlord to impose additional noise and odor control measures if the land-

lord determines that the initial measures do not work. Any odor and noise mitigation ultimately must meet with the landlord's reasonable approval. State that the landlord has no responsibility for other tenants' noise or odors, provided the landlord exercises reasonable efforts to require those tenants to comply with law.

40.14 Permitted Use. State that the landlord has no obligation, implied or otherwise, to allow any change in the permitted use of the premises, even if the landlord consents to (or is required to consent to) an assignment or subletting or any alterations.

40.15 Quality Standards. If the landlord requires a certain quality level, try not to use words like "first class." Instead, define the required standard of operation, such as "white tablecloth" or "table service" in the case of a restaurant. These standards can be very tricky. It is best to use a very specific and objectively determinable standard. For example, the lease could require that the quality level match the quality level of a comparable business/location, as of a specified date. Pricing may be a dangerous test. Obligate the tenant to remodel and/or renovate as necessary to maintain the desired quality level.

40.16 Recapture Right. In a retail lease, especially one without an operating covenant, give the landlord a continuous or periodic recapture right if the tenant ceases to operate for a stated period. Structure the right so a lender can exercise it after foreclosure. For example, do not just give the landlord a one-time right to recapture within a certain period after the tenant closes its store; provide for a periodic or continuous right. Anything less will make lenders nervous.

40.17 Restaurant Use. If the local restaurant inspectors issue ratings, state that if the tenant's rating drops below a certain level, certain consequences follow. For example, the lease could give the tenant a limited but reasonable time in which to "clean up its act." Ultimately, if the tenant cannot do so after a long cure period, the landlord may want the right to terminate the lease.

40.18 Security Requirements. Make the tenant responsible for any additional security (and any damages) resulting from the tenant's presence in the building and its use of the premises.

40.19 Single-Store Operation. Require the tenant to use and operate the premises only as a single retail operation (no separate stores or stalls, except bona fide licensed departments or concessions not operated under

a separate name). Prohibit the tenant from segregating any part of its space from the rest of the space for use as a separate store, with or without a separate entrance.

40.20 Zoning Restrictions. Do any zoning restrictions or rules limit the uses of the premises? If multiple units, consider limitations that apply to the building as a whole, or units as a group. For example, if retail space exceeds X square feet, must it have a loading dock? The landlord should consider requirements and issues like these in determining the scope and size of permitted uses within the leased space.

41. Vault Space

41.1 Diminution. State that any reduction of vault space (such as use by any government or utility) does not entitle the tenant to any rights.

41.2 Recapture. Give the landlord the right to recapture any vault area if the landlord, a utility or governmental authority ever needs the space.

41.3 Use and Occupancy. Since vault space may lie outside the boundaries of the landlord's property, state that the landlord makes no representation about any right to use or occupy such space. If the tenant uses any vault space, require the tenant to maintain, repair, and pay any municipal fees imposed from time to time. Alternatively, the landlord may want to prohibit the tenant's use of any vault space to avoid liability and other issues.

42. Due Diligence, External Considerations

42.1 Accounting Implications. The Financial Accounting Standards Board has finally issued new guidance on how to account for leases. Those new standards may drive substantive changes in the terms of leases, such as by leading tenants to favor shorter leases. This could affect not only lease negotiations but also the entire dynamic and structure of commercial real estate ownership. Any attorney negotiating a commercial lease, especially a substantial one, for the landlord or the tenant should involve the client's accountants to consider how the FASB's new provisions affect the lease negotiations and agenda.

42.2 Background Check. Perform suitable background and credit checks, including any tenant litigation history (court records, L & T law firms) and online checks. Check the Office of Foreign Assets Control

(“OFAC”) list of terrorist entities online at www.fincen.gov to see if the tenant, or any of its principals, appears on the list. Perform a UCC and bankruptcy search for the actual specific entity that will be the tenant, as well as its parent company and perhaps major affiliates. Check any corporate and limited liability company entities on the applicable department of state website. Look online for general information about the tenant’s past litigation, other history, activities, and plans. Some types of background investigation will require a consent from the person being investigated. Do not assume the prospective tenant can consent to a background check for some other person, such as a guarantor.

42.3 Consents. Does any mortgage, ground lease, other space lease, development agreement, or reciprocal easement agreement limit who may be a tenant in the building? Confirm that this tenant complies. If appropriate, obtain suitable representations and warranties (for example, not a “prohibited person”). Does the transaction require any consent on the landlord’s side, such as from a joint venture partner, mortgagee, mezzanine lender, or ground lessor? Do any of these parties require the landlord to include particular provisions in space leases? If so, include them. And what will the consent process require? How long will it take? Can the landlord seek consent based on just a term sheet, or must the landlord wait until the transaction has been fully documented? What needs to go into the package sent to the party whose consent the landlord needs? And what else can the landlord or its counsel do to expedite the consent process?

42.4 Green Construction. Every company now seems to say it is a “green” company—whatever that means. Leases are starting to sprout new “green” covenants, e.g., obligations to recycle. But most new occupants of commercial space still fully demolish their new space, if it wasn’t already raw when delivered. Every time a space turns over to a new tenant, huge amounts of construction debris still go to landfills. If a landlord wants to reduce the environmental impact of its building, what can that landlord do over time to change construction techniques in the building, to eliminate or reduce those truckloads of construction debris? How can landlords make their spaces more adaptable to the needs of multiple tenants over time, so every tenant will not need to fully demolish the space? Those questions go beyond lease negotiations and legal issues. A “greener” approach to tenant improvements would eventually affect the terms of leases.

42.5 Identities of Tenant and Guarantor. Determine early the exact name of the tenant. Understand the tenant’s equity ownership structure. Get the right entity as the tenant. Cross-check the tenant’s name

against its charter certificate as filed, or at least the appropriate Secretary of State website. The same comments apply to any guarantor.

42.6 Incentives and Subsidies. Understand any incentive and subsidy programs available for the contemplated lease. Can this tenant qualify? If so, the landlord should consider that qualification—and any economic benefits the tenant will realize—as part of rent negotiations. If the tenant will save a dollar through incentive and subsidy programs, perhaps the landlord can charge an extra 90 cents of rent, demonstrating that geographically targeted incentive programs may ultimately do nothing more than increase the value of real estate investments (and ultimately land) in the targeted area. These programs often require that when the beneficiary applies for benefits, the beneficiary has not yet taken some action to “commit” to a particular location, such as filing a building permit or signing a lease. Keep these pitfalls in mind in managing the process.

42.7 Lease Cross-Check. Just before signing the lease, take one last look at the term sheet or deal summary. Recheck to confirm that the final lease documents, after whatever negotiations occurred, still fully conform to the term sheet or deal summary. If the landlord moved away from that starting point in negotiations, counsel should confirm that the landlord signed off on those concessions in writing, at least by email. In the morass of leasing issues great and small, do not lose sight of the single most important issue: the rent. Consider circulating just the final rent numbers to the client and the client’s broker—separately from anything else—with a request for final confirmation that they are right. As with any other numbers in a legal document, these numbers can look right but be very wrong. And so can the rent adjustment dates.

42.8 Legal Requirements. Do any special legal requirements apply to this landlord? For example, if the landlord is somehow a governmental contractor, then procurement regulations may require this landlord to include in its leases an obligation for tenants to comply with equal opportunity requirements, hiring of particular categories of person, or other governmental agendas, including for example the foreign policy of the City of New York.

42.9 Other Leases. Does any other tenant have a right of first refusal or other preemptive right for the space now being leased? The landlord should understand all possible preemptive rights under other leases in the building, to assure that no two tenants can ever claim the same space at the same time. Does any other tenant’s lease contain any

other provisions that this lease ought to take into account, such as a right to enter the premises to run cable or obtain access to telecommunications installations? Particularly in a retail context, has the landlord given any other tenant an exclusive right that this one might violate? If the tenant requests any rights outside the leased premises (for example, an antenna on the roof), can the landlord accommodate that request without running afoul of rights already given to other tenants? Rather than deal with all these issues on a one-off basis for each lease, the landlord or its counsel should maintain—and keep updated—a correct and complete master list of all rights of the types mentioned in this paragraph.

42.10 Plans. Does the landlord plan any significant changes, redevelopment, repositioning or sale of the building in the term of this lease? How would those plans affect the terms of the lease? Does this lease match the landlord's plans for the building?

42.11 Previous SEC Filings. If the tenant is publicly held and any previous lease of the tenant was a "material obligation," the tenant should have incorporated that prior lease in a previous SEC filing. As a strategic matter, the landlord may wish to review that filing and see what the tenant accepted in the previous transaction.

42.12 Real Estate Tax Assessment. Think about the real estate tax assessment in the base tax year. If for some reason the landlord knows it is "too high," will probably drop in later years, but probably will not drop for the actual base year, then over time the real estate tax escalation in the lease may not help the landlord much. How to handle this problem will depend in part on the particular building and the particular landlord, as well as local tax assessment procedures and timing.

42.13 References. Obtain references for the tenant and its principals.

42.14 Scope of Premises. Think about where the premises begin and end, identifying and resolving any uncertainties. Do not just refer, for example, to "the eighth floor" or "all the rentable space on the eighth floor." Prepare a clear floor plan (or at least a sketch) to attach to the lease. Even for a full-floor tenant, clearly demarcate where the premises end and the common areas (and other landlord-controlled areas) begin. Do the premises include service closets? Elevator lobbies and restrooms, particularly in the case of full-floor premises? The landlord may, for example, want to switch to the tenant the burden of restroom maintenance; inclusion in the premises can help achieve that. If someone prepares and throws onto the back of the lease an intuitive sketch of the space at the last

minute, this can lead to serious disputes later if the sketch included even very tiny spaces that it shouldn't have included. If the lease refers to rent as a function of "rentable area"—an undesirable approach—then a space sketch could even somehow create arguments or uncertainty about the amount of "rentable area" and hence the rent. Give the landlord some flexibility to reconfigure the leased premises if needed, and at least the building core.

42.15 Status of Premises. Is the space presently vacant? Do any issues exist about its present physical condition? Does the landlord anticipate any problems obtaining vacant possession?

42.16 Tax. Consider any tax issues arising from, e.g., the structuring of the rental stream and allocation of depreciation deductions arising from any initial capital investment for the lease.

42.17 Tenant Representations. Obtain representations and warranties on the tenant's ownership structure, perhaps backed by a secretary's certificate and copies of documents. Also seek confirmation that the tenant obtained all necessary approvals, especially if the tenant is a non-profit or other unusual type of entity. Consider obtaining the same for any entity guarantor.

43. Other Documents And Deliveries

43.1 Advice and Administration Memo. The landlord may want its counsel to prepare a memorandum summarizing important provisions of the lease and advising the landlord on actions it should remember to take to avoid problems, issues or disputes. Any such memorandum should also include reminders of any important dates (including any that recur periodically); a disclaimer of counsel's responsibility to remind the landlord of those dates; and a suggestion that the landlord maintain a tickler file. Because such a memo can't include everything, it should include appropriate disclaimers. But to the extent it does cover anything, make it 100 percent right. Check it three times.

43.2 Brokerage Agreement. Confirm early on that the landlord has entered into suitable brokerage agreements (or has obtained commission waivers) with every broker involved in the transaction in any way. Any brokerage agreement should waive any claim unless the parties actually sign a lease and all conditions to its effectiveness are met. Consider the effect of a possible tenant default on the landlord's liability for unpaid brokerage commissions. What about an early negotiated termination of

the lease based on a change in the tenant's financial condition? Try to negate any further payment obligations to the broker in any such event. If the lease gives the tenant early termination options, then defer any commission payments accordingly. Try to express any brokerage commission as a dollar figure rather than as a formula, because formulas invite disputes, especially when they provide for exclusions, gross-ups, adjustments, hypothetical eventualities, and other sources of complexity and disputes. Did the landlord ever enter into any previous leasing transaction with this tenant, creating the risk that a broker involved in the previous transaction will expect a commission from this one? Conversely, try to negate any obligation to pay today's broker a commission on future renewals. The landlord should reach out to the tenant to discuss renewal well before the tenant contacts the broker. The landlord and its counsel should mark their calendar. If the landlord cannot avoid such an obligation to pay a commission on renewals, then set as high a standard as possible for payment. For example, allow the broker to collect a commission on a renewal only if: (1) the tenant exercises a renewal option in accordance with its terms; (2) the broker still represents the tenant at the time of renewal; or (3) the tenant has formally notified the landlord of that continued relationship. Require the broker to keep the contents of the brokerage agreement confidential.

43.3 Certificate of Insurance. Have an insurance consultant review the tenant's insurance certificate as well as the tenant's underlying insurance policy and endorsements. There is really no substitute for reviewing the actual policy and endorsements themselves.

43.4 Copies. Say once, somewhere, that whenever the lease requires the tenant to deliver copies of anything, that means true, correct, and complete copies, without redaction.

43.5 Disclosures. To the extent that governing law requires a prospective landlord to disclose information to a prospective tenant, identify those requirements and make the disclosure. Ever-expanding disclosure requirements have become part of the territory for certain consumer transactions. The trend has started to affect commercial leasing. For example, New York requires prospective landlords to notify prospective tenants of certain vapor intrusion issues.

43.6 Environmental Assessment (Baseline). Particularly if a tenant will lease an entire building or conduct activities that might cause contamination, obtain an environmental assessment as of the beginning of the lease term. Attach it as an exhibit. Use it as a baseline to measure any

possible contamination the tenant caused or for which the tenant might otherwise be responsible.

43.7 Estoppel Certificate. Attach a form of estoppel certificate to the lease. Make it as broadly acceptable as possible, and consistent with the form contemplated by any existing loan documents. Give the landlord the right to add to the form. It should allow reliance not only by third parties but also, if possible, by the landlord.

43.8 Exhibits. To the extent that the lease will contain exhibits, who prepares them? For example, will someone else want to prepare the rules and regulations for the lease? Construction rules and regulations? Have they changed since the last version included in the Standard Form? Don't wait until the lease is otherwise ready to sign. Focus on the exhibits from the beginning.

43.9 Financial Statements. Obtain for the tenant and any guarantor(s), and perhaps selected affiliate(s). Make sure the client has reviewed them. Confirm they relate to the correct entity.

43.10 Good Standing and Organizational Documents. Obtain and review the tenant's good standing certificate and government-certified copies of organizational documents. Ask for an organizational chart if the tenant's structure is complex.

43.11 Guaranty. Obtain a guaranty executed by the correct guarantor—check the name against some appropriate document and the Secretary of State website—and acknowledged before a notary. Confirm the authority of the signer for any entity guarantor. Require the guarantor's taxpayer identification number and (for an individual) residence address under the guarantor's signature. Check the guarantor's address on Google maps. Verify it is a residence. If an individual guarantor resides in a joint property state, consider obtaining the signature of the guarantor's spouse as well. If the guaranty covers anything less than all lease obligations, think about how the landlord might enforce the guaranty in the context of various possible defaults, and try to prevent any surprises. If the tenant defaults and perhaps cures some of those defaults in various ways, how does that affect the landlord's claims under the guaranty?

43.12 Letter of Credit. Review the letter of credit form as early as possible in the process. Obtain lender sign-off as needed. If the lender requires any arrangements to give the lender control of the letter of credit,

set up those arrangements. They may involve third parties, hence take longer.

43.13 Lender's Rights. Review the landlord's loan documents to assure that the landlord's rights and obligations under the lease track the landlord's obligations as borrower under the loan. What landlord consent rights do the existing loan documents require the borrower to retain? And what landlord consent rights will future lenders probably require? If the loan documents are being negotiated at the same time, try to correct any disconnects by modifying the loan documents if necessary. The concerns in this paragraph go beyond assignment and subletting, but seem most likely to apply to assignment and subletting.

43.14 Marked Leases. When preparing final lease documents for signature, mark them against the landlord's standard form to facilitate future lease review projects and administration. Do not give tenants and their counsel those marked copies.

43.15 Memorandum of Lease and Release. If the lease requires the landlord to sign a memorandum of lease, also obtain a release of memorandum of lease, and deposit it in escrow with the landlord's counsel or some other third party willing to assume responsibility.

43.16 Opinion of Counsel. For a major lease, consider obtaining an opinion of counsel on the tenant's due authorization, execution, and delivery of the lease, though probably not enforceability of the lease. Consider requesting a representation by the tenant that entering into the lease does not violate any pre-existing agreements of the tenant. Similar considerations may arise for any guarantor. A landlord might particularly want an opinion of counsel for a foreign, governmental, or nonprofit tenant.

43.17 Original Documents. Create an audit trail showing who received original documents, particularly letters of credit. In general, original documents should go to the client and the landlord's counsel should retain a scanned copy of the entire lease and all related documents, with all exhibits. Is there anyone else to whom the landlord must send copies of new leases? What about the landlord's mortgagee or any ground lessor?

43.18 Plan Approval. If the landlord will perform any construction, have the tenant approve any plans at lease signing, if possible. Failure to do that may give the tenant an opportunity to delay the construction process (by withholding approval of future plans), which could delay commencement of rent.

43.19 Press Release. Particularly if the landlord wants to control or initiate press coverage for the transaction, the landlord may want the parties to issue a press release about their transaction. If so, the parties should resolve the form of that press release as part of negotiating documents, because it will need to go out immediately after signing to achieve maximum attention from the press.

43.20 SNDA Request. Without putting any ideas into the tenant's head, try to determine early in the process whether the tenant intends to require an SNDA. If so, start the process early. See what exactly the governing loan documents will require the landlord to do. Who acts for the lender? What information and other deliveries must that person receive? Match the form of SNDA attached to the lease (or otherwise expected by the tenant) to the form of SNDA contemplated by the loan documents. The same agenda arises for any ground lessor.

43.21 Taxpayer Identification Number; W-9 Form. Require the tenant's taxpayer identification number under the tenant's signature. Sooner or later the landlord will need it. If the tenant delivers an interest-bearing security deposit, the landlord will need the taxpayer identification number immediately. Consider incorporating the tenant's W-9 Form certifications into the body of the lease, as a backup for a separate form, which the landlord should also obtain.

43.22 Term Sheet (Letter of Intent). Any significant leasing transaction often starts with a term sheet or letter of intent, prepared by the brokers. The landlord's counsel should try to participate in preparing that document, at least to the extent necessary to prevent unintended liability, obligations, and issues for the landlord. Typically, it will make sense to say that the term sheet or letter of intent does not bind the parties, except a few provisions that do, such as confidentiality, a brokerage indemnity, consents to background checks, nonreliance, and the agreement of the parties about the otherwise nonbinding nature of the document.

43.23 Third-Party Consents. If the transaction will require any third-party consents, obtain whatever piece of paper evidences that consent. Like any other piece of paper, it may require drafts and negotiations. Start those early.

44. Post-Closing; Monitoring

The following suggestions on lease administration and enforcement do not constitute a complete guide to administering and enforcing leases.

Some of these responsibilities will belong to the landlord's leasing broker or property management company, so they should be delegated accordingly in a way that is unambiguous.

44.1 Abandonment. If the tenant seems to have moved out, then before entering and taking control of the premises, consider sending an "estoppel" notice to the tenant reiterating the lease provisions on "abandonment" and inviting the tenant to confirm that it has not abandoned the premises, with payment of any unpaid rent. If any doubt exists about whether the tenant has abandoned the premises, consider using a summary possession action rather than self-help to avoid claims of wrongful eviction.

44.2 Alteration Consents. A lease sometimes says the tenant need not remove its alterations and restore the premises at the end of the term unless the landlord requires such restoration as a condition to the landlord's approval of the particular work. In those cases, the landlord must remember to exercise its right to require restoration when appropriate—thus creating a little trap for the landlord. So when the landlord receives a request for approval of alterations, the landlord should check the lease to see if it imposes such a requirement. (In a perfect leasing world, of course, the lease would require the tenant to give the landlord a conspicuous reminder of any such requirement whenever the tenant submits plans.)

44.3 Casualty and Restoration. If a casualty occurs during construction and affects the construction, identify and comply with any lien statutes or other contractor-protection statutes that might apply. In New York, for example, insurance proceeds that arise under these circumstances will be subject to the trust fund provisions of Lien Law article 3-A, a minefield for all concerned.

44.4 Changes of Address. If the landlord or any other notice recipient relocates, send formal notices to all tenants. Do not assume an ordinary emailed or bulk-mailed announcement will do the job. Update any filings, such as the Secretary of State and corporate service companies. If a tenant gives a formal notice of a change of address, the landlord should update its records. If the landlord becomes informally aware of a tenant relocation, the landlord should add the tenant's new address to its records, but use it in addition to continuing to use the old address. For clarity in that case, the landlord might request the tenant to give a formal update.

44.5 Commencement Date; Delivery of Premises. Issue formal notice and confirmation of delivery of the premises and commencement

date, in a way that satisfies the specific delivery requirements of the lease. Exactly who needs to receive notice? Does anyone else need to receive a copy? The requirements may exceed those of the regular “notices” clause in the lease. Think about how to comply with them before the commencement date actually occurs, because delays in giving notice may result in lost rent dollars. Memorialize the commencement date with a document filed in such a way that someone will be able to find it in five years. If the lease (or a memorandum of lease) was recorded, consider recording notice of the commencement date. Once the lease is signed, prepare the commencement date notice with a blank date so it’s ready to go. Provide that if the parties never actually confirm the commencement date, the landlord can provide evidence of rent payments (with backup) to establish the commencement date.

44.6 Consent Requests. If the tenant requests consent to anything, check the lease to see what conditions the tenant must satisfy. The tenant’s request for consent may give the landlord an opportunity to solve problems or uncertainties that may have arisen. If the landlord anticipates incurring attorneys’ fees in dealing with the consent, confirm that the lease obligates the tenant to reimburse those fees. If it doesn’t, try to have the tenant agree to do that before the landlord starts to consider the request for consent.

44.7 Contact Person. Keep accurate records of the tenant’s emergency contact details. Check them occasionally.

44.8 Document Files. The landlord should establish reliable procedures to assure that when the tenant requests an estoppel certificate, the landlord will be able to list all documents that define the landlord-tenant relationship, such as option exercise letters, change of address notices, other notices, and the like. The landlord should prevent issues that might arise if the landlord delivers an estoppel certificate and forgets to include any of these other miscellaneous documents.

44.9 Escalations. If the landlord and the tenant agree on simplifying assumptions or formulas for calculating operating expense or other escalations, memorialize those understandings in writing. Otherwise, they leave the door open for a future lease auditor to come in many years after the fact and try to recalculate escalations in accordance with the precise words of the lease, an exercise that may and may not be practical.

44.10 Estoppels. The landlord may wish to request periodic estoppel certificates simply to try to prevent future issues from arising. Request an

estoppel certificate (or include equivalent language in the documentation) for any amendment, consent, waiver, favor, or other concession of any kind. Consider periodically requiring an estoppel certificate on general principles, including from guarantors. Obtain one when the landlord has finished initial build-out. If the tenant has a deadline to respond to these requests, and perhaps in all cases, communicate these requests in compliance with the notice provisions of the lease. Periodically ask the tenant to confirm its formal notice address. If the tenant wants to negotiate the form of estoppel, it must pay the landlord's lender's legal expenses. Don't amend the lease in an estoppel certificate, as the parties may never find it again.

44.11 Fair Market Value Determinations. If the lease will require the parties to determine fair market rental value for any rent adjustments or option terms, the landlord should plan ahead for those likely disputes. At a minimum, the landlord should maintain suitable notes on other transactions and useful information, and perhaps engage the "best" appraisers well in advance to try to assure the process goes well if the parties can't agree on fair market rental value. If a renewal option term is for less than ten years and priced at fair market value, describe it as "the first three years of a ten year hypothetical fair market value term." Price renewal option terms at highest and best uses. If there is to be a fair market rent appraisal, how does the rent bump after the appraisal date? The appraiser can either determine or take it into account in the analysis. The lease should indicate which.

44.12 Future Amendments. If the landlord and the tenant amend the lease, the landlord should obtain guarantor consent (even if the guaranty waives such a requirement); amend any recorded memorandum of lease; and obtain any consents needed from lenders, partners, or other parties. Consider including estoppel-type assurances in any amendment.¹ Among other things, lease amendments give the landlord a good occasion on which to check the file, understand all amendments that have occurred to date and make sure the landlord's housekeeping remains in order.

44.13 Future Deliveries. To the extent the lease requires the tenant to make future or periodic deliveries of documents (such as financial statements of the guarantor or the tenant, certificate of ownership structure, insurance renewals or sales reports), remember to ask for them. If the

¹ Lease amendments create their own minefields, as described in Joshua Stein's article on the topic, *How to Stay Away From The Minefields in Lease Expansions, Extensions, and Renewals*, *The Practical Real Estate Lawyer*, March 2012, at 17.

landlord fails to enforce a tenant obligation long enough, that might create a waiver.

44.14 Future Events. Memorialize any exercise of an option, delivery of additional space, and the like, and any resulting rent or base year adjustments. Keep a copy of any resulting documentation in the lease file, in a place where someone will find it when they want “all” the lease documents. Memorialize any such understandings or event in writing. Do not rely on a course of dealing or other circumstances.

44.15 Guarantor. For an individual guarantor, check occasionally to see if the guarantor has died or has become disabled. If this occurs, the landlord may need to file a claim in probate, quite quickly, or lose its rights against the guarantor.

44.16 Insurance. Monitor expiry dates of insurance. Update coverage limits and requirements as markets change. Check insurance certificates for renewals, to confirm they continue to comply with the lease.

44.17 Lease-Related Agreements. If the landlord and the tenant enter into any future agreements related to the lease, think about whether they constitute lease amendments and require approval from lenders or other third parties. Unless they constitute lease amendments, any nonpayment or nonperformance under these future agreements will probably not constitute a default under the lease, and thus may not allow the landlord to exercise lease-related remedies.

44.18 Letters of Credit. Establish a single safe location to store letters of credit, and memorialize that location among all who need to know about it. Check that location once in a while to make sure the letter of credit has not somehow walked away. Monitor expiry dates. Pay attention to possible credit downgrades affecting the letter of credit issuer; they may allow the landlord to draw the letter of credit. If the letter of credit is an evergreen, consider obtaining periodic confirmations that the letter of credit remains in effect. It’s hard for a landlord to prove the landlord never received a cancellation notice. Typically, draw at the earliest possible opportunity, if necessary.

44.19 Notice Address. From time to time, confirm that the tenant’s notice address remains valid.

44.20 Permits. Periodically check the official records for open building permits that the tenant should have closed.

44.21 Preemptive Rights. Give the tenant notices of available space, and other notices, under any right of first refusal or other preemptive rights in the lease. Track this tenant's rights, and potential triggering events for those rights, in a way that nothing will fall between the cracks. In giving notices, do it right the first time.²

44.22 Tenant's Name. If the tenant operates or identifies itself under any name other than its legal name in the lease, check with landlord-tenant counsel to see whether this could create an issue in an eviction action. Similarly, if checks for rent under the lease show the name of anyone other than the tenant, consider any issues this may create. If necessary, notify the tenant that future rent checks should come from the tenant, and not any affiliate or other party.

44.23 Tickler Reminders. If the tenant persuaded the landlord to remind the tenant of certain matters (e.g., option exercise deadlines), establish appropriate reminders in the landlord's calendar. Track lease renewal dates. Approach the tenant well in advance to make sure no broker is involved. Counsel may also wish to make appropriate "tickler" entries, but should avoid assuming responsibility to remember. To the contrary, counsel should affirmatively warn the landlord that counsel does not assume responsibility to remember any dates.

44.24 Title Search. Any careful property owner may want to obtain an updated title search on their property periodically, just to check for surprises. As a landlord, the most common surprise would consist of a mechanic's lien arising from a tenant's work.

44.25 Violations and Real Estate Taxes. Check periodically for outstanding Department of Buildings violations and for payment of real estate taxes (if that's the tenant's obligation). For the latter item, the landlord may want to engage a tax service.

² For suggestions, see Joshua Stein's article on the topic, *A Checklist for Giving Legally Effective Notices*, *The Practical Lawyer*, August 2005, at 11.

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CHAPTER EIGHT

**MODEL NEW YORK LANGUAGE FOR
SPACE LEASES**

Joshua Stein, Esq.

[8.0] I. INTRODUCTION

This chapter seeks to collect, for convenient reference, language that a New York leasing lawyer may want to include in any space lease because of legal considerations unique to New York. This chapter offers three sets of sample provisions: (1) the base case, which would typically apply to all Leases; (2) special cases, which reflect New York leasing law but would apply only sometimes; and (3) general provisions, which do not uniquely apply to Leases but could also apply to any other document governed by New York law.

Footnotes explain and comment on the model provisions, and when and why one might want to use them.

Any competent New York real estate lawyer will helpfully point out that New York leasing law and practice requires a lot more than shoveling a few paragraphs of standard language into a Lease. But the few paragraphs of New York language offered here do provide a good starting point to think about New York law or check a space lease for New York issues. Knowledge of New York law also helps.

The sample clauses offered here seek to demonstrate plain English writing: short and direct sentences, verbs, ordinary words, active voice, not too many parentheses, general principles expressed before their exceptions and presentation of concepts in an orderly and logical way. Even a non-lawyer should have no problem understanding any of these provisions, though not necessarily the logic, if any, that drives them.

These sample clauses assume the overall Lease already defines common capitalized terms. Any user must confirm that defined terms used in the model provisions match those in the rest of the Lease. Check every capitalized term. If a particular paragraph does not itself define a capitalized term it uses, then the larger document will need to do that. No paragraph in these model provisions uses a capitalized term defined anywhere outside that paragraph.

This chapter assumes the Lease already defines, once: (1) “include” to mean “include without limitation”; and (2) any statute to include its amendments, replacements and supplements. For ease of use, this sample language does not establish defined terms for statutes, instead spelling them out every time. A user can change any of this, of course.

This chapter does not collect generic “boilerplate” that is not state-specific or city-specific, such as jury trial waivers or attorneys’ fees clauses. Sometimes this becomes a hard line to draw. In general, if particular language would appear in about the same form in any transactional document anywhere in the United States, this article omits it, even if it is very important language.

Any opinions expressed or implied are solely those of the author, and only at the moment of writing.

[8.1] II. LEASES (BASE CASE)

Almost every Landlord for almost every Lease will typically want to include these clauses. Other clauses apply only in certain cases, as listed below.¹

1.1 *Casualty*. The provisions of this Lease on casualty constitute an express agreement on damage or destruction of the Premises by fire or other casualty. Therefore, Real Property Law § 227 (RPL), providing for this contingency absent express agreement, shall not apply.

1.2 *Conditional Limitation*. If an Event of Default² exists, then without limiting Landlord’s other remedies, Landlord may serve on Tenant a written five-day³ notice of cancellation and termination of this Lease (that five-day period, the “*Conditional Limitation Period*”). When the Conditional Limitation Period expires, this Lease and the Term shall automatically and without any further action by anyone terminate, expire and come to an end, by lapse of time, as fully and completely as if the last day of the Conditional Limitation Period were the Expiration Date. After the Conditional Limitation Period, Tenant’s tenancy no longer exists. Tenant shall then quit and surrender the Premises to Landlord but remain liable as this Lease provides. This

1 New York law gives Landlords no statutory lien or “distrain” right. If they want one, they must create and perfect it under the Uniform Commercial Code, N.Y. UCC § 9-109. Only then would it make sense for a Tenant to ask a Landlord to agree to waive or subordinate any such lien. Nothing about that waiver or subordination would be specific to New York. 52A C.J.S. Landlord & Tenant § 1410 (2016).

2 The Lease should say, once, that an Event of Default exists only until Tenant has cured it and maybe Landlord has accepted the cure. This avoids the need to refer repeatedly to an “uncured Event of Default.”

3 Tenant will often negotiate for more than five days.

paragraph establishes a conditional limitation, not a condition subsequent.⁴

- 1.3 *Delivery of Premises.* Tenant waives any right it might have under Real Property Law § 223-a. Landlord’s obligations under this Lease on delivery of the Premises constitute “an express provision to the contrary” as Real Property Law § 223-a contemplates.⁵
- 1.4 *Holdover.* If Tenant holds over after the Term then, without limiting Landlord’s other rights and remedies, Tenant shall Indemnify Landlord regarding that holding over. Without limiting Tenant’s liability under the previous sentence, Tenant shall Indemnify Landlord against any loss Landlord suffers because, as a result of Tenant’s holding over, the next tenant of the Premises fails to take possession of the Premises or Landlord is otherwise in default, or incurs any incremental obligations, under that next tenant’s lease.⁶
- 1.5 *Mitigation of Damages.* Notwithstanding anything to the contrary in this Lease or governing law, if Tenant defaults then Landlord has no obligation to mitigate its damages or to seek to relet.⁷
- 1.6 *Right of Redemption.* Tenant waives any right of redemption under Real Property Actions and Proceedings Law § 761.

4 This paragraph responds to New York landlord-tenant jurisprudence that allows Landlord to bring a summary proceeding against a Tenant only if a Lease terminated by its terms, not if Landlord exercised a direct right to terminate. N.Y. Real Prop. Acts. Law § 711 (RPAPL). The distinction is rather arcane but drives much landlord-tenant jurisprudence in New York.

5 RPL § 223-a.

6 It has become standard to require New York tenants, if they hold over, to indemnify their landlords against the “loss” of the next tenant of the Premises as a result of holdover. This began with a court case that allowed the “next” tenant to recover from a holdover tenant for interfering with the next tenant’s occupancy. *See Kronish Lieb Weiner & Hellman LLP v. Tahari, Ltd.*, 35 A.D.3d 317, 318, 829 N.Y.S.2d 7, 9 (1st Dep’t 2006). Tenant can reasonably argue that Landlord’s next lease with the next tenant, if standard, should contain language relieving Landlord of the risk, such as the standard language on “Delivery of Premises” offered in this article. Nevertheless it is usually a landlord’s market in New York. Sometimes the parties compromise by saying the holdover tenant does not become responsible for loss of the next tenant until the holdover has continued for some time, e.g., 30 days. Just how does one measure that loss?

7 This language is not statutory, just customary. It universally appears in New York commercial leases, except sometimes very large or tenant-friendly leases. Although New York law does not require commercial landlords to exercise commercially reasonable efforts to relet at market rates, a customary measure of damages in any lease—the one that will most likely apply in most cases—does give Landlord a reasonable incentive to do exactly that.

- 1.7 *Security.* To the extent General Obligations Law § 7-103 (GOL) requires: (a) Landlord shall deposit the Security in an account at a bank with a place of business in the State; (b) if the Building contains six or more family dwelling units, then that account shall earn interest at the prevailing rate earned by similar deposits with banks in the State; (c) Tenant acknowledges that Landlord has Notified⁸ Tenant that Landlord shall deposit the Security at _____ Bank located at _____; (d) if the Security is deposited in an interest-bearing account, then Landlord shall be entitled to receive, as administration expenses, 1% per annum of the Security; and (e) any other interest paid by the bank shall belong to Tenant and Landlord shall hold it in trust until repaid, applied to Rent or annually paid to Tenant.⁹
- 1.8 *Waiver of Stay.* Tenant expressly waives, for itself and anyone claiming by or through Tenant, any rights under Civil Practice Law and Rules 2201 (CPLR), for any holdover proceeding or other action or proceeding on this Lease or Tenant's rights in the Premises.
- 1.9 *Window Cleaning.* Tenant shall not clean, nor require, permit, suffer or allow anyone else, to clean, any window from the outside in violation of Law.¹⁰
- 1.10 *Zoning Lot Waiver.* Space Lease. Tenant, and anyone claiming through Tenant: (a) is not a "party in interest" as defined in New York City Zoning Resolution § 12-10 (definition of "zoning lot"); and (b) shall promptly on demand execute and acknowledge any document Landlord reasonably requests to confirm that or as Landlord reasonably requires so Landlord can combine the Land with any other real property as a zoning lot, or subdivide the Land from any zoning lot.

8 The statute may require Landlord to give this Notice only after the Security has been deposited. If so, Landlord must remember to give a separate Notice after the fact. GOL § 7-103.

9 This paragraph just restates New York law, so it doesn't seem strictly necessary, but many tenants ask for it and it's a good reminder for landlords. *Id.*

10 Labor Law § 202 prohibits certain window washing techniques. N.Y. Lab. Law § 202. Most Leases specifically refer to that section, "or any other Law, including the rules of the New York City Board of Standards and Appeals." It is apparently not enough to say Tenant must comply with all law generally.

[8.2] III. LEASES (SPECIAL CASES)

Only some Leases will require the additional clauses collected here. Footnotes offer local color on some of these clauses and when they might apply.¹¹ Some of these clauses might apply to all Leases, but don't always appear. If a clause would apply only to a ground lease, it does not appear here.

- 2.1 *Acceptance of Rent.* If Landlord accepts any payment from Tenant after the Term expires, then Landlord shall credit it against any damages that Tenant may owe Landlord. By accepting that payment, Landlord shall not be deemed to have reinstated this Lease or to have agreed to continue or accept Tenant's tenancy or occupancy on any basis whatsoever. This paragraph constitutes "an agreement . . . providing otherwise" within the meaning of RPL § 232-c.¹²
- 2.2 *ACP-5 Form.* If legally required, Landlord shall, reasonably soon after Landlord has approved Tenant's plans and specifications for Tenant's Initial Work, give Tenant an ACP-5 form showing Tenant's Initial Work is not an "asbestos job."¹³
- 2.3 *Fee Estate Conveyance.* During any Construction by Tenant known to Landlord, Landlord shall immediately Notify Tenant of any conveyance of Landlord's interest in the Premises. Tenant shall, to the extent Law requires, comply with General Obligations Law § 5-322.2(1), which requires the "owner" of a building under Construction to notify

11 As another New-York-specific commercial leasing issue, if Landlord and Tenant disagree on whether certain defaults exist under a Lease, this dispute often results in a temporary restraining order or preliminary injunction to prevent Landlord from terminating the Lease, a so-called "Yellowstone injunction." The need for such an injunction arises from a somewhat arcane glitch in New York's landlord-tenant statute. CPLR 6301. That glitch has existed for at least 50 years and no one has fixed it. With a Yellowstone injunction in place, the court resolves the disagreement on whether a Lease default exists, and the parties then proceed accordingly. This would all work really well if the courts resolved the dispute quickly. Instead, the status quo gets preserved for an extraordinarily long time. For example, in the most recent "Yellowstone" proceeding involving one of the author's clients, the court took 26 months to rule against Tenant—26 months during which Landlord was stuck with a defaulting Tenant and enjoined from doing anything about it. This strange dynamic has achieved almost constitutional stature in New York. Great legal minds sometimes struggle to craft language to make the "Yellowstone" process work better, or not at all, but no standard language exists to solve the problem. Landlord-tenant courts would probably laugh at it anyway.

12 RPL § 232-c.

13 This paragraph applies in New York City assuming the usual allocation of responsibility on asbestos. To prepare and sign an ACP-5 form, Landlord first needs to see Tenant's plans and specifications. Tenant will often try to set a short deadline, e.g., five days.

the contractor, by certified mail, within five days after any conveyance of the underlying land.¹⁴

2.4 *Landmarks Preservation.* The Premises are subject to jurisdiction of the New York City Landmarks Preservation Commission (LPC). As required by New York City Administrative Code, Title 25, Chapter 3 and Rules of the City of New York Title 63 (R.C.N.Y.) (collectively, “LPC Law”), Tenant shall not in any way alter the Premises, as defined in LPC Law, without first complying with LPC Law. Tenant shall ascertain and comply with LPC Law requirements. Nothing in this paragraph limits any other Alteration restrictions in this Lease.¹⁵ Tenant shall promptly correct or at Landlord’s option reimburse Landlord’s cost to correct any threatened or actual violation of LPC Law Tenant causes.

2.5 *Modifications to Memorandum of Lease.* If the parties record a Memorandum of Lease, they shall execute, acknowledge and record an amendment to that Memorandum of Lease promptly after any amendment of this Lease, even if it changes nothing in the Memorandum of Lease.¹⁶

2.6 *No Implied Consent to Remaining in Possession.* If, after Tenant’s default in payment of Rent or under any notice from Landlord demanding payment of Rent or possession of the Premises, Landlord accepts any Rent payment, partial or complete, that shall not consti-

14 That’s what the words of the statute require. No available cases interpret the statute. The statute says nothing about consequences of any violation. GOL § 5-322.2(1).

15 New York City has a very extensive landmarks preservation program. For a substantial percentage of properties in the City, particularly in Manhattan, LPC acts as a second buildings department, with power to approve even the smallest change in a building. For example, if someone wants to install a sign in a landmarked building, the approvals process requires far more work than the sign. If LPC has landmarked only the exterior of a building, then delete the words “within or” in the second sentence. N.Y.C. Admin. Code tit. 25, ch. 3; R.C.N.Y. tit. 63.

16 New York law requires these additional recordings. Failure to record means the undisclosed Lease amendment does not bind third parties. Once the parties have decided to record a Memorandum of Lease, they then bear the burden of recording notice of any Lease amendment, whether or not germane to anything the Memorandum disclosed. Though this requirement sounds bizarre, it isn’t really; it means that once the parties have chosen to “go public,” anyone who searches the public record can rely on the public record. This may give Tenants a reason to disfavor Memoranda of Lease, especially after taking possession, because possession puts all parties on notice of all of Tenant’s rights. A Memorandum of Lease becomes unnecessary and potentially dangerous if the parties amend the Lease and forget to amend the Memorandum of Lease. Tenants typically do not record Memoranda of Lease, except for: (a) ground leases; (b) very large or institutional leases or (c) leases with significantly delayed delivery of possession. RPL § 291-c.

tute Landlord's "express consent in writing to permit the tenant to continue in possession" within the meaning of RPAPL § 711(2).¹⁷ Landlord shall not be deemed to have waived its right to commence and prosecute summary proceedings against Tenant under the Real Property Actions and Proceedings Law on that basis.¹⁸

2.7 *Prohibited Use.* As used in this Lease, the words "obscene" and "material" shall have the same meanings as in Penal Law § 235.00 (PL).¹⁹

2.8 *Sidewalks.* For any sidewalk this Lease requires Tenant to maintain or repair, Tenant shall perform Landlord's obligations, and shall Indemnify Landlord against any liability, under N.Y.C. Admin. Code § 7-210 and 211. Tenant shall maintain all insurance the cited sections require, naming Landlord as an additional insured.

2.9 *Stale Rent.* Tenant waives any right it might have to assert or claim a limit on the amount (or accrual period) of unpaid Rent that Landlord may seek to collect in a summary proceeding under RPAPL Article 7. If Tenant has failed to pay Rent for more than one month and believes or intends to assert that Tenant may suffer prejudice because of Landlord's failure to promptly exercise its remedies under this Lease for that nonpayment, Tenant shall Notify Landlord and ask Landlord to promptly exercise those remedies. Tenant assumes responsibility to fund appropriate reserves to prevent any surprise or prejudice that Tenant might otherwise suffer from any accumulation of unpaid Rent. Nothing in this paragraph limits Landlord's rights or remedies.²⁰

2.10 *Summary Dispossess.* Nothing in this Lease limits Landlord's right to commence and prosecute a summary dispossess proceeding under RPAPL Article 7.

17 RPAPL § 711(2).

18 This is a possible "overkill" provision designed to respond to occasional cases inferring that Landlord agreed to allow a defaulting Tenant to remain in possession.

19 PL § 235.00(1), (2).

20 Courts have used "stale rent" as a basis to kick Landlords out of court, though more often in residential than commercial cases. Failure to pay, continued long enough without action by Landlord, results in no further obligation to pay. This paragraph seeks to respond to that jurisprudence. Rather than use this language, Landlord would be well advised not to allow "stale rent" to accrue. *Marriott v. Shaw*, 151 Misc. 2d 938, 574 N.Y.S.2d 477 (1991).

2.11 *Untimely Exercise*. If this Lease gives Tenant any Option(s), Tenant acknowledges that if Tenant fails to exercise an Option in the Option Exercise Period, Landlord would inevitably suffer prejudice if Landlord were required to honor Tenant's untimely exercise. The amount of prejudice may be difficult or speculative for Landlord to establish. It could include, for example, Landlord's possible loss of the ability to relet the Premises to a new tenant of Landlord's choice at then-current market rates; expenditure of Landlord's time to seek replacement tenant(s) or to prepare the Premises for reoccupancy; costs of brokers; and other costs, expenses and expenditure of time, of Landlord. Tenant recognizes that Landlord's prejudice may not be demonstrable or provable in court. In recognition of that prejudice, if any court requires Landlord to accept an Option exercise outside the Option Exercise Period, then Landlord may require that the Rent under this Lease be adjusted to equal then-current fair market rent.²¹

[8.3] IV. GENERAL PROVISIONS

The general provisions collected here do not apply only to Leases. They could also apply to any other document governed by New York law. Some of these clauses might apply to all Leases, but don't always appear.

3.1 *Consumer Contract Statutes*. This Lease is not a "consumer contract" within the meaning of GOL § 5-327, or any other Law that applies only to transactions for personal, family or household purposes.²²

3.2 *Disputes*. If any litigation arises over this Lease: (a) if that litigation is heard in the Commercial Division, New York State Supreme Court, then the parties agree to application of the Court's accelerated procedures, Uniform Rules for the Supreme and County Courts (Rules of

21 This paragraph is nonstandard. It responds to New York cases allowing late exercise of Options based on the theory that late exercise causes no prejudice to Landlord. Whether or not an Option already contemplates fair market Rent, then perhaps Landlord should collect a fee for its trouble in dealing with any late exercise.

22 Ordinarily the nature of the transaction will be obvious. In those cases, this paragraph seems unnecessary. If uncertainty exists, this paragraph might help, but a court will probably still reach its own conclusion. So should counsel. Many special requirements apply to consumer contracts. For example, GOL § 5-327 says that if any consumer contract requires a consumer to pay the other party's legal fees, then that obligation automatically becomes mutual.

Practice for the Commercial Division § 202.70(g), Rule 9)²³ and (b) the parties shall promptly enter into and submit to the court, with a request to be “so-ordered,” a Stipulation and Order for the Production and Exchange of Confidential Information as promulgated by the New York City Bar Association Committee on State Courts of Superior Jurisdiction.²⁴

3.3 *Governing Law.* New York internal law, disregarding any law on conflict of laws, governs this Lease and any claims arising under it or from the parties’ relationship, whether in contract, in tort or otherwise, regardless of the location of any real property.²⁵

3.4 *Non-Business-Days.* If this Lease requires Tenant to pay any sum on any day that is not a Business Day then, notwithstanding any Law to the contrary, including General Construction Law § 25 (GCN),²⁶ Tenant shall not be credited for that payment until the date Tenant actually pays it.

3.5 *Notices.* Any attorney may give notice on behalf of his or her client.²⁷

23 These procedures, the so-called “Rocket Docket,” seek to limit discovery and streamline the litigation process. Ordinarily whichever party favors quick resolution of a dispute will want the special procedures to apply. They are by no means “industry standard” yet. N.Y. Unif. R. for Trial Cts. (22 N.Y.C.R.R.) § 202.70(g).

24 In any business litigation, though the parties will disagree on the facts, the law and other things, they will usually agree they want to preserve confidentiality. Thus they may already have every incentive to enter into a stipulation of this type. Still, the language suggested here may make sense, though it is not “market standard.”

25 If a transaction involves only New York real property and only parties located in New York, why might any other state’s law possibly apply? That is a great question. But most New York Leases do expressly choose New York law. They often also include a consent to jurisdiction and a consent to venue, both with generic language rather than anything New York-specific.

26 This statute allows payment on the next business day, but requires calculation of interest as if the payment were made on the non-business-day when due. For a large rent arrearage, the difference could matter. GCN § 25.

27 An unfortunate New York case held that attorneys could not give notice on behalf of their client because the notice recipient bargained for notice from the counterparty, not the attorney. Hence this sentence. That case has been widely ignored. *Siegel v. Kentucky Fried Chicken of Long Island, Inc.*, 108 A.D.2d 218, 488 N.Y.S.2d 744 (2d Dep’t 1985).

CHAPTER NINE

HIDDEN COSTS IN LANDLORD'S LEASE FORMS

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[9.0] I. INTRODUCTION

For the corporate tenants you represent, office space is a significant expense. For many companies it remains the second- or third-largest expense—after payroll costs. However, it can be unnecessarily expensive if a tenant fails to gain protection against the hidden costs and restrictions that are buried in many leases.

An important point to remember when negotiating an office lease is that your client's prospective landlord probably has the advantage. If you are like many lawyers, real estate may be just part of your practice—you may negotiate a lease of this type, or in this market, only occasionally. You are familiar with all the basic principles and issues. You treat a lease as a relatively routine matter. Your focus may be on avoiding extraordinary risk, alerting the tenant to lease conflicts with its non-real estate loan covenants, and other corporate issues.

The building owner, whose business is leasing space, is in a different position and buildings are its major asset. The landlord is highly motivated to plan for the long term and to write conservative, pro-landlord leases that maximize the return on its assets. Terms in the landlord's so-called "boilerplate" that may represent acceptable legal solutions can impose unnecessary costs on your client.

This presents an opportunity to provide additional value to your client. By fine-tuning your understanding of certain key business terms, you can help your clients reduce long-term costs and turn office leases into assets that provide flexibility to respond to changing business conditions. Here are some of the more obscure lease provisions that protect landlords at their tenants' expense—and give you the opportunity to provide additional value.

[9.1] II. THE SPACE

Office space priced per "rentable" square foot often turns out to be much more expensive than tenants expect because landlords may include space that tenants consider unusable. Normally, a tenant will be able to use only 75% to 90% of the space it pays for. This difference—the loss factor—depends on three things: the physical configuration of the offices, the landlord's method of measuring rentable area, and, increasingly, the landlord's whim.

Rentable area is sure to include a portion of elevators, janitors' closets, lobbies, stairways, and more. Fair enough. Be aware, however, that some buildings have a higher loss factor than others. Fancy curves or sharp angles, elevator banks placed in the center of the building instead of on the side, and an abundance of columns in a tenant's space contribute to a higher loss factor.

In addition, landlords often develop their own methods for measuring rentable area. A landlord may measure from the outside of one exterior wall to another, for example, and include questionably "public" areas like air shafts. Some buildings seem to be measured from gargoyle to gargoyle (facade ornaments unrelated to a tenant's usable space).

Beyond this, many landlords create an arbitrary loss factor. Once they've determined how big a space is, they just inflate the number by, say, 25%, and then call that the rentable area.

For instance, my firm completed an analysis of how building owners "re-measure" their buildings to increase reported rentable area not accompanied by any physical change. We studied 50 randomly selected buildings in mid-town Manhattan over a 15-year period, from 1990 to 2005. More than 33% of these buildings "grew"—without any change in physical area—by more than 5%. Several buildings grew by more than 20%. Although many, many buildings reported growth, only one building actually changed in any significant way in physical size. This building used development rights from another site to add space to an existing structure. Taking into account the reported increase in rentable area where no real growth occurred, and then-current asking rents for such space, the revenue at stake was significant. Extrapolated to the entire Manhattan market, the annual increase in revenue for landlords, as of early 2006, was estimated at \$387 million—all from an increase in quoted rentable area which had no physical counterpart. And, while Manhattan may be an exemplar of this technique, similar practices can be found nationwide. So understanding the issue really can make a difference to your clients. To help your clients protect themselves, you may recommend that they hire an architect or tenant advisor to measure the space they plan to lease and advise whether the *usable* area will satisfy their business's needs. The tenant advisor should use a generally accepted standard, like that adopted by the Building Owners and Managers Association, so the prospective tenant can precisely compare one space with another.

Then, whatever number the landlord uses, your client will know how much he or she will be paying per usable square foot, and will have a

more informed basis for negotiation. In some markets, the loss factor—the difference between rentable and usable area—may be negotiable. A landlord may agree to reduce the loss factor on your unit or to make a trade-off. As an example negotiation: The landlord agreed to reduce the loss factor for a tenant from 18% to 15%, provided that the tenant accept within its premises about 65 square feet that otherwise would have been common corridor. On this 20,000-square-foot suburban transaction at a mid-\$20s rent, the tenant kept the same usable area (i.e., the same functionality) but, because of the reduced loss factor, reduced the nominal rentable area by about 600 square feet. This saved the tenant approximately \$130,000 over the lease term.

The best protection against excessive loss factors remains comparison. While loss factors are often excessive, they are not uniformly so. Tenants who understand their value, look for differences in the marketplace, and accurately factor these differences into their decision making will reduce occupancy costs. You can help guide your clients to a knowledgeable advisor in this area.

On lease renewal, the tenant may also find that the landlord has “remeasured” the space and now claims it is much larger. In one instance, a well-known Manhattan landlord told a tenant that the tenant’s space had grown 20%, and also demanded a higher rent per square foot—a double blow.

[9.2] III. OPERATING EXPENSES— THE TRICKIEST CLAUSE

An operating expense clause permits building ownership to recover normal out-of-pocket costs of running a building. That should be all it does. Operating expenses listed in a tenant’s annual billing statement should correspond directly to benefits the tenant receives under the lease, and they ought to meet an objective standard such as GAAP (generally accepted accounting principles), not conventions particular to a given landlord.

When representing tenants in this aspect of lease negotiations, insist on a precise and limited definition of the items to be included. Landlords sometimes use the operating expense clause as a profit center; in other cases, operating expenses become a convenient source of reserve funds. If you approve a catch-all clause, which many landlords argue is necessary, it can become a blank check for the landlord to draw on your client’s account. Your client may be billed for charges that have little to do with

running a building. And, as you well know, ambiguity is likely to increase the risk of litigation your client faces.

Here are key factors to consider when negotiating an operating expense clause to protect your client:

[9.3] A. Umbrella or Enabling Clause

The initial portion of the operating expense clause functions as an overarching definition of what may be billed as operating expenses. Negotiate this so that it is appropriately narrow and linked to objective standards.

[9.4] B. Exclusions

Certain items—which might otherwise be permitted by the enabling clause, or which simply have a propensity to cause problems, or for which your client wants extra assurances that it will not pay—should be specifically excluded from operating expenses. For example:

1. electricity that serves tenants' spaces (the landlord recovers this from each tenant individually);
2. executive salaries;
3. consulting fees;
4. market study fees;
5. commissions and advertising costs;
6. initial landscaping costs;
7. structural repairs or replacements;
8. penalties incurred because the landlord failed to pay taxes on time;
9. fees and higher interest charges caused by the landlord's refinancing of the property;
10. money the landlord must pay if it defaults under a lease or other agreement;
11. any legal fees to resolve disputes involving the landlord;

12. any excessive amount the landlord pays a contractor or vendor because of a special relationship;
13. the cost of above-standard facilities or services provided to other tenants;
14. new items added after the base year; and
15. all reimbursements of expenses that would otherwise be included in operating expenses.

In negotiating exclusions from an operating expense clause, it's important to consider the nature of the building and its systems, their age, the operations of other significant tenants in the building, and similar matters. The better a tenant can anticipate the expenses a landlord may incur over the life of the lease (and advise you of same), the more likely you will be able to effectively exclude from billable operating expenses those which are improper. Many of the most important exclusions will be particular to a given building or lease or relate to the tenant's particular operations, so be sure to work closely with your client's real estate advisor in this area.

[9.5] C. Capital Improvements

Capital expenditures require particular attention when you're negotiating a lease. The operating expense clause should exclude them generally from the operating expenses for which your client will be billed.

Barclay's Bank in New York got a repair bill after its landlord, Panel Realty Company, installed a new air conditioning system. Barclay's refused to pay, and the case ended up in court. The bank's lease required the landlord to make all structural repairs. The bank was responsible for its share of all other building maintenance and repairs, including repairs to the air conditioning system. The court reasoned that replacing the system goes beyond traditional notions of repair. This was a capital expenditure that Panel Realty couldn't pass on to Barclay's. While the bank won, it had taken needless risk because its lease didn't make the landlord responsible for capital expenditures.¹

Remember, however, that if your client enters into a net lease—taking, for instance, an entire building for its use—and agrees to be responsible for “maintaining” the building, that client may unwittingly be agreeing to

1 *Panel Realty Co. v. Barclay's Bank of N.Y.*, 130 A.D.2d 427, 514 N.Y.S.2d 1010 (1st Dep't 1987).

be responsible for structural repairs. Like everything else, this can be negotiated to appropriately limit your client's liabilities. Foremost among your considerations in this situation will be the age and nature of the structure and special tenant uses that may stress the building or its systems and increase the likely need for structural repairs or capital improvements. This means that even in the case of a single-tenant occupant, net lease, it remains important to define what will be considered structural, and to be especially clear if your client's business objective is to exclude structural repairs from its obligations.² Work closely with your tenant's real estate advisor on these issues.

Even with an exclusion, substantial capital expenditures—artfully relabeled—can find their way into a tenant's operating expense charges if you're not careful. For instance, a lease may require your client to pay for equipment rentals. This is a common technique for converting capital expenditures into expenses that are passed on to the tenant. Your client should agree to pay for equipment rentals only if they're not a substitute for capital equipment the landlord would otherwise have to buy. Tenants should be on the lookout for charges like this because tax law often makes equipment leasing more attractive to landlords than buying.

Certain capital improvements (like new, more efficient elevators or a new HVAC system) are supposed to reduce the cost of running the building and thus become operating expenses which a landlord passes on to a tenant. Such capital expenditures normally are not included in operating expenses. Landlords often insist, however, that tenants absorb a portion of the cost. To protect your client, take four important steps.

First, work with the tenant's real estate advisor and determine if the landlord currently plans to make specific cost-reducing upgrades. You may be able to exclude these known, planned expenses in their entirety. Second, as for future cost-saving capital expenditures the landlord may make, include in the lease a requirement that savings be demonstrated before such expenditures may be billed as operating expenses. Third, to the extent such expenditures may be billed as operating expenses, work with the tenant's advisor to determine appropriate amortization formulas and interest rates to be allowed (if any) based on the nature of the building and prevailing market practices. Finally, make sure that any amount which may be billed is always less than the demonstrable savings realized that

2 *1833 Assocs. v. Fryling Carpets Co., Inc.*, 156 Misc.2d 696, 594 N.Y.S.2d 121 (Civ. Ct., N.Y. Co. 1992).

year. These steps will help assure that your client's operating expenses are never greater than they would have been without the cost-saving improvement.

[9.6] D. Double-Dipping

The landlord's costs of running separate income-producing parts of the building should be excluded from operating expenses—or the costs permitted into operating expenses—only after the income they generate is deducted from your client's billable operating expenses. This goes for sundry shops, coffee shops, observation decks, recycling operations, and so on. If the building has a garage, the building owner likely charges tenants and the public for parking spaces, but the cost of operating the parking garage may also be included among the tenants' operating expenses. If a tenant's lease doesn't specifically exclude this cost, the building owner has a good argument for billing your client.

Perhaps the most common area for double-dipping is labor costs. Tenants are routinely billed for episodic services provided by building staff, and 100% of staff salaries are also billed as operating expenses. For instance, one tenant in a large office building reserved the freight elevator each morning for early morning deliveries to its cafeteria, and paid a fee to cover all expenses for this special service. At the same time, the landlord included in operating expenses billed to the tenant who used the elevator—and all others in the building—overtime labor charges for the engineers required to handle the elevator's early morning runs. This is a clear example of double-dipping; the landlord was paid twice for the same services. Work with your tenant's advisor to understand how a particular building or landlord's method of operating a building exposes your client to double-dipping risks and then seek to exclude or limit these excess charges.

[9.7] E. Electricity

For many tenants, electricity is one of the biggest operating expenses. Landlords who want to augment their revenues without quoting a higher rent often use the electricity clause as a profit center, inflating the already substantial cost for this essential service. Help your clients ensure that a building owner's profit center does not unnecessarily increase their rent. Multi-tenant office buildings, whether central business district or suburban, typically provide that tenants will pay for electricity in one of three ways: (1) direct metering, (2) submetering, or (3) rent inclusion.

Direct metering is straightforward and may be the least costly for most tenants. When only one meter in a building connects to the utility, the tenant or its landlord may install a separate meter to measure the electricity used by a particular tenant. In this situation, the landlord pays the utility company and the tenant pays the landlord. This method, called “sub-metering,” can provide a tenant with less-costly electricity, provided the tenant knows what to ask for. If building ownership can buy electricity at low bulk rates, you should bargain for your tenant to receive the benefit of that lower rate. Landlord draft leases often say the tenant will be billed “in accordance with” a utility’s published rate schedule. This may mean the landlord will charge your client the highest rate that would apply to its own consumption and pocket the difference. Particular areas of concern in dealing with sub-metered electricity are to ensure that your client is billed only for its own consumption, accurately measured, and to ensure that the demand component of the electrical charges is not permitted to artificially increase your client’s electrical bills. Some building owners seek to add an administrative fee to sub-metered electric charges. This fee commonly ranges from 3% to 12% of the amount billed, and is generally unjustified. The most common ongoing cost associated with sub-metering is monthly meter reading, which often costs less than \$30/month (2006), and can often be accomplished through online monitoring at a fraction of this cost. The purported administrative fee is a profit center and should be avoided.

So-called “rent inclusion” is the riskiest option for tenants. The landlord usually estimates a tenant’s electrical usage by looking at installed or planned-for office equipment and asking how many hours the tenant uses each piece of equipment in a typical day or week. Alternatively, the landlord’s proposed lease may permit ownership to assume that a tenant uses each piece of equipment at maximum capacity eight hours per day, five days per week. Such estimates are inherently less certain than measuring the amount of electricity a tenant uses. On one Manhattan block, the basic rate landlords charge for electricity by this method varies by more than 30%.

Be wary of such estimates for another reason. They may include a substantial “safety factor” that needlessly increases your client’s costs. For instance, suppose your client’s landlord pays \$2.25 per square foot for electricity, but adds \$2.75 a square foot to the base rent (this is the “rent inclusion”). A 10% rate increase would raise your client’s electricity charges to \$3.02 per square foot, and the landlord’s profit would grow from 50 cents to 55 cents per square foot per year. If your client leases 100,000 square feet—that extra 5 cents alone would cost \$50,000 over a

10-year lease term. The landlord's total profit on this tenant's electricity usage is \$550,000—and that's assuming no further increases.

Can the landlord cut off your client's electricity? Leases used throughout the country often allow a landlord to do this on short notice—leaving a tenant to deal directly with a utility. Landlords usually insist that they need this flexibility to operate their buildings. But a tenant forced to make its own arrangements for electricity is likely to find this expensive and time-consuming. It may require much interior work—like new risers, conduits, and wiring—which, incidentally, are capital in nature and which the lease may not give your tenant the right to install. Such clauses also would require tenants to perform work outside their own premises, perhaps with a requirement to obtain consent from other tenants for access and alternatives, and with liability for damage to other building systems' and other tenants' systems and property. Landlords have used such clauses to gain leverage when dealing with unrelated matters.

Deregulation of electricity presents your client with additional issues related to utility supply. A building owner may reserve the right (or where a lease is silent, may claim that it has the right) to change utility providers from time to time. Building ownership may do this to benefit from bulk purchase arrangements, to benefit from reduced rates for common area electrical services, or for other reasons. But the result for a tenant may be disruption or inferior supply, with no compensating advantage.

Depending on the nature of your client's operations, it may be appropriate to limit building ownership's choice of utility suppliers, and how and when they make any substitutions to minimize cost and disruption to your client. In some circumstances, it may be appropriate to reserve this right for the tenant alone, or to give the tenant an independent right to choose utility suppliers. Work closely with your client's real estate advisor on this issue.

In protecting your clients from excess operating expenses, inappropriate capital expenditures, excess utility costs and the like, one of the most important assets is good information about the building where a lease will be signed. You may find it worthwhile to encourage your client to retain an architect or engineer to perform a limited feasibility study. A few thousand dollars spent before a lease is signed to identify potential problems can save many thousands of dollars over the life of the lease. A tenant considering a 40,000-square-foot lease retained an architect to perform a feasibility study. They learned that the HVAC units serving their space were 12 years old. Such units have an expected life of about 10 years. The

tenant then negotiated to make replacing these units part of landlord's initial work—saving themselves money, disruption and potential disputes over inadequate service later on.

[9.8] IV. RENT INCREASES

[9.9] A. Base Year

Office tenants generally must pay the increase in building operating expenses and real estate taxes measured over some base point—either a base year or an expense stop. These escalations can easily outstrip the base rent, and courts will generally enforce the provisions in a lease your client signs, regardless of how much the rent may increase over the years. During the last decade, we have seen low inflation, and therefore relatively low escalation increases, but this has not been the case historically, and real estate markets tend to be cyclic. So it's important to understand the mechanics of escalation formulas.

The “base year” is generally considered to be the first 12 months a tenant occupies the space. The expense “stop” is a number representing average, reasonable operating expenses per square foot during those first 12 months. Because the “stop” or “base year amount” is the threshold against which each subsequent year's increases are measured, if your client agrees to an early base year or an expense stop that's too low, the landlord will get higher profits every year of the lease. Landlords sometimes argue that the base year should be the 12 months preceding occupancy, but that would mean the tenant would face a rent increase on the day it moved in.

If a tenant is leasing space in a building that has been functioning for a while, the previous 12 months' operating expenses are a good basis for estimating the expense stop, but these tenants will want to have their tenant advisors check their building's vacancy level. A building with high vacancies will typically have lower expenses, and an appropriate adjustment would be necessary to develop a valid expense stop or base year. Next, your client's tenant advisor should check the estimate with management companies that handle similar buildings or a reliable database of actual building expense data to see if the chosen building's expenses are within normal range for that type and size of building in that particular market. The experience of comparable buildings is also a good source if the building is new or if for some reason you don't have access to its expense history.

[9.10] B. Fair Share

Rent escalation formulas, whether tied to direct operating expenses or to an index (see the next section), should limit the tenant's obligation to pay a fair share of a building's total costs. Usually this means that a tenant will be responsible for expenses in proportion to how much of the building it leases.

Watch out. Some leases make the building's "rented" area (rather than "rentable" area) the denominator in the fraction. This means that the tenant, not the landlord, would pay operating expenses for the building's vacant areas. If the landlord adds floors or converts storage or basement space to office space (thereby adding to the rentable area), the fraction used to determine the tenant's share of the building's expenses should reflect this. Bear in mind that landlords sometimes "re-measure" buildings during the course of a given lease term—as other leases come due. Therefore, at any given time, the landlord may be using more than one measuring standard at a single building. Because of this, it's sometimes helpful to specify during lease negotiations that all tenant shares must add up to no more than 100%, and that building ownership may not collect more than 100% of actual operating expenses.

And be alert for clauses that don't clearly spell out how the landlord will calculate your client's share of the building's area. In one case involving a ground-floor tenant whose lease did not contain a formula, a Pennsylvania court decided that the tenant should pay escalations in the same proportion as its rent to the total rent roll.³ A bad deal for the tenant. Ground-floor space often costs more than double the cost-per-square-foot of office space on upper floors, but ground-floor tenants get no more services.

[9.11] C. Indexing the Rent

As an alternative to a complex operating expense clause, some landlords index their rents. This lets landlords keep their books private. It also saves tenants from a costly, time-consuming review of expenses that may produce legitimate disagreement.

But be wary. There are a variety of indices, with many subtle variations, in common use and their behavior can vary substantially. It's surprisingly common for even large, sophisticated companies to be hit by

3 *Pittsburgh Allied Fabricators, Inc. v. Haber*, 271 A.2d 217 (Pa. 1970).

higher rent escalations than they anticipated. In 1969, for instance, Avon Products signed a 27-year lease for nearly half of a 50-story tower in Manhattan. Avon's rent increases were tied to the "porter's wage"—hourly wage and fringe benefits hikes that certain employees receive under a union contract. Because the contract calculated fringe benefits on a weekly or yearly basis, Avon's landlord, Sheldon Solow, had to translate these fringe benefits into an hourly rate.

For 10 years, Solow assumed, for the purpose of his calculations, that the union employees worked a 40-hour week. But in 1980, Solow notified Avon that he was revising his calculations to base them on the actual hours employees worked—31 hours a week. The effect on Avon was dramatic: its rent would jump \$780,000 a year, more than \$13.5 million over the remaining life of the lease.

In 1981, Avon sued Solow over the increase, but the case was tossed out. The judge ruled that the lease required the parties to settle by arbitration. This triggered procedural skirmishes and arbitration proceedings that continued—with the help of very costly counsel—for about a dozen years. In two proceedings alone, the litigation produced more than 5,000 pages—10 volumes of material. The matter was ultimately settled in a confidential arbitration.

Any tenant is going to feel a loss after years of litigating and arbitrating what should be a straightforward agreement to maintain space for its business operations. Above all, this shows the need to understand the potential effects of escalation formulas and the high cost of ambiguity. Consult closely with the tenant's real estate advisor to gain a complete understanding of the nuances of escalation formulas which building owners may propose. Be skeptical if anyone tells you such indexed escalation formulas are simple. One way to help your client avoid a predicament like Avon's is to include a sample calculation in the lease.⁴

The most common escalation formulas link rent increases to the Consumer Price Index. The CPI measures the cost of food, clothing, recreation, residential rents, and other goods and services, but has no component relating to commercial rents. The components of an index like this may increase far more than the general inflation rate or the cost of running a building.

4 *Avon Prods., Inc. v. Solow*, 150 A.D.2d 236, 541 N.Y.S.2d 406 (1st Dep't 1989).

The CPI-W, a national index, covers only urban wage earners and clerical workers. The CPI-U covers all urban consumers. The CPI-U is generally favored as an index for rent escalation because it covers about twice as many people and is less volatile.

If your city is covered by one of the 27 metropolitan or regional CPI indices, your client's prospective landlord may propose linking the rent to a local index, rather than to the more general CPI-U. But the regional CPIs are generally published less frequently, based on smaller samples, much more volatile and, depending on the local economy, may fluctuate in ways entirely unrelated to the cost of running a building.

Another common gauge, the Producer Price Index, is also highly volatile. It measures changes in large quantities of certain commodities at the wholesale level. During the 1970s, when metals and petroleum products made the index rise dramatically, landlords benefitted from the index. One group of Florida tenants sued their landlord, claiming that the use of this index was unconscionable. The court turned them away.⁵

A New York City tenant sued its landlord with a similar argument. It claimed that its rent increases, linked to a local union contract rather than the landlord's actual costs, were so high that the court should rewrite the lease. The court declined, stating that indexing is a common method of increasing rents, and that the tenant assumed the risk it now sought to avoid after the fact.⁶ It is perhaps worth noting that courts continue, overwhelmingly, to adhere to this long-standing principle. The *Backer* case cited above has been followed in five cases, cited in 204 court decisions, and another 38 statutes, law review articles, ALR annotations and treatises. The message is clear. Tenants should be well advised when negotiating escalation formulas and other non-rent increases. Courts generally insist that parties adhere to the bargains they negotiated.

[9.12] D. Overlapping Escalation Formulas

If your client's landlord indexes base rent in addition to passing through certain operating expenses like fuel, electricity, and real estate taxes, you should negotiate for a partial-CPI, porter's wage formula, or other indexed increase. Otherwise, your client will pay twice for those increases.

5 *Sea Tower Apts., Inc. v. Century Nat'l Bank*, 406 So. 2d 69 (Fla. Dist. Ct. App. 1981).

6 *George Backer Mgmt. Corp. v. Acme Quilting Co., Inc.*, 46 N.Y.2d 211, 413 N.Y.S.2d 135 (1978).

[9.13] E. Disappearing Indices

The CPI has been “re-based” several times over the years, and its components have changed. Several regional CPI indices in common use have been eliminated. The porter’s wage clause, linked to a New York City labor contract, has seen significant changes in composition as categories of workers have been added and eliminated. All these changes can significantly and unexpectedly affect the amount of rent your client pays. One corporate tenant agreed to a CPI increase linked to a Washington, D.C.-area index. The Bureau of Labor Statistics eliminated that index during the term of the tenant’s lease and building ownership proposed to substitute a newly created regional index covering a larger and economically different geographic area. The use of this new index instead of a national index threatened to significantly increase the tenant’s escalation bills. When your client agrees to link rent increases to an index, plan ahead for an alternative and preserve for your client a right to veto a new or changed index which may be inappropriate.

[9.14] V. REAL ESTATE TAXES

In general, real estate taxes are the landlord’s legal responsibility; a tenant becomes liable only for the taxes that it specifically agrees to pay as a result of lease negotiations. Like the operating expense clause, however, a real estate tax clause can be used as a catch-all to cover additional charges. Help your client control occupancy costs by limiting what building ownership may include in billable real estate taxes.

First, limit your client’s obligations to (1) real estate taxes, or (2) taxes a community may impose *instead of* real estate taxes. A lease should protect your client from paying a landlord’s income taxes, corporate taxes, taxes on rents and gross receipts, inheritance taxes, capital gains taxes, and payroll taxes. Be careful about language that tries to make your client responsible for undefined taxes that a government authority might impose some time. One tenant who failed to do this many years ago wound up paying its landlord’s income taxes after the Sixteenth Amendment initiated them.⁷ New taxes are constantly being proposed—Hartford, Connecticut once considered imposing a “view tax” on office buildings near the Capitol building—this is the kind of thing your clients will thank you for helping them avoid. Taxes related to income or the value of an asset, which may be substituted for real estate taxes, require special consider-

⁷ *N.Y. Cent. R.R. Co. v. N.Y. & Harlem R.R. Co.*, 185 Misc. 420, 56 N.Y.S.2d 712 (1945), *aff’d*, 272 A.D. 870, 72 N.Y.S.2d 404 (1947), *aff’d*, 297 N.Y. 820 (1948).

ation. For instance, during the 2006 legislative session, Texas amended its property tax code to include franchise taxes as a substitute for real estate taxes formerly billed. This could subject tenants to tax on items which have no relationship to ad valorem taxes or the building where they are located. In such a situation, it's wise to negotiate a limitation so that, for purposes of the lease, any such franchise tax must be calculated as if the building where the tenant is located is the landlord's sole asset.

Pay attention to special assessments to see if building ownership proposes to include them in billable real estate taxes—charges for new sidewalks, new sewer lines, and so on. These are a species of capital improvement and courts have told landlords repeatedly that special assessments aren't real estate taxes. While including such special assessments as part of defined, billable real estate taxes has become common, whether this is appropriate must be assessed at each building or in each locality where your client is considering a lease. Work closely with your client's real estate advisor on this one. If known or reasonably anticipated special assessments would add significantly to your client's rent, it may be appropriate to exclude them, limit them, or move on to a different location. Special assessments which your client may agree to include should always be limited, and building ownership should be required to pay for them over the longest time permitted by law. Otherwise, by paying assessments as part of its tax bill, your client is giving the landlord more than it bargained for.

Landlords in some areas seek to bill Business Improvement District (BID) fees as part of real estate taxes. BID fees are not real estate taxes, and this can be a back-door way of including capital expenditures, promotional programs, and executive salaries in the rent. These would be excluded by well-negotiated operating expense terms. Other problems arise when BID fees are instituted during the course of a lease. Aside from the fact that they are not taxes, they are not in your client's base year, so the "increase" is actually 100% of the cost, and occupancy costs become excessive and markedly uncompetitive compared to what other tenants are paying.

In some situations, a building owner will contest high taxes to enhance the property's value. Make sure the lease your client signs entitles it to the benefit of any tax reduction building ownership or other tenants may gain after they've recouped their expenses.

[9.15] VI. ALTERATIONS, MAINTENANCE, AND REPAIR

[9.16] A. Alterations

The building owner's proposed alterations-and-improvements clause may give your client a false sense of security. It may say that your client can make whatever non-structural changes it likes and that it may also make structural changes, provided only that the tenant first obtain the landlord's permission, and that the landlord will be "reasonable." But courts have ruled that things as trivial as lighting fixtures are "structural" components of a building. So a seemingly liberal clause like this could make it impossible for a tenant to move even a single partition.

If your client and building ownership disagree about what's structural, after your client has made a "non-structural" change, the landlord may declare your client in default under the lease, even though the changes seemed quite reasonable to your client and necessary for its operations. In such a situation, the tenant may be presented with the unpleasant option of paying a big bill at the end of the lease term or restoring so-called structural changes.

With this type of lease structure, define what is meant by structural elements. Limit the definition to components like bearing walls, columns, roof, and facade. And negotiate for the client to have the right to make alterations and improvements inside its space, without the landlord's permission, so long as these changes don't affect the few agreed-upon structural elements or the systems that deliver electricity and utilities to other tenants in the building.

The procedures that govern alterations and improvements also have a substantial effect on your client's costs and ability to use their space effectively. Most leases require a tenant to submit plans and specifications for landlord's review before proceeding with alterations. Limit the time for review to a reasonable period, and negotiate to require that any rejection of the tenant's plans and specifications be accompanied by a written explanation. Negotiate an adequate remedy; if ownership fails to meet the agreed-upon time limits or provide a reasonably detailed explanation of any rejection, tenant's plans will be deemed approved. An open-ended procedure can be extremely costly to a tenant, both in increased construction costs and impediments to business operations. The time to avoid these problems is when you are negotiating the lease. Another way a landlord can significantly increase your client's cost of alterations and limit its

business flexibility is by limiting the contractors that may be used. Always insist that your client have the right to competitively bid all trades. One acceptable way to achieve this (when a landlord insists upon some measure of control for safety, insurance, or quality reasons) is to insist upon your client's being able to choose from a selection of contractors for each trade who are not affiliated with the landlord.

Also be aware that many landlords will object to allowing a tenant to choose its own contractors because (they say) they are concerned about labor harmony. There is no need for a tenant to give up important rights to control costs and achieve accountability for this reason. Increasingly, even in strongly union-oriented markets, construction jobs are run on an open-shop basis with union and non-union trades working side by side. The key here is often a strong, effective general contractor. Work closely with your tenant's real estate advisor on this issue, as well. Effective negotiation of the alterations-and-improvements component of a lease can reduce tenant build-out costs by as much as 30%.

[9.17] B. Maintenance

In a typical multi-tenant office building, the landlord will be responsible for repairing certain listed items—usually structural elements, the exterior, and parts of the building's common areas. Your client will be responsible for maintaining and repairing everything in its space.

What happens when something outside the tenant's space has to be repaired and isn't among the items that building ownership promised to take care of? Your client may have to pay for the repairs. Whether it pays or suffers the consequences of disrepair, your client may have no recourse to the landlord, even if the problem makes the space unusable.

The best remedy: Make sure your client's responsibilities are specified and limited. The landlord should be obligated to take care of everything that your client is not.

[9.18] C. Wear and Tear

A well-negotiated lease should at least stipulate that your client is not responsible for repairing normal wear and tear. Some landlords require tenants to "restore" their leased space when they leave. Advise your client against agreeing to such an arrangement. Since almost every tenant has needs that require modification of the space it moves into and building ownership will have to demolish the old installation and rebuild to attract

a new tenant, agreeing to restore the space simply obligates your client to bear costs that building ownership must normally incur.

[9.19] VII. CASUALTIES AND CATASTROPHES

[9.20] A. Casualties

Many leases have clauses allowing the landlord to terminate the lease after a minor casualty affecting the building, even though your client's space remains quite usable. This clause gives the landlord an opportunity to force tenants out in a rising market or to force tenants to renegotiate unrelated parts of their leases before it will agree to restore the damage. It also exposes your tenant to a loss of its improvements and the value of the lease if the landlord's lender refuses to allow insurance proceeds to be used for rebuilding after such a casualty.

Negotiate your client's lease to ensure that the building owner is obligated to restore the building and your client's space after a casualty if the work can be done in a reasonable time. Work closely with your client's real estate advisor to determine a reasonable time for restoring the space given the nature of the installation, the needs of the operation, and customary build-out times in the marketplace. Your client should have the right to walk if the damage is so severe that the space can't be restored at all, or within a time that's reasonable, given its business needs. Without this right, your client could be compelled to wait for an unreasonable period as ownership debates whether to (or attempts to) restore the space, and could ultimately have to continue paying rent even though it has leased other space.

A doctor in Suffolk County, New York, signed an eight-year lease for office space. Less than a year later, the building burned down. The landlord sued to keep collecting rent and won, even though he had no obligation to repair the building. New York law would have protected the doctor against this kind of thing, but the lease contained a clause providing that rent wouldn't abate and that his responsibility under the lease would continue even if a casualty destroyed the building. In effect, the doctor signed away his legal rights.⁸ Dr. Nachamie argued that forcing him to pay rent on space he couldn't use was unconscionable, but this and subsequent courts have routinely rejected such arguments. The tenant had many

⁸ *Rodriguez v. Nachamie*, 57 A.D.2d 920, 395 N.Y.S.2d 51 (2d Dep't 1977); *Schwartz, Karlan & Gutstein v. 271 Venture*, 172 A.D.2d 226, 568 N.Y.S.2d 72 (1st Dep't 1991); *RVC Assocs. v. Rockville Anesthesia Grp.*, 267 A.D.2d 370, 700 N.Y.S.2d 231 (2d Dep't 1999).

choices available to him when he signed the lease. After signing, he would have to live with the bargain he had made.

To protect your client against a casualty, it's also essential to ensure that the landlord will have enough money on hand to restore the property. Negotiate to require the landlord to carry adequate insurance and to assure that insurance proceeds must be used first to restore damage and not to pay down mortgages or other debt.

[9.21] B. Other Catastrophes—Off-Site Events

Casualties traditionally include events like fires, floods, hurricanes and the like, and assume at least some physical damage to your client's building if not their premises. In addition to casualties, off-site events which have no direct physical impact on your client's building or premises can wreak financial havoc, and leave your client obligated to pay rent on space that they cannot use or sometimes even access. Typical examples of such off-premises events include malfunction of a utility company's transformers or other equipment so that your client's space has no service, e.g., the blackout that incapacitated much of the East Coast of the United States in August 2004, water main breaks off-premises that result in loss of water and plumbing services to a tenant's premises, and events that curtail access to buildings, such as those in New Orleans that could not be entered after Hurricane Katrina, even though they were physically unharmed, because the entire surrounding area had been declared off-limits by local authorities.

To protect your client against excessive real-estate related costs from such events, it's important to define the concept of essential services and provide remedies if your client's space will be without essential services for any prolonged period—whether or not such cessation results from a casualty.

[9.22] VIII. ESCAPES AND EXTENSIONS

If the lease your client's prospective landlord proposes says nothing about subleasing or assignments, your client is free to do either. This, however, would be a rare find in almost any U.S. market. Even in the case of long-term, single-occupant, net lease, landlords typically try to restrict a tenant's sublease rights. Most landlords are acutely aware of the profit potential subleasing and assignment may offer a tenant. Usually, they're also concerned about controlling the character and quality of tenants in their buildings. Often a landlord's proposed lease flatly prohibits a tenant

from assigning or subleasing its space. In a variation that is little better, unless well negotiated, landlords will permit subleasing or assigning only with their consent, and they'll agree to be "reasonable."

[9.23] A. Subleasing

Flexibility could be crucial to your client's business in a changing and competitive business environment. Unless your client leases a tiny space or takes a very short lease-term—less than three years, for instance—negotiate for your client the right to sublease part of its space without the landlord's approval. This allows a tenant to warehouse unneeded space but gives it the option of easily regaining the space from the subtenant.

In a very common approach to subleasing, the landlord's draft lease requires ownership's consent before a tenant may sublease and provides that the landlord must be "reasonable." Define what this means. Companies interested in subleasing space are often looking for a quick, ready-to-go solution to their space needs. Prospective subtenants probably won't wait while your client wrangles with the landlord over the terms under which it can sublease, nor do subtenants wish to walk into an adversarial situation. They will just move on to other choices. Accordingly, the landlord's rejection of prospective subtenants should be for limited, objective reasons—like financial inability to handle sublease payments (a common component of "reasonableness," though arguably irrelevant) or a use inconsistent with that of other tenants in the building. Also limit the landlord's time to decide on any proposed subtenant. A "yes" that comes too late will cost your client a subtenant as surely as a "no."

Whether your client is required to turn over 100% of sublease profits or only a portion, define sublease profits to make sure it can recover expenses before any so-called profit must be paid. A tenant must be able to deduct from rents it receives any expenses like advertising, brokerage commissions, the cost of negotiating and drafting the lease, and concessions like free rent, carpeting, and painting—as well as the unamortized cost of its own improvements in the subleased space. Work with the tenant's real estate advisor to ensure that you have a full picture of expenses your client may incur, based on the nature of its operations and the building where it intends to locate.

Also negotiate the right for your client to deduct rent paid while the space sits vacant as it tries to sublease it. A tenant that is obligated to share sublease profits should agree to pay the landlord only when and if it actually receives income. If the subtenant defaults, leaving your client

without a promised income stream, your client won't want to be obligated to pay illusory profit to building ownership. For the same reason, negotiate a right for your client to recover expenses in full before "profits" are paid. Your client incurred all expenses up front and should be able to recover them in this manner.

Some landlords will insist on the right to take back space your client may want to sublease at some time during the lease term. This allows a landlord to regain desirable space in a rising market and rent the space out itself, perhaps negotiating a longer term with another tenant. If your client agrees to a lease term like this, make sure the landlord is limited to taking back only the space your client wants to sublease, not the entire premises, and only for the time that your client wants to sublease it.

Make sure, too, that if the landlord recaptures space for whatever benefit it wishes to enjoy—100% of the profit or other advantage—the landlord pays all the costs associated with the recaptured space, including brokerage commissions that may be due from your client and costs of demising or altering the space. Be aware that if you agree to a recapture provision and ownership will not pay brokerage commissions on space it takes back, your client will be left with a large expense and no opportunity to recover it.

If your client's operations are in any way regulated, be sure to allow for this in negotiating sublease rights. For instance, if certain activities can only be performed by licensed professionals or a specifically licensed entity, provide that your client can sublease a designated portion of its space—10%, 20%, or whatever might be appropriate—to such an entity without landlord approval and without any of the restrictions or obligations that might otherwise accompany a sublease.

[9.24] B. Assignment

Protect your clients especially from leases that flatly prohibit assignments or give a prospective landlord unfettered discretion to prohibit one. In many cases, a merger or acquisition will result in an assignment when the lease is transferred to a new legal entity. This means your client could be in technical default, and it could enable the landlord to force your client out of the space—especially in a rising market, or if the preferred use for this type of space has changed.

The landlord also may try to impose capitalization requirements on an assignee—demanding, for example, that any potential merger partner

have assets at least equal to those of your client. Yet, in a merger, your client may not be in control. We can all think of recent mergers or acquisitions when the acquirer was smaller than the company it acquired. Similarly, building ownership may seek to impose a requirement that any subsidiary to which your client assigns its lease have assets as solid as those of the original tenant. But subsidiaries are seldom as well-endowed as their parent companies. A clause like this seriously hampers your client's business flexibility, especially if the landlord requires it to remain primarily liable even after the assignment.

Make sure your client can assign to any subsidiary or affiliate as long as it owns at least 33.33%; your client will be safest if it negotiates a deal with no capitalization restrictions on companies with which it may merge. If management anticipates that your client may be an acquisition target—e.g., a young, fast-growing company—it can preserve its flexibility by retaining the right to assign the lease to any acquiring company that meets only minimum capitalization requirements (e.g., that it have a net worth at least equal to your client's at the date the lease was first signed).

[9.25] C. Renewals

An extension option can be valuable. Economics aside, it ensures that your client can continue operating its business, uninterrupted, at the same location for more than a short three, five, or ten years. If your client agrees to a fixed rent during the renewal term, both it and the landlord are gambling on a future market. For this reason, leases frequently include a formula—usually tied to the fair market rate—to determine rent during the extended term.

The fair market rate depends on many individual considerations, like a tenant's credit rating (for instance, IBM will probably get a greater discount than a two-year startup because the landlord's risk is lower), the formula for calculating operating expenses, and the lease term. If your client agrees to a fair market value renewal option, specify factors that would be especially important in the client's situation. This is another area where close coordination with the tenant's real estate advisor is required. Moreover, insist that the space be valued for use as office space, lab space, etc., depending on your client's current and anticipated uses, even if those are not its "highest and best" uses at renewal time.

Quite a few leases don't require the landlord to commit to the renewal term rental rate until after the term has started. Though the mechanism for determining the renewal rate may be clear, most tenants do not want to

commit to paying for space unless they know the cost in advance. Structure a renewal mechanism so that building ownership is obligated to specify a firm rate far enough in advance so that your client can effectively shop for alternatives. Otherwise, your client gives up leverage essential to help ensure it a fair renewal rate. An ambiguous arrangement or one which pushes key decisions close to your client's lease expiration date has another hidden cost if it does decide to move: Your client may have to pay steep holdover rates—one-and-a-half to two times or more than the normal rent while it shops for new quarters.

Be sure that your client understands that a holdover clause—with its specified rental rate—should not be used as a backdoor lease extension. A 2006 New York case showed how costly this can be.⁹ A well-known apparel company leased space in a prestigious office building under a long-term lease. This tenant had no right to extend its lease term. Rather, at the end of the term, this space would become the premises of another tenant in the building who had negotiated a right to expand. At the end of its lease term, the apparel company refused to move out. After a protracted dispute with the landlord, the apparel company was finally compelled to leave, but the incoming tenant had suffered a delay of many months. This tenant sued on a theory of trespass, seeking damages for its losses and prevailed. The apparel tenant became liable to both the landlord and the incoming tenant.

So, whatever you do, specify the essential terms of your client's extension option. Don't postpone the decision with a vague lease clause that "agrees to agree." This invites costly litigation and could leave your client with no office space—and costly bills.

[9.26] IX. DISPUTE RESOLUTION

Landlords' proposed leases often include a clause saying that in a dispute about such items as operating costs, electricity, and real estate taxes, the tenant must pay whatever ownership has billed, but can take the landlord to court. This is a bad idea for your clients. It gives them nothing they did not have already, and the landlord has no incentive to settle. Time-consuming and costly litigation may leave a tenant with no answer for years. Meanwhile, the landlord has your client's money even if the court eventually rules in favor of your client.

⁹ *Kronish Lieb Weiner & Hellman, LLP v. Tahari, Ltd.*, 11 Misc. 3d 1057(A), 815 N.Y.S.2d 494 (Sup. Ct. N.Y. Co. 2006).

Provide for dispute resolution in the lease. Here are a few guiding principles:

- Arbitration may be the best method to resolve disputes like disagreement over the fair market rent or whether a tenant's use of space has caused more damage than normal wear and tear. Real estate experts are more qualified than the lay public to say who's right. Depending on the nature of your client's lease and operations and the issues likely to arise, it may be prudent to specify private arbitration with defined time periods for each action, the qualification for arbitrators, how costs will be allocated, and fallback measures if one party does not comply. This can lead to fast, low-cost resolution of many items. It may be appropriate to specify more than one type of arbitration proceeding depending on the issues that may arise.
- In certain disputes, the tenant should have the right to withhold operating expenses—for instance, if the landlord fails to provide essential utilities or repair services.
- The tenant should have convenient access to documentation supporting the landlord's bills and should be given reasonable time to audit the operating expenses. An independent CPA, not the landlord's nephew, should prepare the statement, or the statement should be verified by one of the landlord's officers, and the tenant should be free to select the advisor of its choice to review this documentation. Don't agree to terms that limit your client to using a CPA or someone approved by the landlord.
- The landlord should share certain audit costs with the tenant.
- If it prevails in a dispute, the tenant should get a prompt refund with interest, plus reimbursement for out-of-pocket expenses and attorney fees.
- An obvious but essential reminder: Once you agree on a way to resolve disputes, follow the procedure to the letter. Paine, Webber, Jackson & Curtis, Inc.—the financial services company that was UBS Paine-Webber's predecessor—took its landlord to court over a dispute about operating expenses, but the case was tossed out by

a judge without even a hearing. The company had neglected to start the proceeding within 30 days, as its lease required.¹⁰

[9.27] X. NEGOTIATING THE WORKLETTER

When a tenant seeks a build-to-suit office or a turnkey interior installation, the landlord is responsible for building out the space.

[9.28] A. The Build-out Workletter

The workletter, which provides for the build-out, may be a separate contract that sets out rights and liabilities for finishing off a building's interior space before the tenant moves in. Whether separate or included in the body of the lease, it describes a unique relationship between landlord and tenant during the initial build-out. It covers installation of interior walls, fixtures, flooring—all the finishing work—and provides a timetable for completion. It must also specify what the landlord is obligated to provide—base building work—regardless of any agreement about tenant improvements.

Build-out costs often exceed budget because of delays. Many landlords propose workletters that recognize two kinds of delay: “tenant-caused delay” and “force majeure,” or excusable delay. With tenant delays your client pays, usually by reimbursing the landlord for extra out-of-pocket costs and by paying rent even before it can move into the space. But many landlords, concerned about their expenses, try to make tenants responsible for delays they can't control. Similarly, landlords may penalize tenants for delays that are actually part of the normal back-and-forth required to get everyone to sign off on working drawings or unit prices, or that arise because of field conditions.

To protect your client, check the definition of tenant-caused delay. It should cover only those situations your client can control. Work with your client's real estate advisor and make sure the workletter includes a realistic schedule for producing and reviewing drawings, bidding out the work, and so on. If your client's build-out requires so-called long-lead items, allow for these in the schedule—don't allow them to be the basis for billing your client extra charges. And make sure that if there are delays, your client pays only for delays that affect a project's critical path—the sched-

¹⁰ *Silverstein Props., Inc. v. Paine, Webber, Jackson & Curtis, Inc.*, 104 A.D.2d 769, 480 N.Y.S.2d 724 (1st Dep't 1984), *aff'd*, 65 N.Y.2d 785, 493 N.Y.S.2d 110 (1985).

ule of dates that tells the landlord when each task must be finished so that it doesn't interfere with any other.

In addition, require that the workletter your client agrees to allows enough time to review design drawings and other documents it must approve. A landlord's delay in delivering the documents shouldn't cut into your client's allotted time.

Force majeure, or excusable delay, is supposed to cover events the landlord can't control: flood, strikes, hurricane. Be sure that it applies only to those few situations for which the landlord can't reasonably be held responsible. Otherwise, this becomes a catch-all that excuses the landlord from managing the work your client has hired it to do.

What happens to your client if building ownership suffers from an excusable delay? Landlords normally propose that no matter how long the delay, or how much it costs the tenant to make alternative arrangements, the tenant can't break the contract. They propose only to delay the date when a tenant starts paying rent. In other words, your client has to wait around. But every tenant needs assurance that its business will continue with minimal interruption. Protect your client by negotiating for additional free rent for every day that the landlord delays beyond a certain point. This creates real incentive for building ownership to perform in a timely way. The ultimate protection your client requires is a specific walk date. Except for delays your tenant causes, if the space isn't ready after a reasonable time, it needs the right to terminate the lease and go elsewhere—without having to pay rent on two leases.

[9.29] B. Interior Allowance and Fit-up

Whether or not the landlord built the space, tenants often get an interiors allowance for the initial fit-up work: Landlords provide a credit of so many dollars per square foot or they provide certain standard items like electrical outlets, doors, latchsets, lighting fixtures, plasterboard, and carpet.

Most tenants prefer better quality or simply need something other than the building standard. But unless you negotiate it, the lease may permit no credit for items your client doesn't want.

The tenant portion of fit-up can quickly reach \$55 or \$70 per square foot for interiors that aren't lavish. Tenants with more technical requirements (e.g., any type of raised floor, trading rooms, laboratories, or clean

rooms) can easily incur costs in the \$150 to \$300 per square foot range. So refuse any clause that would oblige your client to use the landlord's resident or otherwise preferred contractors. It's essential that your client retain control over costs and accountability by bidding out work to several independent general contractors.

Make sure that your client understands and has thought through precisely how the lease distinguishes between "base building," which the landlord pays for, and tenant work, which your client pays for. Otherwise, your client may find it's obligated to pay for expensive wiring, duct work, removing hazardous materials or relocating utilities, etc., it hadn't planned on.

Be aware, too, that many times workletter issues are resolved relatively late in the lease-negotiation process—when both landlord and tenant are comfortable enough with other aspects of the deal structure that they are willing to invest in architectural and engineering time to explore and resolve these nitty-gritty issues unique to tenant build-out. As more data about build-out costs becomes available, what looked like a low-cost option may turn into the high-priced alternative, and your client may need to move on to an alternative location.

Shield your client from obligations to demolish existing space. As outsiders, your client and its advisors can't know what expensive obligations may lurk behind drywall or above a dropped ceiling. Even if your client accepts space "as is," it needs to protect itself against the cost of asbestos removal and compliance with existing laws such as the ADA or fire-safety codes. To best address these issues, work with your client's real estate advisor to understand particular cost risks associated with a given space—e.g., spalling concrete, slab-related issues, functionally obsolete HVAC equipment, etc.

It's also important to pay attention to mold as your client considers its build-out obligations. Mold may accumulate almost anywhere water does, and unwary tenants who accept space "as is" may find themselves saddled with mold in wall cavities or above ceilings when they start to build their premises. Because of the costs associated with removing mold, many landlords explicitly shift this obligation out of base-building work, where it would traditionally lie, onto tenants—often with extensive lease language that obligates the tenant to remediate.

The workletter allowance is an important economic term, so be sure your client has adequate time to use the funds. Some landlords propose

that funds be forfeited if not used within a short time. Always insist upon reasonable procedures for securing landlord approval of tenant drawings and reimbursement of tenant expenses.

[9.30] XI. CONCLUSION

As part of your clients' real estate team, you can help them achieve a major business objective—controlling and reducing real estate costs. Do this by understanding and eliminating hidden lease costs.

CHAPTER TEN

MODEL MEMORANDUM OF LEASE

Joshua Stein, Esq.

This chapter offers a sample Memorandum of Lease (the “Memorandum”), which the parties to a Lease can record to give constructive notice of their Lease, without recording the whole document.¹ This document is designed for use in New York. In any other state consult local counsel for state-specific problems, issues and requirements.

[10.0] I. COMMENTS FOR THE USER

[10.1] A. Must We?

These cover notes and the following model amply demonstrate that a Memorandum can require some thought and raise issues. Before going to the trouble, the parties—particularly Landlord—should first ask themselves whether they really need a Memorandum or should perhaps not bother. Landlords in particular may hesitate to burden their record title with documents that may become irrelevant, and future title problems, over time. That discussion lies outside the scope of these cover notes. As a general practice, however, a Memorandum is atypical for most routine New York leases, excluding: (a) ground leases; (b) very large space leases; or (c) leases with substantial delayed delivery obligations or where the tenant will spend extraordinary sums to fixturate the space before taking possession. If the parties record a nondisturbance agreement, joined in by landlord, referring to the lease, this may provide a limited and temporary substitute to recording a Memorandum.

[10.2] B. Term of Lease

The governing statute (RPL § 291-c) states that a Memorandum may be recorded for any lease “for a term exceeding three years.” This conforms to RPL § 291, the general recording statute, which allows the parties to record a lease (as opposed to a Memorandum) only if the term exceeds three years.

[10.3] C. Execution Requirements

A Memorandum must be executed by the parties and acknowledged as necessary for a conveyance to be recorded.²

1 See New York Real Property Law § 291-c (RPL).

2 See RPL § 291-c.

[10.4] D. Addresses

Addresses for the parties in the Memorandum must conform to those in the Lease.³

[10.5] E. Lease or Sublease

This model Memorandum works for either a Lease or a Sublease. For a Sublease, confirm that a correct memorandum of the underlying master lease has been recorded. Include its recording information in this Memorandum. Change “Lease” to “Sublease” except, of course, in the context of “Master Lease.” Replace the recital about Landlord’s ownership with a recital like this one:

A. *Landlord’s Leasehold Estate.* Landlord has leased from _____, a _____ whose address is _____ (“*Master Landlord*”) the real property described in **Exhibit A** (“*Landlord’s Premises*”) under the _____ Lease dated _____ (as amended, modified, or extended from time to time, the “*Master Lease*”). A memorandum of the Master Lease dated _____ [is to be recorded prior to this Memorandum] [OR] [was recorded at Reel _____, Page _____ on _____, 20__] in the Official Records of _____ County, New York.

Under such circumstances, in defining the “Lease” identified in the Memorandum (under these facts really a sublease), the parties may want to add language like this:

Although the Lease is denominated as a “_____,” the Lease is a sublease, by which Landlord subleases to Tenant only Tenant’s Premises, constituting only part of Landlord’s Premises as demised to Landlord under the Master Lease.

When this Memorandum is being used for a sublease, all the same issues apply—both as between sublandlord and subtenant and, sometimes, for protection of Master Landlord. For simplicity, however, these cover notes do not otherwise mention subleases or master landlords. If

3 See RPL § 291-c.

this Memorandum is being used for a sublease, consider the need for non-disturbance assurances from Master Landlord.⁴

[10.6] F. Purchase Options

If the Lease contains a purchase option, disclose it of record in a separate memorandum of contract under RPL § 294. This may mitigate mortgage recording tax issues, but not necessarily. Purchase options also raise transfer tax issues.

[10.7] G. Brackets

Options and comments for the user appear in brackets.

[10.8] H. Nonstandard Provisions

Some leasing transactions, particularly ground leases, may justify adding certain additional nonstandard provisions to a Memorandum. This Model Document collects some such provisions after the exhibits, with comments in footnotes. Whenever these provisions are appropriate for a particular transaction, they should be edited and tailored as necessary to conform to the larger terms of the particular transaction. The drafter can otherwise usually ignore them.

[10.9] II. OTHER DOCUMENTATION

A Memorandum raises the following concerns about other documentation, including items and exhibits that the parties should attach to this document.

[10.10] A. Defined Terms

This Memorandum assumes, particularly in optional provisions, that the Lease defines certain terms. Confirm and conform as needed. Anything essential to this instrument should appear within the four corners of this instrument, and not be incorporated by reference from the Lease. This model Memorandum calls for all essential information, and that information should be provided here, instead of relying on a cross-reference to the Lease.

⁴ Some object to using the word “nondisturbance” to refer to preservation of a subtenant’s rights after a master lease terminates. They argue that the right word is “recognition.” The writer disagrees and thinks “nondisturbance” is a perfectly appropriate word and the two words are interchangeable.

[10.11] B. Exhibit A: Landlord's Premises

Attach as Exhibit A a legal description of Landlord's overall premises—not just the part being leased to Tenant. If the Memorandum discloses restrictions or burdens that affect any other real property Landlord owns, identify that other real property as well. (Check that Landlord and not an affiliate owns it, too!)

[10.12] C. Exhibit B: Tenant's Premises

The Memorandum must include a description of Tenant's premises in the same form contained in the Lease. Therefore the Memorandum must include any legal description or diagram that appears in the Lease.⁵

[10.13] D. Cover Page

The cover page must include block and lot (and, in New York City, street address) to allow proper indexing.

[10.14] E. Nondisturbance

Tenant should consider the need for nondisturbance assurances from mortgagees. A Tenant would prefer to record any nondisturbance agreement, or at a minimum refer to it in this Memorandum and have the non-disturbing party join in this Memorandum. Tenant may also want to consider the implications of a bankruptcy affecting the nondisturbing party. For more on nondisturbance issues, see chapters 48–50.

[10.15] F. Title Insurance

Tenant should consider leasehold title insurance. To the extent that the Lease includes an option to purchase, or otherwise contemplates future transactions, try to obtain the title company's commitment today to issue a future policy at a reduced rate.

[10.16] G. Release of Memorandum

Landlord may want Tenant to sign a Release of Memorandum of Lease (the "Release") to go in escrow when the Memorandum is recorded. If the Memorandum were later to impair inappropriately Landlord's title and Tenant were unavailable or uncooperative, Landlord might solve the problem by recording the Release. Such arrangements are by no means "mar-

⁵ RPL § 291c.

ket standard.” They seem likely to add much value, because: (a) the Release will probably get lost; (b) if a dispute arises, Tenant will seek injunctive relief against Landlord anyway; and (c) they incur a genuine present dollar cost today, in the form of preparing a suitable Release and negotiating an escrow arrangement.

[10.17] H. Recording Requirements

When a Memorandum is recorded, the clerk will require New York City and State Transfer Tax Returns and a \$25 check for the privilege of filing them. In Bronx, Brooklyn, Manhattan and Queens counties, these documents and a few others must be prepared online. Similar requirements are starting to spread to other counties. Certain leases incur a transfer tax. In those cases, the transfer tax applies as soon as the parties enter into the lease, whether or not they record it. Recordation just gives the recording office a convenient collection mechanism. The clerk will also want to see the Lease (probably an original counterpart), to determine whether the Lease and the Memorandum are subject to the mortgage recording tax.⁶ This tax may apply if, for example, the rent is, in effect, a loan secured by a lien or deferred purchase price. The mortgage recording tax is governed by New York Tax Law §§ 250 *et. seq.* It is not known how often the clerk determines that a Lease in fact constitutes a mortgage. Mortgage recording tax arises only upon recordation. If a lease is in fact a mortgage but no one records it, then it should incur no mortgage recording tax, though other issues may arise, beyond the scope of this discussion.

[10.18] III. FOLLOWTHROUGH REQUIREMENTS

[10.19] A. Lease Modifications

Any modification to a Lease will not be enforceable against future bona fide purchasers unless notice of the modification has been recorded.⁷ A memorandum of a Lease modification agreement must contain information like that in a Memorandum.⁸ These requirements apply even if a Lease modification relates entirely to issues outside the scope of those covered in the recorded Memorandum. The requirement may sound illogical or unreasonable, but it conforms to the theory and function of the

6 RPL § 291-c.

7 *See* RPL § 291-cc(1).

8 *See* RPL § 291-cc(2).

recording system and makes sense. Try to advise the client in writing of this requirement soon after the initial Lease closing. Once a space tenant takes possession, creating constructive notice of its rights, Tenant may prefer to terminate the Memorandum to avoid the risk that the existence of the recorded Memorandum will vitiate future unrecorded modifications. The risk seems low, but if Tenant went to the trouble of recording a Memorandum Tenant presumably worried about maintaining its rights against future grantees; so if Tenant truly cares about that Tenant should care about preserving those rights. A ground tenant and its leasehold mortgagee would typically never want to unrecord the Memorandum.

[10.20] B. Lease Dates

If the original Memorandum did not disclose the actual Commencement Date or Expiration Date, e.g., because they depend on Landlord's actual delivery date, the parties will need to record a further document to disclose those dates. If they remember, it is a good mechanism to prevent future uncertainties and problems; the recording system effectively becomes a reliable home for a leasing document that often gets lost, the commencement date confirmation.

[10.21] C. Termination or Cancellation

If the parties agree to terminate or cancel the Lease, they should terminate or cancel the Memorandum. Landlord should not release the security deposit until this has occurred.

[10.22] D. Title Policy

If the Lease is insured, typical only for a ground lease, confirm receipt of a satisfactory policy of title insurance.

[10.23] E. Recorded Original

Confirm the Memorandum actually got recorded and indexed. Look for it in the land records. Confirm receipt of the original recorded Memorandum. Keep a copy. Create a paper trail to show where the original went.

RECORD AND RETURN TO:

Attn: _____, Esq.

File No.: _____

Title Order No.: _____

_____, **a** _____,

LANDLORD

and

_____, **a** _____,

TENANT

MEMORANDUM OF LEASE

_____, 201____

This instrument affects real and personal property situated, lying and being in the [City of New York], State of New York, known as follows:

Block(s):

Lot(s):

Street Address: [NYC Only]

[End of Cover Page]

MEMORANDUM OF LEASE

This **MEMORANDUM OF LEASE** (the “*Memorandum*”) is entered into as of _____, 201__ (the “*Effective Date*”),⁹ by and between _____, a _____, whose address is _____ (“*Landlord*”), and _____, a _____, whose address is _____ (“*Tenant*”). Terms may be used in this Memorandum before being defined.

By executing and recording this Memorandum, Landlord and Tenant give notice of the facts below. Any person taking any interest in Landlord’s Premises, or any other real property subject to this Memorandum, shall do so subject to all documents (including all terms of those documents) and other matters that this Memorandum refers to or discloses.

1. *Landlord’s Premises.* Landlord owns the real property commonly known as _____ and more particularly described in **Exhibit A** (“*Landlord’s Premises*”).

2. *Lease.* Landlord and Tenant entered into a _____ Lease dated the Effective Date (as amended, modified, renewed or extended from time to time, the “*Lease*”).

3. *Demise of Tenant’s Premises.* For good and valuable consideration, Landlord has demised and hereby demises to Tenant [part of] Landlord’s Premises ([that demised part of Landlord’s Premises,]“*Tenant’s Premises*”), all as the Lease provides.

⁹ If the parties sign and record the Memorandum on a date other than the Effective Date of the Lease, adjust as appropriate.

4. *Description of Tenant's Premises.*¹⁰ A diagram of Tenant's Premises is attached as **Exhibit B**. The Lease describes Tenant's Premises as follows: "_____" The street address of Tenant's Premises is _____.

5. *Term.*¹¹ The "*Commencement Date*" of the Lease is _____. The Term of the Lease _____ [began/begins] on the Commencement Date and ends at [11:59 p.m.] on _____, unless terminated sooner under the Lease. Tenant has _____ Option(s) to extend the Term, each Option Term for _____ years. The maximum period for which the Lease may be extended is a total extension period of _____ years. The latest date to which the Lease may be extended by Tenant's exercise of all Options is _____. Tenant must exercise each Option, if at all, in writing no less than _____ calendar months and no more than _____ calendar months before the first day of the corresponding Option Term. The Lease more fully describes Tenant's Options, including conditions and procedures for exercise. The Lease grants Tenant no option or other right to expand, renew, extend or purchase except, or beyond, any such rights (if any) this Memorandum describes, all as the Lease more fully provides.¹²

6. *Lien Law Trust Fund.* Landlord, in compliance with Lien Law Section 13, covenants that Landlord will receive the consideration for this conveyance and will hold the right to receive that consideration as a trust fund to be applied first to pay the cost of the improvements at the Property for which Landlord is responsible. Landlord will apply that consideration first to the payment of the cost of those improvements before using any part of it for any other purpose.¹³

7. *No Effect on Lease.* The parties have prepared, signed and acknowledged this Memorandum only for recording purposes. It does not modify, increase, decrease or in any other way affect any party's rights, duties or obligations under the Lease. Landlord and Tenant each has rights, duties and obligations (and conditions to its rights) under the Lease but not

10 Edit this paragraph as appropriate under the circumstances. Leave in and edit all statements relevant to this Lease. The description of Tenant's Premises should track the Lease. The Memorandum should merely identify Tenant's Premises enough so a reader will understand what Tenant's Premises include. Don't further describe Tenant's Premises, such as by specifying square footage. It doesn't help. It could hurt.

11 Same comments as previous footnote. If the dates are not yet determined, disclose the basis for determination and then remember to amend the Memorandum after determination. See cover notes.

12 For expansion options, insert similar descriptions.

13 This should also appear in the Lease itself.

stated here. If the Lease and this Memorandum conflict, the Lease governs. Nothing in this Memorandum constitutes any representation or warranty by either party. To the extent, if any, that the Lease limits anyone's liability, that limitation also applies to any liability under this Memorandum.

8. *Successors and Assigns.* The Lease and this Memorandum bind and benefit the parties and their successors and assigns. This does not limit any restrictions on assignment or other transfer in the Lease.

9. *Termination.* This Memorandum shall automatically terminate and be of no force or effect upon any termination of the Lease, including any termination by Landlord upon an Event of Default as the Lease provides.

10. *Further Assurances.* Each party shall execute, acknowledge (where necessary) and deliver such further documents, and perform such further acts, as are reasonably necessary to achieve the parties' intent as expressed in the Lease and this Memorandum. If the Lease terminates, then Tenant shall execute, acknowledge and deliver such documents as Landlord reasonably requires or as any title insurance, abstract company or institutional lender requires to remove this Memorandum of record.

11. *Counterparts.* This Memorandum may be executed in counterparts.

IN WITNESS WHEREOF, Landlord and Tenant have executed this Memorandum as of the Effective Date.

[SIGNATURE BLOCKS FOR LANDLORD AND TENANT]

Attachments:

Acknowledgments

Exhibit A—Landlord's Premises

Exhibit B—Tenant's Premises

ACKNOWLEDGMENTS

EXHIBIT A

LANDLORD'S PREMISES

[To attach.]

EXHIBIT B

TENANT'S PREMISES

[To attach.]

[Typical Memorandum of Lease Ends Here.]

NONSTANDARD PROVISIONS

[NOTE: These provisions are all nonstandard (and usually omitted for a typical commercial space lease) but may sometimes make sense, particularly in ground leases. In any case, they may help and should do no harm. None are statutorily required.]

Definition: Fee Estate. The “*Fee Estate*” means Landlord’s fee simple interest in Landlord’s Premises.¹⁴

*Mechanics’ Liens*¹⁵

Restrictions on Alterations. Under the Lease, Tenant may not authorize or perform any alteration, demolition, design or construction of any improvements in, on, at, for or relating to Landlord’s Premises or any part of it (a “*Work of Improvement*”). Landlord does not consent to any Work of Improvement.

NOTICE OF NONRESPONSIBILITY. LANDLORD SHALL UNDER NO CIRCUMSTANCE BE RESPONSIBLE OR OBLIGATED TO PAY (AND THE FEE ESTATE SHALL NOT BE SUBJECT TO ANY LIEN) FOR ANY MATERIALS, LABOR, SERVICES OR EQUIPMENT PROVIDED TO TENANT OR ANY CONTRACTOR, SUBCONTRACTOR OR MATERIAL SUPPLIER OF TENANT FOR OR IN CONNECTION WITH ANY WORK OF IMPROVEMENT, OR ANY OTHER “COSTS OF IMPROVEMENT” (AS DEFINED IN THE NEW YORK LIEN LAW) RELATING TO LANDLORD’S PREMISES OR ANY PART OF IT AND DIRECTLY OR INDIRECTLY CAUSED BY ACTS OR OMISSIONS OF TENANT, OR OTHERWISE ACTUALLY OR POTENTIALLY THE BASIS FOR A LIEN UNDER THE NEW YORK LIEN LAW ARISING FROM THE ACTS OR OMISSIONS OF TENANT OR TENANT’S CONTRACTOR, SUBCONTRACTOR OR MATERIAL SUPPLIER OR ANYONE CLAIMING BY OR THROUGH ANY OF THEM OR ON ACCOUNT OF DEALINGS WITH ANY OF THEM (A “*LIEN*”). THE FEE ESTATE SHALL NOT BE SUBJECT TO ANY LIEN.¹⁶

14 Some of the further provisions of this Memorandum use this term.

15 New York law does not provide for a “disclaimer of responsibility” as contemplated here. California law does, though not necessarily in a Memorandum. Do not assume these provisions will work.

16 Even though this language is EXTREMELY FIERCE, do not assume it will have any effect at all.

Tenant's Exclusive Use. In the Lease, Landlord grants Tenant the exclusive right (Tenant's "Exclusive Use") to sell _____ anywhere within [Landlord's Premises] (Tenant's "Exclusivity Zone"), subject to conditions, restrictions, exclusions and limitations in the Lease. To the extent that any future lease (or amendment of lease) of any premises (except Tenant's Premises) within Tenant's Exclusivity Zone directly or indirectly allows operation of Tenant's Exclusive Uses, that authorization: (a) violates Tenant's exclusive rights under the Lease; and (b) in that event is null, void and of absolutely no force or effect, except to the extent, if any, Tenant's Lease expressly states otherwise.¹⁷

Zoning Lot Waiver. The Lease states that Tenant waives any rights it may have: (a) regarding any transfer of any right to construct "floor area" (as defined in the New York City Zoning Resolution, the "ZR") to or from Landlord's Premises; or (b) to consent to or execute any Declaration of Restrictions (as defined in ZR § 12-10) relating to Landlord's Premises that would cause Landlord's Premises to be merged with or subdivided from any other zoning lot under the ZR or to any document of a similar nature and purpose. That waiver also binds all of Tenant's parties-in-interest. Each party-in-interest agrees to that waiver by accepting its interest in Tenant's Premises. Tenant shall nevertheless deliver, and cause its parties-in-interest to deliver, any document Landlord reasonably requests to confirm and join in that waiver.¹⁸

Restrictions on Subletting. The Lease states that Tenant may not enter into any sublease of any or all Tenant's Premises (a "Sublease") without complying with the Lease, including requirements that any Sublease: (a) needs Landlord's prior written consent; and (b) must contain certain provisions. Any Sublease violating the Lease shall be null, void and of no force or effect and a default under the Lease.

Appointment. In the Lease, Landlord appoints Tenant as Landlord's attorney in fact to _____. Landlord reaffirms that appointment, confirm-

17 Exclusive uses are often quite complicated, with lots of complicated exceptions and nuances. Landlord would probably prefer to place them of record verbatim, to avoid uncertainty in future leasing transactions and the need to share Tenant's Lease with a future tenant or make representations and warranties about what it says.

18 Conform to Lease language.

ing that Tenant holds an agency coupled with an interest on those matters.¹⁹

*Leasehold Mortgages.*²⁰ The Lease contains these provisions, among others, on mortgage(s) that encumber Tenant's estate under the Lease ("Leasehold Mortgages") and their holders ("Leasehold Mortgagees").

Limitations. The Lease limits who may be a Leasehold Mortgagee and the indebtedness a Leasehold Mortgage may secure.

Required Provisions. Any Leasehold Mortgage must contain certain provisions as the Lease states.

New Lease. If the Lease terminates or if Tenant rejects the Lease, Landlord has agreed to enter into a "New Lease," on the same terms as the Lease, with certain persons. Any reference to "New Lease" includes any amendment, modification, renewal or extension of such a lease, subject to any governing restrictions or limitations. Any New Lease shall have the same priority as the Lease and this Memorandum. Any New Lease shall be subject to no lien, covenant, declaration, encumbrance or other interest (including any transfer of unused floor area or development rights; any mortgage encumbering the Fee Estate; and any conveyance by foreclosure or in lieu of foreclosure under any such mortgage) first recorded after this Memorandum (collectively, "Subordinate Claims"). All holders of Subordinate Claims, including their successors and assigns, should take notice that they and their Subordinate Claims will be junior and subordinate not only to the Lease and this Memorandum but also to any New Lease.²¹

Leasehold Mortgagee Rights in Bankruptcy. The Lease states that if it is rejected in a Bankruptcy Proceeding (as defined in the Lease) affecting Landlord, then: (a) Tenant may not treat the Lease as terminated without concurrence of all Leasehold Mortgagees [whose recorded Leasehold Mortgages require that concurrence]; and (b) if Tenant remains in possession of Tenant's Premises, all Lease terms shall remain effective for that continued occupancy, and all Leasehold Mortgages encumbering Tenant's

19 Consider beefing up this paragraph to comply with the technical requirements for a power of attorney. If the Lease contains other appointments of one party as agent for another, consider dealing with them as well.

20 These provisions usually apply only to ground leases. Consider the possible effect of Landlord bankruptcy.

21 The notion of "pre-subordinating" future Subordinate Claims makes a great deal of sense, but no one should assume it will work. Build in a mechanism for Fee Mortgagees to approve future Lease amendments.

estate under the Lease shall remain in full force and effect with the same priority as before rejection.

Restrictions on Amendment, Cancellation, Etc. Neither the Lease, any New Lease nor this Memorandum may be amended, waived, modified, subordinated, released or canceled without written consent by _____.²²

*Transactions Affecting Fee Estate.*²³ The Lease restricts some transactions affecting the Fee Estate, including as follows.

Fee Mortgages. Landlord may grant mortgages encumbering the Fee Estate (each, a “*Fee Mortgage*”), but only in compliance with the Lease, including requirements on provisions that must appear in any Fee Mortgage. Any Fee Mortgage entered into without compliance with those conditions is null and void and of absolutely no force or effect whatsoever. Without limiting the more general application of this paragraph, any Fee Mortgage shall be subject and subordinate to the Lease, this Memorandum, any New Lease and certain other interests in Tenant’s Premises, as the Lease states.

Transfer of Fee Estate. Landlord must satisfy some conditions and requirements for, and as a prerequisite to, any sale, conveyance, assignment or other direct or indirect transfer of the Fee Estate or any interest in it or in any entity²⁴ with a direct or indirect interest in it, including creation of any Subordinate Claim (any of these, a “*Transfer*”). Those conditions include, in some cases, compliance with Tenant’s Right of First Refusal under the Lease. Any Transfer that violates the Lease shall be null and void.

22 Even without a Leasehold Mortgage, this disclosure may make sense, although for a typical space lease with an SNDA, recordation of the SNDA should suffice.

23 Same comments as preceding footnote.

24 This language would not give notice to a transferee of equity in Landlord.

CHAPTER ELEVEN

COMMERCIAL LEASING BROKERAGE AGREEMENTS

Lawrence P. Lenzner, Esq.*

* Mr. Lenzner wishes to thank Andrew Herz of Patterson Belknap Webb & Tyler LLP for his assistance in the preparation of this chapter.

[11.0] I. PRELIMINARY CONSIDERATIONS

[11.1] A. Overview

This chapter analyzes brokerage or listing agreements between a landlord and a real estate broker who procures a commercial lease. It provides a general introduction to the basic concepts of commercial real estate leasing brokerage agreements and examines important brokerage issues. Hopefully, it will assist real estate attorneys in their daily practice, but it will not analyze statutory or case law. Several forms of listing agreements are appended at the end of this chapter to assist real estate practitioners.

A listing agreement between a real estate broker and the landlord of real property authorizes the broker to solicit offers to lease the property on the terms and conditions in the agreement. The listing agreement usually lists the conditions that the broker must satisfy to earn a specified commission.

A contract for the retention of a broker's services is a personal service contract for the employment of an agent. Although the broker agrees to endeavor to find a tenant for the property and the landlord agrees to pay the broker a commission, the landlord cannot force the broker to locate a tenant. Absent an agreement to the contrary, a listing agreement is an offer by the landlord to pay a commission upon the occurrence of certain conditions. The broker accepts the offer by producing a tenant who satisfies the requirements set forth in the listing agreement.

The existence of an agreement with the landlord is crucial, since the broker must prove employment by the landlord in order to receive a commission. Such agreement may be oral or written.

[11.2] B. Oral Listing Agreement

A binding contract to pay a brokerage commission may be oral. Even an oral brokerage agreement can be quite specific as to the terms and conditions of the hiring. A broker legally may be entitled to receive a commission even if a lease is never executed. Therefore, when a written agreement has not yet been executed, it is advisable to enter into an oral agreement to provide that no commission will be due if the transaction is not fully consummated. Good practice dictates that such an agreement be confirmed by a subsequent letter or memorandum.

Oral brokerage agreements are expressly not barred by the Statute of Frauds if they can be performed within one year. However, the better practice is for all brokerage agreements to be in writing. The broker wants the agreement to be in writing so that it can prove the existence of the agreement to pay a commission or to prove its particular terms. In addition, if the landlord does not pay the commission, a real estate broker licensed in New York State is authorized by statute to file a mechanic's lien to claim a commission involving an executed lease which has a term of more than three years and covers commercial real property. A written brokerage agreement is required for the broker to be entitled to file such a lien and a copy must be annexed to the notice of lien.

Brokerage agreements for commercial leases often provide for the commission to be paid based on rentals that are not capable of being calculated until more than a year has elapsed from the date of hiring (especially if percentage rentals or cost of living increases are provided for in the lease). Because of the Statute of Frauds, such brokerage agreements must be in writing to be enforceable.

[11.3] C. Types of Listing Agreements

[11.4] 1. Non-Exclusive Agreement

A nonexclusive agreement, also known as an open listing, gives the broker the right to a commission only if the broker actually procures a tenant for the property. A landlord can hire several brokers under this type of agreement. In such instance, the landlord will pay a commission only to the broker or brokers who procure tenants.

Although landlords may feel that a nonexclusive agreement will give them the benefit of wider exposure to potential tenants, brokers often assert that this type of agreement gives them little incentive or protection. Brokers are reluctant to expend much energy or expense searching for potential tenants when there is little chance for them to earn a commission. Therefore, a nonexclusive listing can only be effective where tenants are plentiful and the use of this type of listing is widespread.

A nonexclusive listing may be effective if the landlord limits the scope of the listing to provide the broker with greater incentive to locate tenants (for example, by agreeing to grant a nonexclusive agreement to only two brokers).

[11.5] 2. Exclusive Agency Agreement

In an exclusive agency agreement, the landlord designates a single broker as its exclusive agent. The broker earns a commission for every completed lease transaction, whether or not it procured the tenant. A landlord may not hire other brokers to lease the property, although the landlord may lease the property directly to a tenant without the involvement of any broker. If such a transaction is consummated in good faith directly by the landlord to a tenant not procured by the broker, the landlord is not liable to the broker for a commission.

It is customary for the exclusive broker to be obligated to enlist the cooperation of other brokers. In such situation, the exclusive broker coordinates the activities of other brokers and arranges for showings of the property. Where a cooperating broker procures the tenant, the cooperating broker will usually be entitled to receive a full commission and the exclusive broker will usually receive an additional amount, called an “override,” which is a percentage of a full commission.

If an exclusive agent is hired to lease property, the landlord cannot lease the property through another broker without being subject to liability to the first broker for damages for breaching the exclusive agency agreement.

Brokers generally prefer exclusive agency agreements. They will agree to diligently attempt to lease the property when given this type of listing. A landlord who is reluctant to give an exclusive agency to a broker may be persuaded to do so for a short time period, such as one month, with the understanding that if a tenant has not been found by the end of such time period, the exclusive agency will not be renewed.

Exclusive agency agreements are commonly used for the leasing of commercial property. The agreement should contain an explicit statement that the parties intend an exclusive agency. The agreement also should include a clause reserving the right of the landlord to lease the property to tenants procured by the landlord without liability for a commission. If the landlord has previously been contacted by, or has negotiated with, any prospective tenants, a clause reserving the landlord’s right not to owe any commission with respect to those prospects may be added.

[11.6] 3. Exclusive Right to Lease Agreement

An agreement granting a broker the exclusive right to lease establishes the right of the broker to a commission upon the consummation of any lease, even a lease by the landlord without the involvement of any broker. Such an agreement is in contrast to an exclusive agency, which only excludes the employment of another broker by the landlord, and is the type of agreement most often sought by brokers. In order to avoid any ambiguity, a brokerage agreement providing for an exclusive right to lease should clearly express that a commission will be due upon any lease by the landlord and that the landlord may not independently negotiate a lease without liability to the broker.

Absent an unequivocal expression of intent by the express terms of the agreement or by necessary implication from its terms, a listing agreement headed “Exclusive Right to Lease” probably will be considered an exclusive agency, especially if the agreement provides that a commission is earned if the broker delivers a ready, willing, and able tenant.

**[11.7] II. DRAFTING COMMERCIAL LEASING
BROKERAGE AGREEMENTS****[11.8] A. Generally**

A broker must prove that it was hired to be able to recover a real estate brokerage commission. A mere volunteer is not entitled to a commission. Implied employment is difficult to prove.

Much litigation can be avoided by carefully drafting brokerage agreements. Counsel should focus on when the parties think the commission is earned and when it should be payable. Landlord’s counsel should understand the effect of a brokerage agreement stating that the commission is not earned until the lease is executed and delivered. Broker’s counsel should be concerned about clauses that preclude the broker from receiving a commission even if a ready, willing and able tenant has been procured by the broker.

The brokerage agreement with respect to leased space may be considerably more complicated than a brokerage agreement with respect to the sale of real property. Because a lease transaction may have many more aspects that must be covered in the brokerage agreement, such agreements are often lengthy. The major areas that should be covered are set forth below.

[11.9] B. Principal Areas to be Covered by the Brokerage Agreement**[11.10] 1. Nature of the Agency Created**

As discussed above, a landlord may grant a non-exclusive agency, an exclusive agency or an exclusive right to lease. The brokerage agreement must clearly set forth the nature of the agency.

[11.11] 2. Term

The agreement should clearly set forth its term. The length of the term is generally negotiable. It will often depend upon the type of agency being created and the type of commercial property being leased. It will affect other terms of the listing agreement, such as whether the agreement may be terminated with or without cause and how the agreement may be renewed.

[11.12] 3. Standards of the Broker's Performance

The listing agreement will typically state the standard to which the broker shall be obligated to perform. Landlords may seek to require the broker to use its "best efforts" but that is a dangerous and vague standard. Better practice is to provide for exactly what is expected of the broker. This may include (a) provisions requiring the development of a marketing plan and an advertising budget, (b) a requirement that the broker advertise in designated newspapers, prepare brochures and/or post signs on the property and (c) a requirement that the owner or broker pay all or a portion of the broker's advertising and promotion expenses. Ultimately, the goal is to define sufficiently the expectations of the parties so that neither party is unnecessarily disappointed.

[11.13] 4. Conditioning Payment of the Broker's Commission

Absent an agreement to the contrary, a commission in most states becomes due if the broker procures a ready, willing and able tenant to lease the premises in accordance with the landlord's terms. Negating this standard is one of the principal purposes of a brokerage agreement. Frequently, the payment of the broker's commission will be conditioned upon the satisfaction of certain conditions. The conditions that must be satisfied in order for the broker to have earned its commission may include that:

- (1) the lease (together with any required guaranties of third parties) has been executed and unconditionally delivered;
- (2) the security deposit and any initial rent have been tendered;
- (3) the term of the lease has commenced;
- (4) the tenant has accepted occupancy of the premises; and
- (5) any required consents or agreements (such as non-disturbance or recognition agreements) have been obtained (including, in the case of a sublease, any required consent of the overlandlord).

A brokerage agreement may specify that the broker is not entitled to a commission until a written lease has been executed and delivered. Such agreement is binding and prevents the broker from collecting a commission if no lease is signed. If the landlord obtained such agreement fraudulently, the broker will not be deprived of its commission.

From the broker's perspective, the brokerage agreement should state that the landlord agrees to pay the broker a commission, as opposed to stating that the broker agrees to accept a commission.

[11.14] 5. Amount and Payment of Leasing Commission

Calculation of a broker's commission for a lease of real property is generally more complicated than the calculation of a commission for a sale. The commission for a lease transaction is typically based upon a percentage of the yearly rent. Rates vary depending upon local practice and are often calculated on a sliding scale. The agreement should be specific as to what items are considered to be part of the rent for the purposes of computing the amount of the commission. Frequently excluded from the definition of rent for such purpose are:

- (1) escalation rental payments;
- (2) the cost of work in excess of a normal work letter (whether in the form of payments by the tenant or a work allowance provided by the landlord);
- (3) the value of obligations borne by the landlord to induce the tenant to enter into the lease, such as assuming the tenant's existing lease obligations;

- (4) utility charges;
- (5) percentage rent; and
- (6) rental concessions or rent abatements. If free rent is included within the calculation of rent, the broker would want the brokerage agreement to provide that it be amortized on a straight-line basis over the term of the lease if the commission is calculated on a declining sliding scale.

The time and method of payment of the commission should be specified. If a commission is to be paid in installments, a provision for the acceleration of any remaining installments following the landlord's default may be included as well as an obligation to pay interest on overdue installments. Large commissions are commonly paid in installments. For example, a specific percentage may be payable upon execution of the lease, a like amount may be payable after payment of the second month's rent and the remainder could be payable one year after the commencement of the term of the lease.

From its perspective, the broker's right to payment of all or any portion of the commission should not be forfeited if the tenant defaults under the lease. The broker would argue that it is not a guarantor of the tenant's obligations. In addition, the broker would seek to have all unpaid installments of the commission accelerated upon the sale by the landlord of the building if the new landlord does not assume in writing the obligation to pay to the broker the remaining installments. Similarly, the broker would not want any limitation upon the landlord's liability with respect to the proceeds of a sale or net lease of the building, insurance proceeds or condemnation awards. In addition, the broker should be wary if the landlord seeks to limit its liability to its interest in the building if the landlord has no equity interest in the building (e.g., some subleases).

[11.15] 6. Options for Additional Space and Renewal Options

The brokerage agreement may provide for the payment to the broker of additional commissions if the tenant exercises options in the lease to lease additional space or to extend the term of the lease. If (1) the renewal, extension or expansion option is set forth in the lease and such provision includes a specific dollar amount payable by the tenant upon the exercise of such option or (2) the expansion occurs near the beginning of the term, the broker contractually may be entitled to a commission if another broker is not involved. Commissions for renewals, extensions or expansion

options, if payable by the landlord at all, generally are deemed due upon the exercise of such option.

[11.16] 7. Landlord's Default

Where payment of the broker's commission is conditioned on the happening of a specific event such as the execution and delivery of a lease, the issue of the landlord's default often arises. Since the commission is dependent upon an event partially within the control of the landlord, brokers often seek to exclude the "willful default" of the landlord.

Counsel representing the landlord may wish to include a provision in the brokerage agreement to the effect that the failure to execute and deliver a lease (or the failure to satisfy any other conditions with respect to the obligation to pay the commission) for any reason whatsoever will excuse the landlord from any liability for the payment of the broker's commissions. Counsel may further protect the landlord by including a provision stating that the landlord has the right to terminate negotiations with any of the broker's prospects for any reason whatsoever at any time.

Counsel representing the broker may seek to protect the broker against the landlord's willful default. Counsel should be aware that the exclusion of willful default does not preclude the landlord from opting for a better offer if the lease is not yet executed.

A compromise position would provide that the broker would be entitled to a commission in the event of a willful default of the landlord only if such willful default occurs after the lease has been unconditionally executed and delivered.

[11.17] 8. Representations, Warranties and Indemnification

Most brokers often seek the cooperation of other brokers to locate a tenant. Depending on the circumstances, the landlord and the listing broker may wish to establish limitations with respect to the use of cooperating brokers and the manner in which such cooperating brokers are to be compensated. If the listing broker is obligated to pay any commission to a third party broker, the listing agreement should clearly set forth such obligation. If, on the other hand, the landlord desires to preclude the use of cooperating brokers, such prohibition should be clearly set forth in the agreement.

It is also common for a brokerage agreement to contain a clause whereby the broker represents that it is the sole procuring cause of the lease and agrees to indemnify the landlord against the commission claims of any other broker. Brokers may wish to modify such clause to provide that the liability of the broker should (a) exclude any leasing agent of the landlord (the landlord should agree to pay any commission payable to its leasing agent in connection with the lease) and (b) state that in the event of any claim which may give rise to liability under the indemnity, the landlord shall (1) give the broker prompt written notice of any such claim, (2) cooperate with the broker in the defense of such claim, (3) not settle such claim without the broker's prior written consent, which consent will not be unreasonably withheld or delayed, and (4) permit the broker to defend any such claim with counsel selected by the broker. A broker is often reluctant to extend its indemnity obligation to the portion of the commission which is unpaid since in such instance, the broker may be obligated to expend more money than it has received from the landlord.

In most lease transactions where the landlord is to pay the commission, it is common for the tenant to make the same brokerage representation as the broker. In the event of a breach of such representation, the broker would prefer that the landlord first pursue its remedies against the tenant. The position of the tenant is the opposite. The landlord would not want to limit its ability to proceed against both parties. It is also appropriate for the landlord to indemnify the listing broker against claims by third party brokers with whom the landlord may have dealt either before or during the term of the agreement.

[11.18] 9. Arbitration

Counsel should consider the inclusion of an arbitration clause in a brokerage agreement. Standard arbitration clauses often specify that a dispute arising between the parties will be settled by arbitration conducted in accordance with the Rules of the American Arbitration Association. The American Arbitration Association has prepared suggested arbitration language to be included in such agreements.

The arbitration clause may provide that the arbitration panel have three members, at least one of whom must be an attorney with a specified amount of real estate experience. Alternatively, the clause may be drafted to provide for arbitration by a single arbitrator or by arbitrators selected by the parties. If the latter type of clause is used, it is recommended that the clause specify that each arbitrator chosen must have at least 10 years' experience. If a panel of three arbitrators is utilized, the agreement may

provide that if the two arbitrators first appointed are unable to agree and a third arbitrator is appointed, the decision of any two of the three arbitrators selected shall be binding. Alternatively, the arbitration provision may provide that the sole function of the third arbitrator is to choose which of the determinations of the first two arbitrators is correct.

Arbitration may be the best approach if the issue to be determined is the correct amount of the commission. Arbitration may not be the best way to resolve disputes involving whether or not any commission is due since it is commonly felt that arbitration results in compromise rather than total victory.

[11.19] 10. Parties/Authority

The listing agreement should clearly identify the parties and also contain a representation with respect to the authority of each party to enter into the agreement. If the landlord anticipates that specific persons shall be working on the transaction, the agreement should specify such persons.

As stated above, the relationship between a real estate broker and a landlord is one of agency. As the broker's principal, the landlord may be liable for the representations or omissions of the broker, even if the principal has no knowledge of such representations or omissions. Due to such concerns, it is customary for the brokerage agreement to characterize the broker as an independent contractor and not as an agent of the landlord.

[11.20] 11. Expenses

The listing agreement should state if the landlord is responsible for all or any portion of the broker's expenses incurred in connection with the transaction. Such responsibility frequently depends upon the nature of the listing agreement. In an exclusive agency agreement, the broker is more likely to insist on some form of expense reimbursement if the lease is consummated with a party procured by the landlord. The listing agreement should clearly identify any expenses that the landlord agrees to pay.

[11.21] 12. Leasing Transactions Following the Expiration of a Brokerage Agreement

In order to protect the broker's right to a commission with respect to a transaction that closes after the expiration of the brokerage agreement with a tenant introduced by the broker to the landlord during the term of the agreement, the landlord often agrees to pay the broker a commission

for such transactions if they occur within a certain period following such expiration. The listing agreement may provide for the broker to provide a written list of such prospects to the landlord upon the expiration of the agreement. If the premises are thereafter leased to any of the prospects on such list within the stated period after such expiration, the broker is entitled to a commission.

[11.22] 13. Miscellaneous Concerns of Brokers

Counsel for a broker may also consider addressing the following issues in the brokerage agreement: (1) the definition of the tenant to include both the proposed tenant and its designee or nominee, (2) the brokerage agreement to state that in the event either party shall commence litigation against the other party to enforce its rights under the agreement, the party prevailing in such litigation shall be entitled to recover its reasonable attorneys' fees from the other party and (3) that the broker may issue a standard tombstone advertisement which does not disclose the financial terms of the lease.

[11.23] III. CONCLUSION

As this chapter illustrates, commercial leasing brokerage agreements may be quite complicated. Some of the major issues that such agreements often address include the nature of the agency, the conditions upon the broker's right to a commission, the representations and indemnities to be provided by the broker and whether the broker is entitled to a commission for leasing transactions that occur following the expiration of the brokerage agreement. The resolution of such issues often depends upon local custom and practice.

APPENDIX A

Exclusive Agency Agreement for Commercial Building

Dated: _____

Re: _____ [Address of property]

1. The undersigned (“Owner”) who owns the building (“Building”) located at _____ [address] by this agreement designates and appoints you (“Broker”) as Owner’s exclusive leasing agent to obtain tenants, other than the parties set forth in Exhibit ____, annexed and attached to this agreement, for all of the space in the Building available for rental during the term of this agreement.

2. The term of this agreement shall commence on _____ [date] and shall expire on _____ [date]; provided, however, that after _____ [date] either party may cancel this agreement upon not less than days’ prior written notice to the other party.

3. If during the term of this agreement, any portion of the Building is leased, Owner agrees to pay Broker and Broker agrees to accept in full payment for all services rendered, whether or not Broker is a procuring cause for such lease, a commission computed as follows:

(a) for each lease transaction in which no other broker is a procuring cause, a commission equal to ___ percent of the average annual fixed rent, payable under such lease;

(b) for each lease transaction in which either (i) one or more other brokers are procuring causes of such leasing or (ii) the tenant under the lease is a tenant in the Building on the date of this agreement who executes a new lease, or extends its present lease, or leases more space, a commission equal to _____ percent of the average annual fixed rent under such lease.

In each instance in which a broker or brokers other than Broker is a procuring cause, Owner shall pay to such other broker(s) a commission upon the terms and conditions as may be agreed to by Owner and these other broker(s). Owner indemnifies and agrees to hold Broker harmless from and against any claim, liability, cost or expense asserted by or payable to any broker(s) other than Broker. Broker agrees to promptly notify Owner whenever it is aware of the involvement of a broker other than Broker with respect to any lease transaction. For the purposes of this agreement,

“fixed rent” shall mean the aggregate rentals and all other sums and charges payable by the tenant under a lease over the term of the lease, exclusive of amounts specifically payable for _____ [*for example: electricity, or for escalation adjustments whether for increased real estate taxes, operating expenses or cost of living increases*]. The “average annual fixed rent” shall be determined by dividing the fixed rent for the stated term of the lease, exclusive of renewal terms by the number of years, and fractions of years, in the stated term of the lease.

4. Any commission due Broker shall be deemed earned in full upon the execution and delivery of the lease with respect to which the commission was earned. Owner agrees to pay each commission in _____ [specify installment payments for example: in four (4) equal quarterly annual payments, the first of which shall be due and payable upon the execution and delivery of the lease].

5. Owner authorizes Broker to employ and use cobrokers or subbrokers to obtain tenants for the Building. Such cobrokers or subbrokers shall be paid by Owner upon terms and conditions agreed to by Owner and such cobrokers or sub-brokers.

6. Owner authorizes Broker to obtain, prepare and secure, subject to Owner’s prior approval but at Owner’s expense [up to \$_____], renting signs, renting plans, circular matter and other forms of advertising for the Building and portions of the Building. Owner agrees in each such instance to promptly pay the advertising expenses up to the specified amount or reimburse Broker in the event that Broker has paid any advertising expenses.

7. Owner shall promptly refer to Broker all inquiries that Owner may receive relating to space in the Building and Owner shall promptly advise Broker of the status of all pending negotiations with respect to the leasing of space within the Building. Broker shall promptly submit all offers and applications which it receives for space in the Building to Owner. Broker shall not have the authority to execute any lease on behalf of Owner or to commit Owner to make any lease. Negotiations with respect to the leasing of space in the Building may be conducted through and/or in conjunction with Broker or by Owner independently. Broker shall supply Owner with such reports and other information with respect to the leasing program as Owner may reasonably request.

8. If any lease for which Broker is entitled to a commission contains an option or a right of first refusal on the part of the tenant under the lease

COMMERCIAL LEASING BROKERAGE AGREEMENTS APPENDIX A

to purchase the leased premises, the Building or any part of the Building or interest in the Building, Owner shall pay to Broker a sales commission equal to ___ percent of the total purchase price, payable at the time the lease or purchase is consummated.

9. In the event Owner is required to take over space then occupied by a proposed tenant, Owner shall grant Broker the exclusive right to act as broker for the lease, sublease, release, surrender or other disposition of such lease(s) for the takeover space and Broker shall be entitled to receive a commission in connection with the disposition.

10. Within ___ days after the expiration or earlier termination of this agreement, Broker shall submit to Owner a list of all prospective tenants for the Building with whom it has conducted negotiations. If within [for example: six] months after the expiration or earlier termination of this agreement, Owner shall lease any space within the Building to any such prospective tenant(s), Owner shall pay Broker a commission computed as if this agreement had not expired or been terminated.

11. Owner covenants to treat this agreement as confidential and agrees not to disclose the contents of this agreement to any party, except as may be required by law.

12. Broker covenants and agrees that during the term of this agreement until such time as leases have been executed for _____ [*specify percentage, such as: two thirds (2/3)*] of the rentable area in the Building, Broker will not act or agree to act as the leasing or rental agent for any building in the _____ [*specify location, for example: Wall Street area in New York City*] except the Building.

13. This agreement shall be binding upon and inure to the benefit of the parties to this agreement and their respective successors and assigns, except that Broker shall have no right to voluntarily assign this agreement without the written consent of Owner.

14. Any dispute or difference with respect to any matter arising out of or in connection with this agreement shall be submitted for final determination to the American Arbitration Association at its principal office in New York, New York.

15. Any notices required or permitted to be given by either party under this agreement shall be in writing and sent by certified or registered mail, postage prepaid, return receipt requested, addressed as follows:

To Broker at: _____ [*address*]

To Owner at: _____ [*address*]

Notices shall be deemed given _____ [*for example: three (3) business days*] after so mailed. Either party may change its address for notices by giving notice to the other party pursuant to this Paragraph 15.

16. This agreement sets forth the entire understanding between the parties to this agreement and cannot be changed, modified or amended nor any of its provisions waived except by an agreement in writing signed by the party to be charged.

[*Signature*]

_____ [*Typed name of owner*]

_____ [*Authorized signature*]

_____ [*Title*]

_____ [*address*]

AGREED TO AND ACCEPTED:

Dated: _____

[*Signature*]

_____ [*Typed name of owner*]

_____ [*Authorized signature of broker*]

NOTES

This agreement is quite favorable to the Broker as, among other things, the Owner assumes the responsibility for paying other brokers, the Broker is not required to indemnify the Owner, and the only condition for the Broker earning a commission is that the lease be signed.

COMMERCIAL LEASING BROKERAGE AGREEMENTS APPENDIX A

Counsel should make sure the actual Owner of Building signs the agreement or adds a statement that the signatory is the Owner's authorized agent. Be sure to set forth their addresses for notices.

No provision has been made for renewal of the term of this agreement.

A clause can be added that the Broker will use its best efforts (consistent with prevailing practices) to negotiate and consummate leases for the Building. Owners like this type of clause, however, it often leads to trouble in determining what "best efforts" are.

In defining fixed rent, this Agreement does not cover "take over" problems as these are not sums paid by the tenant.

Paragraph 4 requires only that the lease be signed for the Broker to have earned a commission. Frequently, satisfaction of other conditions such as term commencement, the obtaining of required consents, and rent commencement are required.

Paragraph 5 puts the onus on the Owner to reach a satisfactory arrangement with outside brokers. If an Owner wishes to enter into a lease transaction where an outside broker is involved, the Owner must promptly reach agreement with the outside broker in order to prevent liability to the outside broker for a commission in the event that the lease is not consummated.

The computation of commissions does not explicitly cover allowances or concessions granted to tenants.

Paragraph 9 is left open ended as to the amount of compensation. However, a particular percent commission can be inserted instead.

Paragraph 14, relating to arbitration can be omitted or, if Owner favors arbitration, can be strengthened.

Note that this agreement is silent as to whether compensation is due for renewal of a lease with a new tenant in the Building procured by Broker.

APPENDIX B

**Exclusive Brokerage Agreement for Lease Drafted by
Owner's Attorney**

_____ [Name of broker]

Re: _____ [address of property]

This letter will confirm our designation of you as our exclusive broker for the lease by us of the property described on the annexed Exhibit ____ (the "Property"). Your exclusive brokerage arrangement shall be on the following terms and conditions:

1. We reserve the right to determine all terms and conditions of any proposed lease and to accept or reject any proposed tenant procured by you for any reason in our absolute discretion.

2. This agreement is made subject to a prior lease or withdrawal from lease of the Property, or change of any terms or conditions of lease, all without notice to you.

3. (a) In respect of any consummated lease of the Property which shall be between us as landlord and a party procured by you as tenant, we shall pay to you, on behalf of you and any and all other brokers who may be entitled to share in the commission, a total commission in accordance with the terms set forth on the annexed Exhibit _____.

(b) A tenant shall not be deemed a party procured by you unless:

(i) the prospective tenant has, in fact, been procured by you;

(ii) you have given us written notice of the name and address of the prospective tenant, and you have exhibited the Property to the prospective tenant, during the term of this agreement and prior to our having learned of the interest of the prospective tenant from any other source;

(iii) negotiations commenced between us and the prospective tenant for the lease of the Property during the term of this agreement.

4. In computing any commission due under this agreement, the following rules shall govern:

(a) The following shall be excluded from the rental used to compute any leasing commission:

(i)_____ [*such as*: any increase in rent pursuant to any escalator provision contained in the lease whereby the prospective tenant pays a share of taxes, costs or expenses or any percentage rentals payable by the prospective tenant in excess of a fixed minimum rental];

(ii)_____ [*such as*: rentals payable by the prospective tenant allocated specifically or otherwise in payment for electricity, heat, air-conditioning or other utilities or services];

(iii)_____ [*such as*: rentals, allowances or other sums payable by the prospective tenant's improvements, decorations or installations];

(b) no commissions shall be paid to you as a result of any renewal or extension of a lease or any new lease between us and any prospective tenant nor as a result of any purchase of the Property whether or not pursuant to any option to purchase the property contained in any lease or other agreement between us and any prospective tenant or otherwise;

(c) if any lease provides that either or both of the parties may cancel the lease upon the happening of a specified contingency after the commencement of the lease but prior to the expiration of the term provided in the lease, then commissions shall be deemed due or earned only upon the uncancellable portion of the term until such right to cancel expires, and the balance of such commission shall then be paid by us to you following the last day on which any such right to cancel may be exercised; and

(d) if for any reason, including but not limited to, noncompletion of the premises covered by any lease because of inability to finance construction, acts of God, strikes or other labor difficulties, governmental restrictions, casualty or any other causes beyond our control, the prospective tenant does not take possession of the premises or commence the payment of rent, other than deposits or prepay-

ments of rental called for under the lease prior to the commencement of the regular periodic installments of rental, then no portion of the balance of your commission shall be deemed to be due or earned, or shall be paid to you by us, and we shall be relieved from any liability for the payment of any portion of any remaining balance of such commissions, and you shall refund to us any and all amounts which may have been paid under this agreement.

5. If for any reason whatsoever, including but not limited to, the acts, omissions, negligence or willful default of us or our agents, employees or representatives, a lease shall not be entered into between us as landlord and any prospective tenant procured by you or the conditions of the lease contained shall not be satisfied, then no brokerage commission, fee, or other compensation, or any portion of brokerage commission, fee, or other compensation, shall be deemed to be due or earned by you under this agreement, and we shall be relieved from all liabilities to you for the payment of any and all brokerage commissions, fees, or other compensation whatsoever. It is expressly agreed that we shall have the unqualified right, in our sole and absolute discretion, to refuse to enter into or refuse to consummate any lease of the Property for any reason whatsoever without incurring any obligation to you for the payment of any brokerage commission, fee, or other compensation.

6. You may not offer the Property through other brokers or enter into any commission arrangements with them which would be inconsistent with the terms of this agreement or which would increase the total amount of our liability under this agreement, and our sole liability shall be to you, and only you, as provided in this agreement. Your receipt of a commission paid by us shall constitute your agreement to indemnify and hold us harmless from and against any and all claims, liabilities, damages, costs or expenses, including attorney fees, which may be incurred by us as a result of the assertion by any other party in respect of any commission, brokerage, or other, compensation claimed to be due with respect to any lease of the Property. Provided, however, that your liability under this indemnity shall not exceed the amount of any commissions paid or payable to you under this agreement.

7. Any commission payable to you under this agreement shall be reduced by an amount equal to any commission, fee or other compensation directly, or indirectly, paid or payable to you by any prospective tenant or any other person, firm or corporation in connection with the proposed lease.

8. It is understood that you are an independent contractor and shall not be considered our agent for any purpose whatsoever. You are not granted any right or authority to assume or create any obligation or liability or make any representation, covenant, agreement or warranty, express or implied, on our behalf, or to bind us in any manner or thing whatsoever.

9. You will undertake an active leasing campaign on our behalf and, subject to our prior written approval in each such instance, will advertise the Property, find and investigate prospective tenants for the Property and otherwise use your best efforts to bring about its leasing. Expenses for promotion, advertising, mailings, providing floor plans and other expenses undertaken to further the leasing of the Property shall be borne by you, and you shall indemnify and hold us harmless from and against any claims of others in respect to these expenses, except that we shall reimburse you for your actual out-of-pocket costs paid to newspapers for advertising the Property up to a maximum amount of \$_____. You shall attend all meetings with respect to the Property to which you are invited.

10. We shall refer to you all calls and inquiries relating to the Property which we may receive from other brokers and we shall not engage the services of any other broker during the term of this agreement. It is understood, however, that we reserve the right to lease the Property ourselves without incurring any liability to you for any commission, brokerage or other compensation.

11. This agreement shall terminate ____ months from the date of its execution, unless the term is extended in writing signed by both of us, or any earlier date on which we shall have entered into a lease for the leasing of all or substantially all of the Property where the tenant of the property is not a party procured by you, as defined above. Upon the termination of this agreement, each of us shall be relieved of any further obligation to the other. However, we shall recognize you as the broker in accordance with the terms of this agreement in respect of any lease of the Property subsequently entered into with any prospective tenant procured by you, as defined above, during the term of this agreement if a lease is entered into within ____ months after the termination of this agreement.

12. You shall execute and deliver to us such further documents and instruments as we may request in order to confirm or implement the foregoing.

COMMERCIAL LEASING BROKERAGE AGREEMENTS APPENDIX B

13. This agreement sets forth the entire understanding between the parties to this agreement and cannot be changed, modified or amended nor any of its provisions waived except by an agreement in writing signed by the party to be charged. If you are in agreement with the foregoing, please sign at the space provided below and return a fully executed copy of this letter to us within ___ days from the date of this letter. Otherwise there shall be no binding agreement between us, and you shall have no right to act with respect to the Property on our behalf.

Dated: _____

[Signature of owner]

[Printed name of owner]

Agreed to and Accepted:

Dated: _____

[Authorized signature of broker]

[Printed name of broker]

Exhibit _____

Real Estate Brokerage Agreement Description of Property: Exhibit _____

Real Estate Brokerage Agreement Amount of Commission: \$ _____

Payment of Commission:

The commission to be paid upon the date when, under the terms of such lease, the prospective tenant (a) obtains possession and (b) commences the payment of rent on a regular and continuous basis.

Confirmed:

Dated: _____

[Signature of owners]

[Signature of broker]

Notes

Broker's counsel may want to add a provision freeing the broker from any responsibility for investigating the prospects' financial condition or ability.

Owner's counsel should consider adding the following clause: Broker will at all times advise owner of the status of broker's endeavors on owner's behalf and will furnish owner with such written status reports as owner may request.

Owner's counsel may wish to add a provision for an indemnity providing that the broker by submitting a prospective tenant shall agree to indemnify the owner against claims by other brokers.

APPENDIX C

Non-Exclusive Brokerage Agreement Drafted by Owner's Attorney

To: _____ [Broker]

From: _____ [Owner]

Re: _____ [address of property]

This letter will confirm our designation of you as our non-exclusive broker, for the lease by us of the property described on attached Exhibit ____ (“Property”). Your non-exclusive brokerage arrangement shall be on the following terms and conditions:

1. We reserve the right to determine all terms and conditions of any proposed lease and to accept or reject any proposed tenant procured by you for any reason in our absolute discretion.

2. This agreement is made subject to a prior lease or withdrawal from lease of the Property, or change of any terms or conditions of lease, all without notice to you.

3. (a) In respect of any consummated lease of the Property which shall be between us as landlord and a party procured by you as tenant, we shall pay to you, on behalf of you and any and all other brokers who may be entitled to share in the commission, a total commission in accordance with the terms set forth on Exhibit ____ annexed to and incorporated in this agreement.

(b) A tenant shall not be deemed a party procured by you under this agreement unless:

(i) the prospective tenant has, in fact, been procured by you;

(ii) you have given us written notice of the name and address of this prospective tenant, and you have exhibited the Property to this prospective tenant during the term of this agreement and prior to our having learned of the interest of this prospective tenant from any other source; and

(iii) negotiations shall have commenced between us and such prospective tenant for the lease of the Property during the term of this agreement.

4. In computing any commission due under this agreement, the following rules shall govern:

(a) the following shall be excluded from the rental used to compute any leasing commission:

(i) _____ [for example: any increase in rent pursuant to any escalator provision contained in the lease whereby the prospective tenant pays a share of taxes, costs or expenses or any percentage rentals payable by the prospective tenant in excess of a fixed minimum rental]

(ii) _____ [for example: rentals payable by the prospective tenant allocated specifically or otherwise in payment for electricity, heat, air-conditioning or other utilities or services]

(iii) _____ [for example: rentals, allowances or other sums payable by the prospective tenant in payment for the prospective tenant's improvements, decorations or installations]

(b) no commissions shall be paid to you as a result of any renewal or extension of a lease or any new lease between us and any prospective tenant nor as a result of any purchase of the Property whether or not pursuant to any option to purchase the property contained in any lease or other agreement between us and any prospective tenant or otherwise;

(c) if any lease shall provide that either or both of the parties may cancel the lease upon the happening of a specified contingency after the commencement thereof but prior to the expiration of the term provided in the lease, then commissions shall be deemed due or earned only upon the uncancellable portion of the term until such right to cancel expires, and the balance of commission shall then be paid by us to you following the last day on which any right to cancel may be exercised; and

(d) if for any reason, including but not limited to, noncompletion of the premises covered by any lease because of inability to

finance construction, acts of God, strikes or other labor difficulties, governmental restrictions, casualty or any other causes beyond our control, the prospective tenant does not take possession of the premises or commence the payment of rent (other than deposits or prepayments of rental called for under the lease prior to the commencement of the regular periodic installments of rental), then no portion of the balance of your commission shall be deemed to be due or earned, or shall be paid to you by us, and we shall be relieved from any liability for the payment of any portion of any remaining balance of such commissions, and you shall refund to us any and all amounts which may have been paid under this agreement.

5. If for any reason whatsoever, including but not limited to, the acts, omissions, negligence or willful default of us or our agents, employees or representatives, a lease shall not be entered into between us as landlord and any prospective tenant procured by you, then no brokerage commission, fee, or other compensation, or any portion thereof, shall be deemed to be due or earned by you under this agreement, and we shall be relieved from all liabilities to you for the payment of any and all brokerage commissions, fees, or other compensation whatsoever. It is expressly agreed that we shall have the unqualified right, in our sole and absolute discretion, to refuse to enter into or refuse to consummate any lease of the Property for any reason whatsoever without incurring any obligation to you for the payment of any brokerage commission, fee, or other compensation.

6. You may not offer the Property through other brokers or enter into any commission arrangements with them that would be inconsistent with the terms of this agreement or that would increase the total amount of our liability under this agreement, and our sole liability shall be to you, and only you, as provided in this agreement. Your receipt of a commission paid by us shall constitute your agreement to indemnify and hold us harmless from and against any and all claims, liabilities, damages, costs or expenses, including attorney fees, which may be incurred by us as a result of the assertion by any other party in respect of any brokerage commission, fee, or other compensation claimed to be due with respect to any lease of the Property; provided, however, that your liability under this indemnity shall not exceed the amount of any commissions paid or payable to you under this agreement.

7. Any commission payable to you under this agreement shall be reduced by an amount equal to any commission, fee or other compensation directly, or indirectly, paid or payable to you by any prospective

tenant or any other person, firm or corporation in connection with the proposed lease.

8. It is understood that you are an independent contractor and shall not be considered our agent for any purpose whatsoever, and you are not granted any right or authority to assume or create any obligation or liability or make any representation, covenant, agreement or warranty, express or implied, on our behalf, or to bind us in any manner or thing whatsoever.

9. This agreement may be terminated at the will of either party at any time upon the giving or mailing of notice of termination to the other party and shall terminate in any event upon our entering into a lease for the leasing of all or substantially all of the Property where the tenant of the property is not a party procured by you, as defined above. Upon termination each of us shall be relieved of any further obligation to the other, except that we shall recognize you as the broker in accordance with the terms of this agreement in respect of any lease of the Property subsequently entered into with any prospective tenant procured by you if, and only if: (i) the prospective tenant was a party procured by you, as defined above, during the term of this agreement and (ii) the lease is entered into within ___ months after the termination of this agreement.

You shall execute and deliver to us all further documents and instruments as we may request in order to confirm or implement the foregoing.

11. This agreement sets forth the entire understanding between the parties to this agreement and cannot be changed, modified or amended nor any of its provisions waived except by an agreement in writing signed by the party to be charged.

If you are in agreement with the foregoing, please sign at the space provided below and return a fully executed copy of this letter to us within _____ days from the date below; otherwise there shall be no binding agreement between us, and you shall have no right to act with respect to the Property on our behalf.

Dated: _____

[Authorized signature of owner]

[Typed name of owner]

Accepted and Agreed to:

Dated: _____

[Authorized signature of broker]

[Typed name of broker]

NOTES

Broker's counsel may want to add a provision freeing the broker from any responsibility for investigating the prospects' financial condition or ability.

Owner's counsel should consider adding the following clause: "Broker will at all times advise owner of the status of broker's endeavors on owner's behalf and will furnish owner with such written status reports as owner may request." Owner's counsel may wish to add a provision for an indemnity providing that the broker by submitting a prospective tenant shall agree to indemnify the owner against claims by other brokers.

CHAPTER TWELVE

PREMATURE COMPENSATION AND HOW TO PREVENT UNPLEASANT BROKERAGE SURPRISES (WITH SAMPLE LANGUAGE AND MODEL BROKER REGISTRATION AGREEMENT)

Joshua Stein, Esq.

PREMATURE COMPENSATION

Consider this common series of events: A leasing broker has a good potential tenant for a property. The broker calls the property owner. The property owner agrees that the prospective tenant might be a good fit. The prospective tenant is willing to pay the asking rent—or at least close enough to it to make the deal work for the property owner. Landlord and tenant reach a deal. A lease goes out. Comments come back. Technical or legal issues arise. Negotiations break down. The tenant goes away. Or maybe the owner decides to rent the space to someone else who offers more rent. Exactly what happened and why isn't quite clear. Each side has its own version of the facts. The broker thinks the landlord killed the deal.

Under facts like these, the broker may conceivably sue for a commission. The broker's claim could survive the landlord's motion for summary judgment. The court could very well rule that the broker did enough to support a commission claim, even without a signed lease, at least under some circumstances. Traditional brokerage law supports such a ruling. A broker can recover a commission if the broker did his or her job: procuring a ready, willing and able tenant willing to pay a price the landlord is willing to accept. The deal doesn't necessarily need to close—i.e., the tenant doesn't necessarily need to sign a lease—for the broker to claim a commission, at least if the broker can somehow argue the landlord prevented the deal from closing. A New York case decided in mid-2013, discussed below, one of many similar cases over many decades, confirmed this traditional principle of brokerage law in the context of leasing brokerage.¹

As a common variation, in a hot market the owner of an attractive building often receives cold calls from brokers waving big numbers, offering highly credible buyers and otherwise trying to get the owner to sell. The owner might have a conversation with the broker and his client, and might even entertain a proposal. If those discussions break down, the broker might, again, still successfully claim the owner owes a commission, if the broker can show he delivered a “ready, willing, and able” buyer at a price satisfactory to the owner even if no formal written agreement ever existed. It's relatively easy for the broker to claim there “would have been” such an agreement if the owner hadn't decided to ditch the transaction.

Like so many ancient legal principles, these principles of brokerage law make no sense in today's world. Today, an owner intuitively expects not to have to pay a commission unless the broker's tenant or buyer actually creates value by signing a lease or closing an acquisition. An owner

¹ *Optimal Spaces, Inc. v. 5 Hanover LLC*, 40 Misc. 3d 1213(A), 975 N.Y.S.2d 710 (Sup. Ct., N.Y. Co. 2013)

also knows that many things can go wrong, including a simple change of heart, between a deal in principle and a closing. If something does go wrong, no owner wants to have to prove why the broker didn't earn a commission. In this case, as in so many others, intuition is a poor guide to the law.

Stories like these call into question the common practice by which an owner enlists or at least accepts the help of brokers without negotiating or signing any brokerage documentation at the outset. Instead, if and when the parties reach an agreement in principle and seem to be moving toward documents, the owner expects to negotiate and sign a brokerage agreement as part of documenting the deal. Without some protective agreement earlier in the process, though, the owner could face the risk, not always theoretical, that negotiations will break down, but the broker will still claim a commission.

A cautious owner should consider a more deliberate process. If a broker is dangling desirable tenants, the owner should put in place some minimal agreement with the broker (just a mechanism to prevent claims) as early as possible in the process, and well before entering any negotiations. The same goes for a potential sale.

In the context of a lease, of course, if the owner has already engaged the broker as leasing agent for the building, then the agency agreement should cover the issue and forestall unexpected commission claims. These problems will occur more often in one-off transactions or if a new (or additional) broker gets involved, especially if the broker and owner don't expect to have a continuing relationship. Without a formal agreement, if the broker is "really" the tenant's broker, or isn't an institutional broker who wants a long-term relationship with the owner, problems can arise.

In the context of leasing brokerage, can an owner eliminate these risks by having a leasing agent for the building? Not really. Even then the risk remains. In the New York court decision mentioned earlier, the leasing agent conducted negotiations for the owner, but the court still thought the outside broker might have a good claim.

Similar problems might arise, in reverse, when a national retailer receives unsolicited inquiries from brokers proposing locations for the retailer's next store. Here, the retailer is the equivalent of the "owner" and therefore wants to avoid claims from a broker who helped negotiate a deal for a lease that the parties never actually sign. Even if the landlord would have paid the commission for a "done deal," a creative broker can claim

PREMATURE COMPENSATION

that because it's the tenant's fault that the deal didn't close, the tenant should compensate the broker for the commission the broker would have collected from the landlord.

In any of these cases, the dynamics of the commercial brokerage business give a broker every incentive to assert a premature claim. Most efforts to bring about commercial transactions fail, so much of a broker's effort will go to waste. In the occasional case where the broker achieves any degree of success, they may have hit the jackpot. Commercial brokerage relies on big hits rather than a steady stream of income from lots of small, easily arranged transactions. So a broker has every incentive to make a claim if any basis at all exists for doing so. Unfortunately for owners, the law allows such claims under circumstances that an owner would regard as premature.

An owner protection agreement needs to state only that the broker won't receive a commission unless the owner actually negotiates and closes a deal. Such an agreement, if entered into early in the process, need not lay out all the details of the commission or the entire relationship between owner and broker. The owner will just want to protect himself from legal arguments that might limit his ability to walk away from the transaction. The essence of such an agreement can be distilled into a paragraph, such as this, in a letter from the broker to the owner:

We look forward to discussing with you the possible interest of _____ ("*Prospect*") in a transaction involving _____. You will have no obligation or liability to us, we will not look to you for any payment, and you may terminate discussions at any time, unless and until you agree upon, enter into and actually close a binding transaction with Prospect, and all conditions to its effectiveness have been met or waived.

If an owner doesn't want to cover the matter in a separate letter with the broker, he can address the issue in the usual preliminary document that the parties exchange as they try to reach a nonbinding business deal, i.e., a term sheet or letter of intent. That document will usually already say something about the broker. Any party worried about exposure to premature brokerage claims might simply ask the broker who might make a claim to add language like this to the letter of intent or term sheet:

No party to this contemplated transaction shall have any liability for any payment to any broker, and each party

may terminate discussions at any time without liability to any broker, unless and until the parties agree on, sign and exchange binding documents, all conditions to their effectiveness have been met or waived and a closing has occurred.

Either of the sample provisions suggested, if the broker signs onto it, should prevent a broker from making premature claims. But each leaves a lot unsaid. One could add many other points to the understanding between the parties, inflating the agreement from a paragraph into a page or more. As always, legal documents of all types only get longer, never shorter. An example of a more complete preliminary—but still not very long—agreement with a broker follows this discussion. That agreement goes into some other issues that an owner or broker might want to resolve early in the process, beyond just protecting the owner from premature commission claims.

If an owner wants to enter into an agreement like this, he should make that clear when the broker submits the first term sheet or other proposal. Nothing stops the owner from requiring it before that. If the owner doesn't want to have a complete, full-blown brokerage agreement at that point, that's fine. The owner just needs to assure that some binding documentation communicates one crucial point: the owner will never owe a commission unless a transaction actually closes. If and when a transaction actually starts to come together, it's up to the owner and the broker to proceed with the usual commission negotiations and sign a more complete agreement.

The model agreement offered here achieves two goals. First, it protects the owner from unexpected claims, something the owner could also achieve with the simpler language options suggested above. Second, this agreement recognizes the broker as the procuring cause of a particular potential counterparty and takes care of some other housekeeping.

The first goal serves the owner, recognizing that brokers can and do assert claims even when their efforts do not bring about an actual transaction, as described above.

Under this letter agreement, if and when the broker actually does earn a fee, the broker can either agree to look solely to its prospect, or acknowledge it has no claim against the owner absent a closing. If the broker acknowledges that it has no claim and a closing occurs, this model registration agreement (just like either of the shorter options suggested above)

PREMATURE COMPENSATION

does not immunize the owner from claims. In fact, in that case—if a true closing occurs and the owner gets the benefit of a completed transaction—then the broker could still potentially assert a claim, even if the parties never actually signed a brokerage agreement. To prevent that, the parties must sign a brokerage agreement before or along with transaction documents, or at the very least before closing.

The second function of the preliminary agreement offered here benefits primarily the broker. A broker will worry that if the broker introduces the owner to a possible counterparty, then the owner might “go around” the broker and deal directly with the interested party. This concern often leads some brokers to ask owners to sign a marginally literate “noncircumvention agreement” very early in any negotiations. Because the broker’s concern is understandable, this model agreement contains the essence of a noncircumvention agreement—though written in English, unlike most such agreements.

This agreement also requires the broker to “register” his client, and requires the owner to recognize that registration. Once that happens, the owner might sometimes already have a relationship with the broker’s client, so the broker’s introduction serves no purpose. One can handle this concern by adding language to give the owner the right to quickly disallow and “unregister” the broker’s client by establishing that the owner already knew that person and was perhaps already having discussions with her. The model registration agreement offers optional language to that effect. If the owner wants to unregister the possible counterparty, then the owner bears the burden of showing some level of pre-existing relationship with or knowledge of that counterparty. The model requires proof of that relationship through email communications dated within a certain period before the registration agreement.

An owner might, of course, prefer to sign a full brokerage agreement now, in place of this letter or a one-paragraph waiver letter, leaving nothing for later. But that may be too much work, the transaction may never happen, the risks may seem manageable, this letter may already be too long, etc. (On the other hand, a full brokerage agreement is not much more difficult to negotiate than this letter and is probably more “standard.”) Until the parties sign a full brokerage agreement for an imminent transaction, though, this letter protects the owner in some important ways. If and when the parties sign a brokerage agreement, it would supersede this letter.

Owners who ask brokers to sign agreements like the one offered here may encounter rough sailing. Brokers do not like signing this type of agreement. They may say it's premature. Many brokers don't like thinking too much about legal concerns or dealing with legal documents of any kind. They might say the model agreement offered below is "too long." They might be right about that and, if so, perhaps they will agree to one of the much shorter options suggested above. They may favor taking their chances, knowing that if the owner takes the bait, the law of brokerage may ultimately support a claim so the broker can hit the jackpot—exactly what this letter agreement seeks to prevent.

As another possibility, once a broker sees this letter agreement, a broker who claimed to have the ideal purchaser may announce that she doesn't want to bother with the property in any way unless she gets an exclusive listing, even though the broker premised their overture on the proposition that they had one ideal buyer for the property. This actually happens a lot. It shows that owners may end up wasting their time if they deal with one-off inquiries from brokers. In other words, the best way to deal with brokers may be to carefully choose one reputable broker and enter into an exclusive listing.

Of course, sometimes a broker who parachutes in with a "great buyer" may in fact: (a) have an actual great buyer who is willing to pay more than anyone else and (b) not really be looking for an exclusive listing.

More often, though, in today's world, everyone knows everyone and everything. That makes it unlikely that a particular broker will add value by introducing the owner to a buyer that no one else could possibly have found. A broker instead will more often add value by developing the best possible marketing program to present the owner's property, determining which prospective buyers should learn about the property and when, and playing multiple buyers against each other to achieve the best possible execution. That type of a brokerage engagement requires the owner to choose a single exclusive and competent broker and then undertake a strategic marketing program with that broker's expert advice, rather than deal with a menagerie of one-off brokers.

The owner's dilemma—how to deal with all these brokers and brokerage alternatives—is not a bad problem to have. The owner also should remember that markets change. If the owner does in fact want to sell in a hot market, then he or she should not waste time. He or she should try to get a solid deal signed and closed before the market turns against him.

PREMATURE COMPENSATION

If an owner chooses to deal with multiple brokers, though, the exposures described above merit careful consideration. An owner doesn't need to do very much to protect himself or herself. And the owner's attorney can play a crucial protective role by encouraging the owner to sign an agreement based on this model—or at least have the broker sign a one-paragraph waiver of the type suggested here—before opening substantive deal discussions.

APPENDIX
MODEL BROKER REGISTRATION AGREEMENT
AND COMMISSION WAIVER

[Date]

CONFIDENTIAL

[Name and Address of Property Owner]

Registration of Prospect for _____ (the “Property”)²

To the Owner:

Please countersign below to confirm (the “*Registration*”) that we: (a) may discuss the Property with _____ or its affiliate (the “*Prospect*”); (b) may seek to develop Prospect’s interest in a possible ground lease, joint venture, recapitalization, redevelopment, sale, space lease or other transaction for the Property (any of these, a “*Transaction*”); (c) introduced Prospect to the Property; and (d) are Prospect’s broker of record.

Notwithstanding anything in the previous paragraph, if you already [had a relationship and lines of communication] [discussed the Property or a possible Transaction] with Prospect, as demonstrated by email communications dated within the last ___ days, then the Registration shall be of no force or effect. You must, however, notify us of that in writing within ___ days of the date of this letter, or the Registration will remain fully effective.³

This Registration will remain in effect only for this “*Registration Period*”: (a) ___ days after the date of this letter (the “*Initial Period*”); (b) if, in the Initial Period, we show the Property to Prospect and, with Prospect’s approval, give you (by email or otherwise) a written letter of intent or term sheet for a Transaction (an “*LOI*”), then so long as you are actively negotiating an LOI or binding documents (the “*Documents*”) with Pros-

2 This assumes the owner owns the Property and may sell it. With adjustments, this letter will work for a landlord with vacant space who receives unsolicited inquiries from brokers, or a national tenant looking for new locations but also worrying about reaching a nonbinding agreement with an owner and then deciding not to proceed.

3 This paragraph is optional. If the parties think very hard about the issues raised here, then they may face a conundrum: which side will show their cards first? As a practical matter, they deal with it. And most but not all brokers and owners are honorable.

pect (the “*Negotiation Period*”); and (c) if you sign Documents in the Initial Period or the Negotiation Period, then until Closing as defined below.⁴

The Registration Period will also continue for ___ more days (the “*Tail Period*”) after: (x) the Initial Period ends with no LOI or signed Documents; or (y) the Negotiation Period ends with no signed Documents or Closing. You or your counsel may, by email: (x) give notice of any Tail Period; or (y) extend the Registration Period.

In the Registration Period, you will not circumvent us in dealings with Prospect. After the Registration Period, we have no rights or claims regarding Prospect, but the rest of this letter still applies.⁵

Although you recognize our Registration, we initiated these discussions. You have made no determination to proceed with a Transaction on terms in an LOI or any other terms. The purpose of this Registration is just so you can see if it makes sense for you to even consider whether you have any interest in a possible Transaction. Your signing this Registration does not imply you plan to enter into a Transaction.⁶

You have no obligation to sign Documents or close a Transaction. You may freely and without liability to us, for any reason or no reason, or arbitrarily, capriciously or willfully: (a) withdraw the Property from the market or any possibility of a Transaction; (b) not sign Documents; (c) default⁷ under any Document; (d) discontinue or not even start negotiations; (e) enter into a Transaction with someone other than Prospect; or (f) work with other brokers or finders, except regarding Prospect in the Registration Period. You may do any or all of these things even if you and Prospect reach an understanding on a Transaction but no Closing has occurred. In any of those cases, you will owe us nothing.

[We will look only to Prospect for any commission, compensation, or other consideration due us as a result of any Transaction or other dealings

4 To shorten and simplify this document, one could provide for, e.g., a 12-month Registration Period and call it a day, deleting this paragraph and the next two.

5 If the broker already had a relationship with Prospect, and brought only one Prospect to the Property, and the owner didn't know the Prospect before, then the broker might reasonably demand perpetual exclusivity. A Tail Period after which “anything goes” may make more sense when an owner engages a broker for a broad marketing program.

6 An owner would add this paragraph only if some other document gives a third party pre-emptive rights if the owner “decides to sell.”

7 Brokers will often seek to have rights against an owner that “willfully defaults.” An owner should resist that concept and insist on absolute freedom to default.

with Prospect.^{8]} We will not look to you for payment of any kind, and you will have no liability to us under any circumstance[, except as follows. If signing of Documents seems imminent, then you and we will promptly and in good faith negotiate a commercially reasonable agreement on ordinary and customary terms for you to pay an agreed commission only if a Closing occurs (a “*Brokerage Agreement*”). A “*Closing*” means: you and Prospect sign and exchange Documents; any due diligence period or termination or rescission right lapses without exercise; all conditions to a Transaction closing are met or waived; you actually close a Transaction with Prospect; and you receive the consideration due at closing. If and only if a Closing occurs but you and we did not sign a Brokerage Agreement, then this letter, except its provisions on confidentiality, shall have no force or effect for any purpose, as if it had never been signed, and shall not bind or limit anyone in any way^{9]}.

You and we may exchange emails on the Property, the Prospect, a Transaction or Documents (the “*Emails*”). No Email and no oral communications will modify this letter, obligate anyone, extend the Registration Period or constitute a Brokerage Agreement (each, a “*Modification*”), except as this letter states. If an Email transmits as an attachment a Modification, manually signed with pen and ink, not an electronic signature, then that attachment binds the signer. Except as this letter states, any Emails will not: (a) be written with advice of counsel or intention of having legal effect; or (b) have legal effect or be admissible in court.

We will keep confidential all information on this engagement, the Property, any Transaction and any Documents, except we can share it with Prospect and Prospect’s advisors. We will direct them to preserve confidentiality. We may disclose this agreement in any dispute between us, but shall seek confidential treatment.

This letter applies only to Prospect. We will not list or publicize the Property, or suggest or communicate its possible availability, except to Prospect. We will not introduce anyone except Prospect to the Property. We will not purport to bind you to any Transaction. This arrangement is non-exclusive. We will not work, and have not worked, with any other broker, finder or other agent for the Property or a possible Transaction.

8 Choose this bracketed language or the next bracketed language, but not both.

9 Here, the broker could claim a commission and a court would decide its amount and timing. Neither owner nor broker should let this sentence govern. An owner might prefer to negate any commission under these circumstances. That seems unreasonable.

If Prospect comes to the Property in a group of investors or other participants, you will have no liability to us unless we affirmatively show you introduced Prospect to that group in the Registration Period, including a Tail Period.¹⁰

You confirm you have engaged no exclusive broker for a possible Transaction (“*Exclusive Broker*”). You have not committed to engage us as Exclusive Broker. If you engage an Exclusive Broker other than us in the Registration Period, then you will promptly notify us. When we receive that notice, the Registration Period will end. A Tail Period will then apply, but only if we affirmatively show you suggested Prospect to Exclusive Broker in that Tail Period.

If Prospect wishes to acquire the business located in the Property (the “Business”), then: (a) references to the Property also refer to the Business; (b) we acknowledge the Business is separately owned; and (c) references to you also refer to the Business owner.

When we say “you” in this letter, we also mean your constituent principals, partners, members, employees, agents, board members, family members, and other related parties.

We look forward to speaking with you about Prospect.

Very truly yours,

[SIGNATURES]

¹⁰ This paragraph and the next two cover situations that have arisen in the author’s experience, but are candidates for early deletion.

CHAPTER THIRTEEN

**CONSTRUCTION AND THE
COMMERCIAL LEASE**

Kevin J. Connolly

[13.0] I. INTRODUCTION

Landlords commonly find themselves having to address construction-related issues. It is not at all uncommon for *some* construction work to be needed or wished for by the Tenant.

The art of building is a dark art. It is risky, expensive, and, in principle, undertaken only when necessary. Construction is often inevitable when commercial leases are made, and herein we have one of the great collisions between differing rules of law and getting things done: Construction Law is not like Real Estate Law. Real Estate lawyers will argue over every sentence and every paragraph, if not every word and punctuation mark, in the contract. This reflects the nature of real estate: it lasts. A fee interest is theoretically perpetual. Leases and mortgages have generational durations. Even a short-term lease is likely going to last for years, which is too long to live with a problem.

Construction is based on getting the work done. The Work cannot be used until it is done, and the time frame for getting the Work done is always (and obviously) of much shorter duration than the lease. Those who use real estate lawyers to handle construction often discover that the contract is still being negotiated as construction begins. It is not unusual to find enormous construction projects for which “the Contract” is signed only at the closeout of construction. The work is substantially complete, the tenants are in possession and sometimes actually operating, the final disbursement of mortgage proceeds has been made and divvied up, and only now is the contract signed, ostensibly “for insurance purposes.”

This is a backward approach to the process. The contract is a tool whose purpose is to get the project built. However, the tool is useless until the contract is signed, and herein lies one of the collisions that so often bedevil construction. A large proportion of commercial construction is accomplished without a contract being in place. This is foolish, and often reflects the intransigence of real estate lawyers who insist on having their way.

Contracts take time to negotiate, and while there are ways to limit negotiations¹ it still remains true that most substantial projects kick off under a Letter of Intent (LOI). All practitioners teach that the LOI should have a very short life, but in practice, a surprising number of construction contracts are not signed until closeout. The LOI keeps being extended, with more and more work authorized to be performed pending the formalization of the contract.

In theory, the “Owner”² retains control during the pre-Contract Stage because the Owner can terminate the LOI at any time and for any reason or no reason.³ In practice, once a constructor actually begins operations pursuant to a LOI or informal agreement, the constructor will act as though it is The Anointed One for the whole project. Depending on what the Owner has paid for during the pre-Contract Stage, it may be impractical to replace the constructor without a good reason. It may also be impossible, particularly if the trades are so beholden to the constructor that they won’t accept a substitute.

[13.1] II. THE LETTER OF INTENT

The Letter of Intent should identify the parties to the project and set out the nature of the Work in as much detail as practical. If a “100% Complete” set of plans and specifications is ready, then the LOI can refer to those documents. If the design is less complete than the Owner will need to attend to describing the project in enough detail to guide the actions of the Constructor.

The LOI should make it clear that “The Contract” is in flux. Owners typically reserve the right to cancel at any time and for any reason or no reason, with its obligations limited to paying for the Work accomplished. There will be additions to that measure to defray the cost of demobilizing and protecting Work in place. Unwinding the insurance coverage may be quite different.

1 One time-honored way is to include all of the terms of the contract in a “Project Manual.” The price quoted or bid thus reflects all of the terms incorporated into the documents and which should have been reviewed by the Owner before approval. When imposing the terms of the contract on bidders, it is advisable to hold a pre-bid conference at which the bidders can express comments and concerns. Those that are adopted are communicated to the bidders through an Addendum, which becomes part of the basis of the bargain in fact.

2 “Owner” is used in the construction industry meaning of “he who pays for the Work.”

3 This right is the distinctive element of a Letter of Intent as distinguished from “The Contract.” A full contract is usually not terminable by the Owner except for default or on payment of compensation for the termination.

Some Letters of Intent sidestep those issues by limiting the interim work to items that can be performed off-site. The Constructor should have its own general liability insurance to cover activity at its workshop, and much of the long lead time Work that is addressed by LOIs will be done by subcontractors and material suppliers at their own premises. Once operations begin on the site, the task of unwinding the insurance coverage becomes more daunting. For example, if the Owner elects to obtain a “Wrap-Up” Policy, the amounts paid up front or irrevocably committed to be paid will have a major role to play in the decision to terminate or not. In such a case, the party that places the insurance—and this is usually but not always the Owner—is not protected by the ability to cancel the Letter of Intent unless it also has the ability to substitute a new Constructor as the insured contractor under the Wrap. These concerns can also arise even without a wrap if the Owner is taking on the obligation to advance front-end costs.

The key to maintaining the LOI as such lies in keeping the constructors on a short leash. Once the Constructor is authorized to proceed with the Work on a Time and Materials basis, the Project has moved beyond the LOI stage: you now have a contract for the whole Project, and unwinding *that* sort of deal is as hard as resolving an acrimonious divorce for two glitterati with no pre-nup.

Bear in mind that some up-front costs should never be paid under a LOI. Tower Cranes come to mind as a large financial commitment, one that once incurred is unlikely to be undone unless the Project is being abandoned. That much said, the performance of substantial parts of the Work under a mere LOI remains an issue that cannot be addressed properly except by getting the contract signed. This is not limited to construction contracts. Most leasing lawyers have war stories in their repertoires that attest to the importance of compromise. Failing to compromise means that you may never get the contract signed in time to be useful, leading all involved to reap only the liveliest awfulness.

The parties usually have only themselves to blame for the outcome. Owners are so petrified at the rising cost of certain components that they will brook no delay in getting that phase built. Contractors will of course extract maximum benefit from working on a *quantum meruit* basis.

[13.2] III. WHOSE PROJECT IS IT, ANYWAY?

Construction is perilous, expensive and hard to control. One of the tried and tested solutions to the risks of construction is to delegate the Work to

the Tenant. The alternative—that of Landlord agreeing to achieve the construction (e.g., “build to suit” deals) puts the Landlord in the construction business, and this brings with it all the perils of construction.

The foremost peril is that of a failure to complete the work. If the Landlord has agreed to do the initial work, it cannot expect to collect rent until the space is ready for the Tenant to occupy and use the space. There is a flip side to using the space: most constructors operate on the theory that once there is “beneficial occupancy” of the Work, it is deemed to be Substantially Complete. That stage usually results in a substantial payment to the constructors.

The Landlord’s work is of course critical. Landlords must be aware that some “base building work” has the potential for significant downsides, among which the presence of asbestos or other hazardous materials must hold pride of place. Even if a Tenant is willing to undertake the abatement, e.g., of asbestos, the health of the entire building can be compromised if the abatement is not done thoroughly and carefully. Moreover, as the owner of the premises from which the toxic or hazardous material is generated, the Landlord owns the materials and their risks in perpetuity. Be aware that if abatement work is performed by a lower-tier subcontractor, the insurance coverage may not help the Landlord unless newer forms of endorsement are being used. Many forms of Additional Insured endorsement provide coverage only to a party with whom the contractor has a contract. Subcontractors’ policies cannot name an Owner as an additional insured unless a novel endorsement is employed.

The risks that come from letting the Tenant engage and hire the constructor and architect are both operational and financial. On the operational side, the Landlord needs to be satisfied that the construction documents reflect the limitations of the site. Zoning and other legal constraints may be relevant; structural and systems adequacy need to be evaluated. The Tenant’s satisfaction with the design should be implied from the submittal of the plan, but Landlords should always evaluate the plans for compliance with law. The Landlord bears the burden if, for example, the newly renovated space does not include ADA-accessible restrooms. Operational concerns extend to the attributes of and controls over the design and construction team. Especially if the Work is being done with other Tenants in occupancy, Landlords need to control the times when noisy work can be performed, as well as to restrict the use of common spaces and vertical transportation systems.

When work is performed “out of the ground,” the constructors should know everything that there is to know about the building. Repurposing, renovating and otherwise working in an existing building brings different issues. The walls are often closed up, leaving the team to rely on existing plans to discern where utility risers and distribution facilities are located. There is no guarantee that the plans were followed to the letter, and while as-built drawings may be available they are not always accurate. We then have the scenario where a wall is cut in order to gain access or perform work, and while the existing documents showed that the location was suitable, it sometimes happens that the contractor hits an electrical or gas line. In especially unlucky cases, both services are severed, with sparks, explosion and fire to follow. Insurance is a subject with which construction planners need to be conversant. This is sometimes seen in construction when a wall is closed up before the Work was inspected. In this case, it may be easier to assign blame, either to a trade who installed risers in the wrong place or the general contractor who did not annotate the documents for “as built” purposes.

On the financial side, a Landlord’s construction exposure is found principally in the laws governing mechanics’ liens. Controlling this exposure is highly dependent on state laws. Many states allow a contractor to waive the right to enforce a mechanic’s lien, not only for itself but for all of its subcontractors. Other states vitiate any waiver of the right to claim a lien in the absence of payment. At least one state provides that not only funds actually received but the right to receive further funds are held in trust for the benefit of “downstream” contractors, laborers and material suppliers.

One recurrent theme in mechanics lien enforcement is whether the Landlord has assented to the performance of the Work. As a general rule, the constructor’ right to a lien requires the Landlord’s positive assent, and this requires more than the terms of the Lease that call for construction work. A contractor who wishes to enforce a lien against the whole building needs to have the assent of the Landlord, and a wise constructor gets it in writing.

[13.3] IV. THE CITADEL OF PRIVITY STILL STANDS

Many states leave the Landlord without adequate remedies against careless architects and engineers who are hired by Tenants. The requirement for privity of contract is not universal, but in states, such as New York, that require it, the lack of a contract between the Landlord and the design/construction teams is fatal to the claim. Indemnification agree-

ments are useful in this connection, not only because they provide for payment to the injured party (almost always, the Landlord) but because they often trigger insurance coverage. However, most forms of architects' and engineers' professional liability coverage do not contain an "insured contract" exception. This means that the policy does not cover contractual liability. To the extent that a loss is occasioned by the designer's negligence, Landlords may be able to prosecute claims against the Tenant and the Tenant will bring a claim for the designer's negligence. The outcomes are highly variable, but the variation can be controlled by invoking a Liquidating Agreement.

Liquidating agreements have been used for decades, especially in construction, to bridge the lack of privity that would otherwise defeat the claim. It has been seen most often in claims by Subcontractors against Owners.

Let us suppose we have three parties, A, B and C. A has a contract with B; B has a related contract with C. If C's misconduct causes a loss to A, A has no remedy against C, but must claim against B. In a Liquidating Agreement, B formally admits that it is responsible to A for the loss caused by C. B agrees to institute a claim against C, including suit if needed. B, who may have its own claim against C, agrees to account for the proceeds of the suit. This enables a Landlord to maintain a claim against remote contractors and consultants without increasing the financial risk to the Tenant.

Bear in mind that liquidating agreements can increase the risks faced by an Owner. If the Owner deals with the contractor, secure in the belief that the trades generally cannot enforce claims against the Owner,⁴ it may be surprised when the Contractor asserts claims derived from the disappointments of the subcontractors. Controlling this risk can be folded into the general terms of the General Contract (or CM Agreement) if the Owner retains the right to approve not only the identity of the subcontractors but also the terms of the engagement. A liquidating agreement is an amendment of the underlying contract, and if the Owner's approval of the terms of the subcontract is required, then the General Contractor cannot enter into a liquidating agreement unless the Owner assents to the change.

One convenient way to ensure that these terms become part of the contract is to require.

4 Mechanics liens are normally the only exception to this rule, and should receive their own proper attention.

In jurisdictions that require privity, the lease needs to cover this gap with a broad form indemnification agreement. Whether the Tenant is able to pass the hot potato back to the architect's insurer depends on how that contract is written.

[13.4] V. DELIVERY METHODS AND PAYMENT OF COSTS

Payment is a critical aspect in which General Contracting and Construction Management differ. A General Contractor covers the costs of construction that it must pay—to subcontractors, laborers, material suppliers and others—prior to the Owner being obligated to pay the costs. The Owner's obligation to pay does not turn on what the Contractor has to pay, but on the percentage of completion of the Work.

Some of these expenses are simply enormous: a project-specific general liability policy with the substantial limits required⁵ represents a significant capital outlay. Unless different terms are negotiated, this premium is recouped pro rata as the Work progresses. Under Construction Management, the CM collects from the Owner the amounts that it is obligated to pay to others. Under CM, payment of the entire insurance premium will fall due from Owner to the CM when the premium bill is payable.

A portion of each "Progress Payment" is withheld to provide some security to the Owner for defective or omitted work, and to ensure that the contractor always has an incentive to finish the Work. There was a time when retainage of 10% of each progress payment was close to universal. The market is different today. Constructors will negotiate lesser amounts of retainage, sometimes using a formula that calls for retainage of 10% until the job is 50% complete, with no further retainage being held. In theory, when the Work is complete, the Owner will still hold 5% of the Contract Sum, an amount which should cover the Owner's exposure as long as it is paying attention to the progress of the Work.

Variable retainage can be a recipe for trouble. Many states have enacted "Prompt Payment Acts" that regulate payments for construction work. The New York Act addresses, among many other things, retainage under general contracts and subcontracts. The statute permits a contractor to withhold retainage from a trade at a rate no higher than the retainage provided in the general contract: "A contractor or subcontractor may also

⁵ For example, New York City mandates that almost all new buildings with 150 feet or 14 stories' height must have carry \$25,000,000 in general insurance limits during construction.

retain a reasonable amount for retainage so long as the amount does not exceed the actual percentage retained by the owner.”⁶

In our hypothetical situation, let us suppose that the project is more than 50% complete. There is no further retainage being withheld on account of the general contract. Does this mean that a painting subcontractor, all of whose work is performed after the project midway point, is entitled to paid all of the value its work, without retainage? Or must we calculate the net amount of the whole contract sum that is withheld after the current payment is made? No court decisions have been found to date. It is, however, worth noting that, according to the only available industry surveys (taken in 2004), most private projects call for retainage at 10% for the entire project.⁷ Current political initiatives by the American Subcontractors’ Association indicate that the fight has a long way to go, but some states have enacted legislation limiting retainage to 5%.

There are alternatives to retainage. When contracts are bonded, many constructors argue that retainage is unnecessary. That argument runs into resistance because construction sureties are not known for the speed with which they pay claims. Hence the self-help remedy of retainage retains significant value.

Landlords may wish to consider the approach to contract security that has become *de rigueur* in Continental Europe, the Middle East, North Africa, Latin America and Oceania: independent bank guarantees. These instruments are functionally indistinguishable from standby letters of credit.⁸ They are not taken for the full contract sum, but for an amount calculated to make the Owner whole following a default. Another alternative is to take a guaranty from the Tenant, and where a credit party is available, recourse to that person can be invaluable.

[13.5] VI. INSURANCE

Construction carries with it a need for insurance. It also has impacts on insurance coverage that outlast the construction project.

6 N.Y. General Business Law § 756-c.

7 ASA Report on Retainage Practice in the Construction Industry, Nov. 2004, www.asaonline.com/eweb/upload/Retainage%20Report%20for%20CKD.pdf.

8 Kevin J. Connolly, *Security for Contract Performance*, The John Liner Review, Vol. 24, No.2 (Summer 2010).

Improvements and betterments, even if they are paid for by the Tenant, are real estate. They increase the insurable value of the building, and even the Landlord has no obligation to replace them they are still part of the building. If the Landlord was carrying just enough insurance to meet the coinsurance requirements of the policies before the Work was done, then the installation of improvements and betterments may result in coinsurance penalties for the Owner. The only way to avoid this problem is to secure an Agreed Value Endorsement, which eliminates the coinsurance requirements of the policy.

Bear in mind that construction work, regardless of its motivation, calls for both First Party property insurance and Third Party liability insurance. Landlords should be aware that the “standard” form of property insurance, the ISO Building & Personal Property Insurance Coverage Form, provides coverage for “additions under construction, alterations or repairs to the building or structure.” This coverage provides \$250,000 of coverage for the building additions and \$100,000 in personal property coverage as long as it is constructed on the Insured Premises and used for purposes similar to the existing building or as a warehouse. The amount of coverage can be increased, but its duration is strictly limited to thirty days. This coverage does not extend to Personal Property of Others, so this coverage is unsuited for heavy projects.

For projects of longer duration, or which involve substantial personal property, *somebody* needs to procure Builders Risk Insurance. Despite its broad-sounding name, Builders Risk Insurance is property insurance on property that is under construction.

Interior construction work is ineligible for coverage under Inland Marine policies. As a result, any request by any constructor to be named as an Additional Insured Party on the builders risk should be resisted. The non-Inland Marine property insurance provides that misconduct by any “Insured,” such as withholding information about the risk, or a providing misleading information about a claim, vitiates the entire policy.⁹

It is also unnecessary. The usual forms of construction agreement provide that the Owner has the power to adjust claims for casualty losses to the Work under construction and that it is accountable for the proceeds of the Policy. The standard form includes terms that require the Owner to

⁹ A mortgagee escapes the forfeiture of coverage because, as long as the premium is paid, a mortgagee who is named as such in the Policy is deemed to have its very own policy of insurance, which is not vitiated by any other insured’s misconduct.

segregate funds and to obtain a surety bond if demanded by any party in interest. In the absence of such an agreed term, some states require the proceeds of the property insurance to be held in trust, though the terms of the trust are highly variable from State to State. In New York, the Lien Law requires the recipient of trust funds to use them solely to pay the “cost of the Improvement,” a defined term that the Landlord’s team should be familiar with. There is not guarantee the trades will be paid equitably, but the trust fund represents a pool of value that may not be used for other purposes as long as any of the protected contractors, subcontractors, laborers, material suppliers and consultants (to include architects and engineers) are unpaid. Diverting the funds is larceny, and while prosecutions under this section were vanishingly rare during the 20th Century, things have changed. People have been prosecuted for diverting trust funds, and even if the money went to someone who had a claim related to the project, if the payment does not match up with the “Cost of the Improvement,” then the payor will have a defense the crime but it will have to restore the funds.

As indicated above, *someone* has to obtain builders risk insurance. Sometimes, because constructors have relationships with insurance producers, it is the contractor who places the insurance. This calls for attention as well, because in many cases, it will be the contractor who is named as the insured party, both on the property coverage and on the liability policy.

On the property side, the trouble with this structure is the way the policy covers materials and equipment that will be installed. The risk of loss of personalty shifts to the Owner not later than the time when they are delivered to the Site. If the materials were purchased under a shipment contract (which is assumed under the UCC) then the risk of loss is on the buyer as soon as shipment takes place. However, an ISO Builders Risk policy does not cover anything that is not at (or within 100 feet of) the insured site. What is needed is an inland marine floater policy to cover the transit risk. If the contractor is still the named insured under the builders risk policy, then a coverage gap arises because the materials and equipment that are laid down at the Site are the property, not of the contractor-named insured, but of the Owner. The builders risk policy provides only limited coverage the Personal Property of Others at the Site, and while the \$2,500 limit can be raised by endorsement it is unlikely that such a endorsement will have been purchased.

The Landlord should always be the sole Named Insured under the property policy.

Similar concerns arise for the liability policy. Users must understand that liability insurance is written with several limits of liability.

It is not a good idea for an Owner to expect that its liability exposures are adequately covered by being an Additional Insured under the constructor's policy. While every Owner should insist on being added to the liability policies of all constructors who set foot on the Site, doing so is not enough. Some insurance companies simply do not defend an additional insured party until a court orders them to do so. There are many cases in which the claims back and forth over Additional Insured coverage went on for years after the underlying claims were settled. In many of these cases, the Additional Insured Landlord had to fund the costs of defense until the case was resolved.

Every Owner needs to have a liability insurance policy that it places and controls.¹⁰ At the very least, it should cover the costs of accident investigation and legal defense, though again, attention is needed.

It has been said that liability insurance is litigation insurance: it pays the cost of defending even the most laughable case—so long as it is a suit for bodily injury or property damage.¹¹ Coverage for defense costs, investigative costs, and other supplemental payments can be provided over and above the limits of liability that were purchased. The ordinary rule is that supplemental payments are “outside the limits.” However, some insurance companies and producers write the policy with supplemental payments being “inside the limit.” In that case, payments made to lawyers, doctors and investigators will erode the amount of insurance available to pay the claim. This is only one of the many changes that are endorsed onto policies that are never reflected in insurance certificates. This is why any insurance lawyer will tell you that you must RTFP, or Read the Friendly Policy.¹²

10 One alternative, known as Owners & Contractors Protective insurance, is supposed to take the place of the Owner's liability coverage and to obviate the contractor covering the Owner as an Additional Insured. While it does satisfy the requirement for a dedicated policy, the form does not cover liability that arises from completed construction, and its coverage is simply not as robust as what a policyholder expect from Commercial General Insurance.

11 Sometimes other coverages are present. CGL insurance may also be written to cover “personal injury and advertising liability,” which addresses false arrest, detention or imprisonment; malicious prosecution, defamation; invasion of privacy and unfair competition; and it can be written to provide medical payments coverage for those who sustain bodily injury from the premises or operations an insured party.

12 That's not what RTFP stands for, but this publication has certain standards. *Cf.*, the Engineer's Saw: RTF Manual.

Certificates of insurance have a fundamental problem: they are not worth the paper they are printed on. Note the boldface legend at the top of every ACORD™ certificate: this certificate tells you nothing: read the policy. In most states, the certificate holder cannot sue the broker who issued the certificate because in the absence of privity of contract, the broker owes no duty of care to the certificate holder.¹³

Additional Insured Parties do not get notice when a policy is canceled, nor do they get notices that the limits of liability for a policy have been exhausted. Unless they make a special effort, they will have no idea of the special policy conditions that may be in the package.

Some of the conditions that are endemic to insurance can be significant. It is common for Owners' and Contractors' policies to mandate that all contractors and subcontractors on the job must name the insured as an Additional Insured Party on their respective CGL policies, and that they have at least a specified amount of insurance. Read this endorsement carefully, as it is frequently specific to each insurance company. The policies range from mild to draconic.

Some policies say that if the Named Insured did not get certificates of insurance from a prime contractor or major trade and the loss occurs on that contractor's watch, then there is a penalty deductible for that claim.¹⁴ This is a mild approach. At the other extreme are clauses that require that every trade on the site, even for a trivial amount of Work, has to get AI coverage for the Policyholder. Some require that the coverage has to attach: a false certificate is as bad as no certificate. Some policies make the AI coverage into a condition of the policy: if a trade does give up what is needed, then the whole insurance policy is void.

RTFP. And make sure that the Lease, which is the fundamental document here, reflects the needed construction and risk management terms.

13 The result might be different if the certificate of insurance is signed by an agent of the insurance company. However, so far as we are aware, none of the companies that markets its policies through agents (as opposed to brokers) will authorize an agent to issue a certificate of insurance. These companies are notable for the speed with which they produce a temporary permanent policy.

14 The usual deductible for construction liability policies is \$25,000 per occurrence; a failure to get the required certificates from the involved trades causes the deductible to increase to \$50,000.

CHAPTER FOURTEEN

DRAFTING CONSIDERATIONS FOR ENVIRONMENTAL ISSUES IN COMMERCIAL LEASING TRANSACTIONS

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[14.0] I. INTRODUCTION

Parties to commercial leasing transactions frequently overlook environmental issues because they believe that tenants who do not use large quantities of hazardous chemicals will not be exposed to significant environmental liability. Consequently, the parties may do little to no environmental due diligence and use obsolete or boilerplate lease provisions that do not specifically allocate environmental risks. Even when a lessee examines environmental conditions of a site, the investigation is often limited to ensuring that there are no environmental conditions that would impair its ability to operate at the site or that the property is adequate for the intended use.

What these parties do not realize is that owners and operators of commercial property can be liable for contamination associated with historic uses. This means that landlords can be liable for contamination caused by their tenants and tenants may be responsible for contamination that preceded their tenancy.

This chapter will review environmental issues that may arise in leasing transactions and provides practical suggestions on how to address these issues. It begins with a summary of the principal sources of environmental liability on parties in commercial leasing transactions and discusses some of the more problematic uses that can lead to environmental liability. The chapter then reviews lease provisions with annotations that may be used to address or allocate environmental liability.

[14.1] II. ENVIRONMENTAL ISSUES UNDER COMMON LAW

Prior to the enactment of modern environmental laws, liability for contamination in leasing transactions was governed solely by contract and tort principles. In the absence of an express agreement or some misrepresentation, the tenant was expected to make its own careful examination of the conditions of the property and the vendor or landlord would not be liable for any harm or defects existing in the property.¹ The tenant was traditionally liable for harm caused to persons or property for dangerous conditions or nuisances created by it without the landlord's knowledge or acquiescence.² The tenant also was required to maintain the demised

1 This concept has sometimes been referred to as "caveat lessee."

2 *State of N.Y. v. Monarch Chemicals*, 90 A.D.2d 907, 456 N.Y.S. 2d 867 (3d Dep't 1982).

premises during the duration of the leasehold and to return the premises in good condition, less normal wear and tear.

Under common law, the general rule was that the lessor would not be liable to the lessee or others for harm for dangerous conditions existing at the time of the transfer³ or created after lessee took possession of the property.⁴ Over time, the courts crafted a number of exceptions to this common law principle of lessor non-liability. One such exception was that a landlord could be subject to liability if it knew or had reason to know of a condition that posed an unreasonable risk of physical harm to persons, the lessor had reason to believe that the lessee would not discover the dangerous condition, and the lessor concealed or failed to disclose this condition to a lessee or sublessee.⁵

Another was that, a lessor may be held liable for tenant activities that constitute a nuisance, such as environmental contamination, if the lessor consented to such action or knew that the tenant's operations would likely release contaminants and the landlord failed to take precautions to prevent such damage.⁶ Under this exception, it is not enough to show that the tenant's expected use of the premises is merely capable of creating a nuisance. If the premises could have been used by the tenant without becoming a nuisance, the landlord will not be liable for any nuisance created by the acts or omissions of the lessee after commencement of the leasehold.

Modern formulations link liability of lessor's and lessee's to a failure to exercise reasonable care and incorporate concepts of comparative negligence. For example, the Third Restatement of Torts moves away from creating duties based on the person's relationship with the land and instead adopts a general duty of reasonable care for by possessors of land- those in control of property.⁷ Thus, a lessor has a duty to exercise reasonable care for any risks that are created by the lessor and a duty to disclose any latent dangerous condition that the landlord knows or should know are unknown to the lessee.⁸ This duty to disclose includes dangerous latent

3 Restatement of the Law, Second, Torts, § 356.

4 Restatement of the Law, Second, Torts, § 355.

5 Restatement of the Law, Second, Torts, § 358.

6 *Monarch Chemicals*, 90 A.D.2d 907.

7 Restatement of the Law, Third, Torts: Liability for Physical and Emotional Harm, § 51. This is consistent with Section 7(a) of this Restatement imposing a duty of reasonable care on actors that create a risk of harm to others.

8 Restatement of the Law, Third, Torts: Liability for Physical and Emotional Harm, § 53.

conditions that were not created by the lessor.⁹ The disclosure obligation hinges on if the lessee appreciates the danger posed by the condition and not simply if the dangerous condition is open or obvious. The lessor's duty is not cut off by a lessee's failure to exercise reasonable care to discover dangerous conditions.¹⁰

In New York, landlords and tenants have been held liable for contamination under common law principles such as strict liability, nuisance, trespass and negligence. Owners who have failed to abate contamination caused by their tenants have been found liable for creating or maintaining a nuisance.¹¹ While some states allow transferees to bring a nuisance action against their transferor on the grounds that "the creator of a nuisance remains liable even after alienating his property," New York courts have held that a nuisance action can only be maintained between adjoining landowners, and is not a proper claim in a suit between successive landowners or operators of the same property.¹²

New York has a three-year statute of limitations for claims for personal injury and damage claims relating to exposure to hazardous substances. However, the statute of limitations is not linked to when the spill or discharge first occurred but from the date that the injuries are discovered or should have been discovered by a reasonably diligent party.¹³

[14.2] III. SUMMARY OF PRINCIPAL FEDERAL ENVIRONMENTAL LAWS AFFECTING COMMERCIAL LEASING TRANSACTIONS

Numerous federal and state environmental laws can impose liability on owner or operators of contaminated property. The principal federal environmental laws of concern in commercial leasing transactions are the fed-

9 *Id.*, comment (e).

10 Consistent with modern notions of comparative responsibility, such failure would constitute negligence and either reduce the lessee's recovery of a lessee or subject the lessee to liability to third parties who are harmed by the dangerous condition. *Id.*

11 *Copart Indus. v. Consolidated Edison Co. of N.Y.*, 41 N.Y.2d 564, 394 N.Y.S.2d 169 (1977); *State of N.Y. v. Monarch Chemicals*, 90 A.D.2d 907, 456 N.Y.S.2d 867 (1982); *State of N.Y. v. Shore Realty Corp.*, 759 F.2d 1032 (2d Cir. 1985).

12 *Nashua Corp. v. Norton Co.*, 1997 WL 204904 (N.D.N.Y. 1997).

13 Civil Practice Law and Rules 214-c; *Jensen v General Elec. Co.*, 82 N.Y.2d 77, 603 N.Y.S.2d 420 (1993); *Aiken v. General Elec. Co.*, 57 A.D.3d 1070, 869 N.Y.S.2d 263 (3d Dep't 2008); *Atkins v. Exxon Mobil Corp.*,⁹ A.D.3d 758, 780 N.Y.S.2d 666 (3d Dep't 2004).

eral Comprehensive Environmental Response, Compensation and Liability Act (CERCLA)¹⁴ and the federal Resource Conservation and Recovery Act (RCRA).¹⁵ The principal New York environmental laws that may trigger liability in commercial leasing transactions are the New York State Superfund Law (SSF),¹⁶ the Oil Spill Law,¹⁷ and the Petroleum Bulk Storage Act (PBSA).¹⁸

A complete evaluation of these environmental laws is beyond the scope of this chapter. However, a summary of the key elements of these laws and how they apply to commercial leasing transactions are provided to assist the reader.

Practice Note: Before discussing these environmental laws, it is important to point out that real estate transactions have grown in complexity and in many instances have outpaced environmental laws that were enacted three decades ago. Law students are taught in Real Property class that property ownership consists of multiple rights that should be viewed as a bundle of sticks that may not necessarily all belong to the same person. Each stick represents a separate right or interest in the land, such as the right to sell, lease or subdivide the land, convey mineral rights, construct buildings, harvest its resources and exclude trespassers. The sticks can be conveyed individually or collectively depending on the extent of the interest conveyed in a transaction. Thus, a landowner may lease surface rights to one person, transfer the underground mineral rights to another entity while still holding the remaining sticks in the bundle such as the right to sell the land, though the sale may be subject to rights extended to others. The government has increasingly been viewed as holding some of the sticks, such as the right to tax, take property under

14 42 U.S.C. § 9601 *et seq.*

15 42 U.S.C. § 6901 *et seq.* Other federal environmental laws of concern to commercial leasing transactions may include the Clean Air Act, 42 U.S.C. § 7401 *et. seq.* (primarily for properties with oil-fired boilers and asbestos containing materials); the Clean Water Act, 33 U.S.C. § 1251 *et seq.* (properties with wetlands and that require stormwater permits), and the Toxic Substances Control Act, 15 U.S.C. § 2601 *et seq.* (PCBs and lead-based paint).

16 Environmental Conservation Law § 27-1301 *et seq.* (formally known as the “Inactive Hazardous Waste Disposal Law”) (ECL).

17 Navigation Law §§ 170–197 (Nav. Law).

18 ECL § 17-0101 (formally known as “Control of the Bulk Storage of Petroleum”). A similar law, the Hazardous Substance Bulk Storage Act, ECL § 40-0101 can impose cleanup obligations on properties that store certain quantities of hazardous substances in underground or aboveground storage tanks.

eminent domain, and establish rules to regulate use or protect certain natural resources.

While these modern real estate transactions have enabled landowners to extract value by slicing the sticks of property rights into thinner and thinner twigs, state and federal laws that impose liability on owners and operators of contaminated sites have not kept up with the creative and innovative forms of real estate ownership. For example, it is unclear if a commercial condominium could be considered a CERCLA owner by virtue of its fractional ownership in the land represented by the unit deed or if it could be deemed to have exercised sufficient control over the property to be considered a CERCLA operator. As a result of this uncertainty, environmental consultants are often unsure if a REC identified on a property pertains to the particular fractional interest held by the client much less the significance of the REC to the client.

One of the more common scenarios where this issue arises is when a property contains a ground lease. For example, a consultant may be asked to perform a Phase 1 on a shopping center and is advised that certain buildings should not be evaluated because they are subject to ground leases and are not of the property. While the structures are not the property of the landowner, they can still impact the property. In this situation, it would make sense to evaluate the structure as if it was an adjacent parcel under E1527-05.

A more difficult question is when the property to be investigated is the building on a ground lease. There are many scenarios in which this structure may be used, but it has frequently been employed when developing contaminated properties. Often times, a developer has developed the site and then a ground tenant builds a structure. The consultant will often be told that it should just focus on the building issue since the client does not own the land. Many times, a land use control was required as part of a cleanup but may not have been properly recorded, or the ground tenant is not even aware of the restrictions. If the land use control has not been recorded or an engineering control has not been maintained, this could trigger a re-opener: who is responsible? Certainly the developer should be, but it may be hard to find, or perhaps was a limited liability corporation that no longer has any assets. Could the ground tenant be responsible? If the building is the primary development on the site, the building owner/operator could possibly be viewed as an operator of the site for purposes of CERCLA liability or state environmental laws.

A more complicated but common situation is where a hotel or office building occupies the air above the land pursuant to a development agreement. There may be a sub-surface garage that serves as an engineering cap and an easement granted in favor of the building so its occupants can use the garage. Does the owner of the building occupying the air above contaminated land have liability if the engineering control is not recorded or maintained? Again, if the building is the dominant structure on the land, it is quite possible that the building owner or manager could be liable as an operator of the site unless it has taken steps to obtain a formal covenant not to sue or other liability release from the appropriate state agency. In the end, liability will be based on the particular facts of each case.

[14.3] A. CERCLA

CERCLA liability is probably the most significant environmental law for commercial leasing transactions. CERCLA applies to releases of hazardous substances.¹⁹ The federal Environmental Protection Agency (EPA) is authorized to perform cleanups (known as response actions) of releases of hazardous substances²⁰ and seek reimbursement of its costs from four categories of potentially responsible parties (PRPs) who may be strictly, jointly and retroactively liable for cleanup costs.²¹ Private parties who incur cleanup costs may also seek reimbursement from PRPs.²² Indeed, because the New York State Superfund law does not expressly authorize the New York State Department of Environmental Conservation (NYSDEC) to recover its cleanup costs, NYSDEC customarily uses CERCLA to seek cost recover.

19 Petroleum is excluded from the definition of hazardous substances. 42 U.S.C. § 9601(14). Because of the so-called petroleum exclusion, neither EPA nor private parties may seek reimbursement of costs incurred to remediate contamination from leaking gasoline underground storage tanks (USTs). *White Plains Hous. Auth. v. Getty Props. Corp.*, 2014 WL 7183991 (S.D.N.Y. Dec. 16, 2014). However, the petroleum does not apply to contaminants added to petroleum during normal use such as waste oil. *City of New York v. Exxon Corp.*, 766 F. Supp. 177, 186 (S.D.N.Y. 1991).

20 42 U.S.C. § 9604.

21 42 U.S.C. § 9607(a).

22 Innocent parties may seek 100% recovery of their costs (known as cost recovery actions) under 42 U.S.C. § 9607(a)(4)(B) while PRPs may file contribution actions under 42 U.S.C. § 9613(f)(1) if they incur costs that exceed their allocated share of the liability.

[14.4] 1. CERCLA Liability for Property Owners and Tenants

The types of CERCLA PRPs that may be liable include current and past owners and operators of contaminated property. The liability for past owners or operators under CERCLA is not necessarily congruent with the liability of current owners or operators. Parties that currently hold title or possession of contaminated property may be liable for historic contamination that occurred prior to the time the owner acquired title or the operator came into possession of the property.²³ However, past owners or operators are only liable only if they owned or occupied the property “at the time of disposal” of the hazardous substances.²⁴

Practice Note: New York courts have held that the term “disposal” does not refer to mere movement or migration of preexisting contamination but requires some affirmative act of disposal.²⁵ Under this line of cases, the mere migration or movement of preexisting contamination during the time a party owned the property is insufficient to impose liability on a past owner when another party placed the pollutants on the property. As a result, the liability of a former owner may be more limited in scope than the liability of a current owner. This is because current owners are responsible for any contamination that is present on the site regardless of who introduced the contaminants into the environment, while past owners can avoid liability for preexisting contamination if no disposal occurred during their ownership and they are fortunate enough to have conveyed title prior to the commencement of any enforcement action or filing of a lawsuit seeking cost recovery or contribution.

Current landlords may be considered CERCLA owners simply based on their ownership of property even if the owner did not place the hazardous waste on the site or cause the release.²⁶ Furthermore, a current passive landlord or sublessor does not have to exercise any control over the disposal activity to be liable as a CERCLA owner.²⁷

Tenants may be liable under CERCLA either as a CERCLA owner, if they had sufficient indicia of ownership, or as a CERCLA operator based

23 42 U.S.C. § 9607(a)(1).

24 42 U.S.C. § 9607(a)(2).

25 *ABB Industrial Systems Inc. v. Prime Tech Inc.*, 120 F.3d 351 (2d Cir. 1997).

26 *State of N.Y. v. Shore Realty Corp.*, 759 F.2d 1032 (2d Cir. 1985).

27 *Bedford Affiliates v. Manheimer*, 86 F. Supp. 2d 67 (E.D.N.Y. 1999); *United States v. A & N Cleaners & Launderers*, 788 F. Supp. 1317 (S.D.N.Y. 1992).

on their control of a property. When deciding if a tenant should be considered a “de facto owner,” courts will examine rights and obligations of the tenant under a lease to see if effective control of the property had been handed over to the tenant. Some of the factors that courts have considered include:

- If there is a long-term lease where the lessor cannot direct how the property is used;
- If the lessee can sublet without permission of the owner;
- Whether the lessee is responsible for paying all costs, including taxes, assessments and operation and maintenance costs; and
- Whether the lessee is responsible for making any and all structural changes and other repairs.

Practice Note: Classifying a party as a CERCLA owner or operator may significantly impact the extent of the party’s cleanup obligations. This is because the scope of liability for a CERCLA operator may not be the same as that of a CERCLA owner. The test that most courts have adopted for determining if a party is a CERCLA operator liability is that the party must have exercised control over the contaminated property or, at least, the activity that caused the contamination. Often times, a current CERCLA owner may be liable for all historic contamination at a site while a tenant that qualifies as a current CERCLA operator may not be liable for any of the costs or just a portion of the costs. For example, a tenant may not be considered a CERCLA “operator” of an inactive UST that leaked hazardous substances and was abandoned before the tenant took possession of the property, and the tank was not part of the demised premises.²⁸

The leading case in New York for determining liability of tenants and subtenants is *Commander Oil Corp. v. Barlo Equipment Corp.*²⁹ The plaintiff initially leased one parcel to the defendant, Barlo Equipment Corp (Barlo), in 1964 and a second parcel to Pasley Solvents & Chemicals, Inc. (Pasley) in 1969. Barlo used its parcel for office and warehouse space while Pasley operated a solvent repackaging and reclamation business on its leasehold. In 1972, the plaintiff consolidated the leases so that

28 A different outcome might be reached for an abandoned petroleum UST under the New York State Oil Spill Law.

29 215 F.3d 321 (2d Cir. 2000).

Barlo was the lessee for both parcels and was sublessor for the Pasley lot. Under the new lease, Barlo was responsible for basic maintenance and payment of taxes on both lots.

In 1981, contamination was discovered on the Pasley parcel. Eventually, plaintiff entered into a consent order with EPA to implement a cleanup and sought contribution from Barlo for the costs plaintiff incurred at the former Pasley lot on the theory that it was a CERCLA owner. Plaintiff did not proceed against Barlo under an “operator” theory because Barlo never conducted operations at the Pasley parcel. The district court granted summary judgment to the plaintiff, ruling that Barlo was a CERCLA owner by virtue of its “authority and control” over the Pasley.³⁰ After a bench trial, the district court ruled that although Pasley was responsible for all of response costs associated with its lot, the costs had to be allocated between the plaintiff and Barlo since Pasley was “financially irresponsible.”

On appeal, Barlo argued that CERCLA’s owner liability was restricted to owners of record while Commander Oil urged a more expansive definition that relied primarily on the right to control property, whether the right is possessory or is a recorded property interest. The Second Circuit acknowledged that most of the district courts that have addressed the issue have held that site control is a sufficient indicator to find lessees or sublessors liable as CERCLA owners. However, the appeals court also noted that the circuit precedent provided that CERCLA “owner” and “operator” liability should be treated separately and suggested that relying solely on a site control analysis could essentially make owners of all operators and thereby render most operator language of CERCLA superfluous.

The court recognized that while the typical lessee should not be held liable as an owner, there might be circumstances when owner liability for a lessee would be appropriate.³¹ However, the court emphasized that in

30 For support of its holding that Barlo was a CERCLA owner, the district court relied on *Delaney v. Town of Carmel*, 55 F. Supp. 2d 237 (S.D.N.Y. 1999) and *United States v. A & N Cleaners & Launderers, Inc.*, 788 F. Supp. 1317 (S.D.N.Y. 1992). These cases interpreted the term “owner” to extend beyond the fee or record owner to anyone possessing the requisite degree of control over the property.

31 The court provided three rare instances where the lessee did not have a typical lease but instead may have obtained a priority of ownership rights: (1) sale-leaseback arrangements . . . if the lessee actually retains most rights of ownership with respect to the new record owner; (2) extremely long-term leases where, according to the terms of the lease, the lessee retains so many of the indicia of ownership that he is the de facto owner; and (3) where a lessee/sublessor has impermissibly exploited more rights than originally leased.

reaching such a conclusion, the critical analysis was the relationship between the owner and the tenant/sublessor, and not the lessee/sublessor's relationship with its sublessee. The court then provided a non-exclusive list of factors that might constitute circumstances where lessees/sublessors might have the requisite indicia of ownership to that they could be liable as de facto owners under CERCLA. These included:

1. If the lease is for an extensive term such as a 99-year lease and does not allow owner/lessor any rights to determine how the property is used;
2. If the lease cannot be terminated by the owner before it expires by its terms;
3. If the lessee has the right to sublet all or some of the property without notifying the owner;
4. If the lessee is responsible for payment of all taxes, assessments, insurance, and operation and maintenance costs; and
5. If the lessee is responsible for making all structural and other repairs.

Turning to the lease, the court concluded that Barlo did not possess sufficient attributes of ownership over the Pasley lot based on the following factors:

- Barlo was limited to using its parcel and only “for that business presently conducted by tenant on a portion of the same premises leased hereunder”;
- Barlo was required to obtain written consent from Commander Oil before making “any additions, alterations or improvements” on the land, which alterations would become Commander Oil's property in any event;
- The lease required Barlo to obtain written approval from Commander Oil to sublet the property, and prohibited from subletting to any entity that had “any connection with the fuel, fuel oil or oil business”;
- Barlo had to obtain written permission from Commander Oil to display any “sign, advertisement, notice or other lettering” on the building;
- The lease required Barlo to keep the property “clean and in order to the satisfaction of” Commander Oil, and responsible for any damage Barlo

itself caused to the premises or to the “systems or equipment or any installation therein”;

- Barlo was prohibited from doing anything that would “in any way increase the rate of fire insurance” on the property, and from bringing or keeping upon the premises “any inflammable, combustible or explosive fluid, chemical or substance”; and
- The lease was limited to a five-year term with one renewal option.

The court also recited the rights reserved by Commander Oil in the lease. Specifically, Commander Oil reserved a right to

- enter onto the lot for various purposes;
- use three oil storage tanks on the Pasley lot;
- maintain “its aerial or a comparable aerial” on the roof of the building;
- make structural repairs; and
- exercise an option to use certain office space on the Barlo lot;

The court went on to acknowledge that Barlo possessed some attributes of ownership with respect to the Pasley lot, such as

- securing insurance for the property;
- responsibility for all assessments on the property and any increases in taxes; and
- assuming responsibility for all nonstructural repairs such as repairs to heating, plumbing and lighting fixtures and equipment; cesspool maintenance, repair and replacement; snow removal; driveway, parking area and pavement repairs, etc.

However, when viewed in totality, the Second Circuit held that Barlo lacked most of the bundle of rights that comes with ownership of property and reversed the ruling of the district court.

More recently, a federal district court granted summary judgment to lessee/sublessor finding that it was not a CERCLA owner. In *Next Millen-*

nium Realty, LLC v. Adchem Corp.,³² the plaintiff's property was identified as one of the sources that contaminated a municipal wellfield. The contamination originated from subtenant dry cleaner following a fire in 1976. The plaintiff's property was placed on the state superfund list and the plaintiff entered into a series of consent decrees with the NYSDEC to remediate its property. Plaintiff commenced a CERCLA contribution action against the lessee and lessee assignee defendants seeking reimbursement of response costs incurred to comply with the consent orders. Because the former tenant had only sublet the property and never operated it, the contribution claim rested entirely on the theory that the tenant could be held liable as a former owner of the site.

Relying on the five factors enumerated in *Commander Oil*, the plaintiffs moved for partial summary judgment that the defendant lessees were liable as CERCLA "owners." The plaintiffs argued that the lessee exercised its right to sublet the property without the landlord's consent, placed a polluting subtenant on the site, had profited substantially from the sublease and despite knowledge that the subtenant was conducting dry cleaning operations and using PCE, the tenant chose to do nothing to prevent the environmental damage caused to the property. Plaintiff asserted that these actions coupled with the indicia of ownership that the tenant enjoyed under the terms of the lease, and mandated that the tenant be held liable as de facto owner under CERCLA as a matter of law.

After reviewing the lease terms, the district court found that the relationship under the lease did not transform the lessee into a de facto owner. Among the lease terms cited by the court were:

- The lease appeared to be a typical commercial lease between a lessor and a single industrial tenant and consisted of a standard Blumberg form lease with two addenda with a term of 20 years;
- Lessor could sell the site without notifying the tenant, assign its lease interests or mortgage or assign the underlying property during the lease term;
- Lessor could terminate the lease before the 20-year term and did in fact terminate the lease midway through its term;

32 2014 WL 5425488 (E.D.N.Y. 2014).

- Lessor also had the right to terminate the lease at its option in the first six weeks of the lease if lessor did not obtain a mortgage or if the building was destroyed by fire;
- Lessor had unilateral right to determine whether to rebuild or terminate the lease if the building was destroyed by fire;
- Lessor's decision to unilaterally terminate the lease rather than restore the site's building following the fire prevented the tenant's continued use of the premises and demonstrated the tenant's lack of ownership rights;
- Lessor could terminate the lease if the tenant defaulted on any lease obligation, in which case lessor was authorized to institute summary proceedings to terminate the lease and the tenant was contractually obligated to waive right to notice;
- While the lease contained a purchase option for the 12th year, the option was never exercised nor came into existence because lessor terminated the lease prior to the option's effective date;
- Tenant's right to exercise the purchase option after 12 years was subordinate to the mortgagee's superior rights and eliminated the defendants' right to withhold rent or charge the owner with repairs if the site was partially damaged;
- Lessor reserved any condemnation award;
- Tenant had to secure and pay for insurance policies that named lessor as a beneficiary and ensured its right to receive insurance proceeds;
- Tenant was prohibited from doing acts that would increase the fire insurance premiums;
- Tenant's interest in the premises would never constitute a lien on the property and at all times remained subordinate to lessor's mortgage;
- Any past and future loans made by tenant to its shareholders would be subordinated to the lessor's ownership interest;
- The lease limited the tenant's use of the property to lamination and coating of papers, textiles and fabrics and for general manufacturing to manufacturing uses;

- Tenant was prohibited from encumbering or obstructing the sidewalk or permit another to do so;
- Tenant was prohibited from committing a waste or injury to the premises;
- Tenant was required to keep the grass trimmed and maintain the grounds in presentable condition;
- Tenant was prohibited from doing any act that could lead to a mechanic's lien on the site;
- Tenant was prohibited from altering the site without lessor's written permission;
- Tenant was prohibited from posting a sign except in compliance with lessor's terms;
- Tenant was prohibited from removing leasehold improvements without notice and escrowing for the cost of restoration;
- Tenant was obligated to keep the site in "presentable condition" and return it "in good order and condition";
- If tenant remained in the premises at the end of the term, it would be considered holdover tenants on a month to month; and
- Landlord was responsible for all repairs during the first two years and all structural repairs thereafter, except those caused by the tenant's act or neglect. The lessee defendants were responsible for non-structural repairs.

The court did note that the tenant had the right to assign or sublet the property without notifying the lessor. However, this right could only be exercised if tenant remained liable under the lease, the assignee assumed all lease conditions, the assignment was recordable and the assignment or sublease did not increase the cost of fire insurance. Thus, the court said the lease preserved lessor's rights to the property in the event of a sublease or assignment and authorized lessor to enforce such rights directly against the lessee defendants.

While the tenant held a common triple net lease where tenant was to pay certain taxes, assessments, utilities and insurance costs, the lessor was obligated to pay inheritance, transfer and corporate franchise taxes. The court

found this was consistent with taxes that are incident to ownership, such as the right to convey or transfer the property.

Based on the lease as a whole, the court ruled that the lessee defendants' lacked most of the core bundle of rights that are associated with ownership of property. Given the insufficient attributes of ownership over the premises, the court held that lessee defendants could not be held liable under CERCLA as a de facto owner, and granted summary judgment in favor of the lessee/sublessors.

Though a New York case, the decision in *Scarlett & Associates, Inc. v. Briarcliff Center Partners, LLC*³³ is nevertheless informative on the potential risks to property managers who ignore environmental issues. And yes, it involves yet another dry cleaner. In that case, a federal district court found there was genuine dispute of material facts as to whether a managing agent of a shopping center was a CERCLA operator. The managing agent did not maintain an office or have personnel at the site, nor did it have keys to any leased space or have the power to evict tenants. The managing agent said its principal responsibilities were to attempt to rent space to tenants that were approved by the owner, collect rent, maintain the common areas of the shopping center, pay bills in a timely manner, and send any excess revenues to the owner. The owner pointed to language in the management services agreement that the managing agent was to obtain all necessary government approvals and perform such acts necessary to ensure that owner was in compliance with all laws. The court noted that the managing agent sent the dry cleaner a certified letter advising the dry cleaner of certain environmental reporting requirements, requested copies of the documentation that the dry cleaner was required to provide to the EPA or an explanation as to why the dry cleaner was exempt from providing such documentation. The court said that this correspondence combined with the other evidence of record indicating that the managing agent generally was responsible for managing and maintaining the shopping center and performing all acts necessary to effect compliance with all laws, rules, ordinances, statutes, and regulations of any governmental authority applicable to the operation of the shopping center was sufficient to create a genuine issue as to whether the managing agent managed the operations of the dry cleaner specifically related to pollution and it therefore met the definition of a former "operator."

33 2009 WL 3151089 (N.D. Ga. 2009).

[14.5] 2. CERCLA Third Party Defense

CERCLA originally only contained three affirmative defenses to liability: act of God, act of war, and the third-party defense. From a practical standpoint, the third-party defense was the only viable defense available to property owners or operator (e.g., tenants). To establish that defense, the owner or operator would have to show that the release was

- *solely* caused by a party;
- with whom it had no direct or indirect *contractual relationship*;
- the defendant exercised *due care* with respect to the hazardous substances; and
- took *precautions* against foreseeable actions or omissions of third parties.³⁴

Most courts broadly construed the phrase “*in connection with a contractual relationship, directly or indirectly*” to encompass virtually all forms of real estate conveyances. As a result, lessors of property that were contaminated by a current or former a tenant could not successfully assert the third-party defense in most states on the grounds that a lease constituted a “contractual relationship” with the responsible party (i.e., lessee). Many courts went as far as holding that a sublease constituted a sufficient indirect contractual relationship to preclude an owner from invoking the third-party defense.

The concept that the mere existence of a lease can preclude an owner from asserting a third-party defense when the contamination is solely caused by a tenant is rather harsh especially in the case of truly absentee landlords with so-called “triple-net leases” or long-term ground leases where the landlord does not exercise any control over the property and its only real contact with the property may be the monthly rent check.

The good news, though, is that the Second Circuit has adopted an expansive view of the third-party defense so that it is a very viable defense for owners or operators of commercial property in New York. The federal courts in New York generally take a narrow view of the phrase “contractual relationship” and have held that the mere existence of a “contractual relationship” does not bar an owner or operator from invoking the

³⁴ 42 U.S.C. § 9607(b)(3).

defense.³⁵ Instead, a party will only be precluded from asserting the defense if there is some relationship between the disposal or release that caused the contamination and the contract or which allow the landlord to exert some form of control over such activities.³⁶ Thus, a commercial lease is distinguishable from a lease to operate a landfill. In the former situation, the fact that the tenant generates hazardous substances as an incident to its business should not bar the lessor from asserting the third-party defense since the generation or disposal of hazardous substances was not the purpose of the contractual relationship.

Perhaps the seminal case on the third-party defense is *State of New York v. Lashins Arcade*,³⁷ where a current owner of a shopping center was able to successfully invoke the third-party defense because it did not have a contractual relationship with a former dry cleaner tenant who had discharged hazardous substances into the ground 15 years prior to the current owner's acquisition.

Assuming that a prospective purchaser or tenant could overcome the "contractual relationship" hurdle, it would still have to establish that it satisfied the third prong of the test to exercise due care in dealing with the hazardous substances and the fourth prong, which requires taking precautions against the foreseeable actions of omissions of third parties. For example, the property owner in *Lashins Arcade* established that it had exercised due care, such as maintaining water filter, sampling drinking water, instructing tenants to avoid discharging into septic, inserted use restrictions into leases and did periodic inspections to assure compliance with this obligation. In contrast, a bank that had subleased its space to a dry cleaner (are you beginning to see a theme about dry cleaners?) was unable to assert the third-party defense because it had failed to assess environmental threats after discovery of disposal would be part of due care analysis.³⁸

35 *But see United States v. Occidental Chemical Corp.*, 965 F. Supp. 408 (W.D.N.Y. 1997) (a deed can serve as an indirect contractual relationship that can prevent a property owner from asserting the third party defense).

36 *Westwood Pharm., Inc. v. National Fuel Gas Dist. Corp.*, 964 F.2d 85 (2d Cir. 1992); *but see United States v. A & N Cleaners & Launderers, Inc.*, 788 F. Supp. 1317 (S.D.N.Y. 1992), where a bank that was sublessor who maintained complete control and responsibility for property where a release occurred was deemed to be an owner for CERCLA purposes.

37 91 F.3d. 353 (2d Cir. 1996). Compare *Lashins* conduct to the purchaser/owner in *Idylwoods Assocs. v. Mader Capital Inc.*, 956 F. Supp. 410 (W.D.N.Y. 1997).

38 *A & N Cleaners*, 854 F. Supp. 229.

A number of cases have recently explored the scope of the “due care” obligations of the third-party defense. In *New York v. Adamowicz*,³⁹ the property owner was unable to establish that it exercised due care despite spending over \$1 million addressing environmental concerns at its site. The problem was that it waited too long to respond to the environmental concerns caused by its tenant.

The owner of a former manufactured gas plant (MGP) site was found not to have exercised due care in *New York State Electric & Gas Corp. v. FirstEnergy Corp.*⁴⁰ The court said that after the owner became aware of the extent of the contamination and that New York State Electric & Gas Corp. (NYSEG), which was complying with a state order to remediate 16 MGP sites, needed to acquire portions of the property to effectuate a proper remediation, the owner engaged in protracted negotiations, failed to timely respond to offers and demanded an aggressive sales price that delayed the sale for two years. The court concluded that the delay complicated the remediation, explaining that NYSDEC had first wanted NYSEG to remove the former gasholders and purifying house located on property, and then address the downgradient contamination. Because of the owner’s negotiation posture and lack of responsiveness, the court said NYSEG was not only forced to address the downgradient contamination first, but that the delay allowed coal tar and other MGP contaminants to further migrate from the source area.⁴¹

Practice Note: The vast majority of cleanups at commercial properties are now risk-based cleanups where residual soil or groundwater contamination may be left behind but engineering controls (e.g., impermeable caps like parking lots or building foundations) or institutional controls (e.g., prohibiting use of groundwater, limiting land use to commercial purposes) must be maintained to protect human health. A subsequent les-

39 2011 WL 4073894 (E.D.N.Y. 2011). For a more detailed discussion of this case, see Owner Incurs \$1MM on Cleanup but Ct Says No “Due Care”—Owner Waited Too Long to Act, *Schnapf LLC*, www.environmental-law.net/2012/03/owner-incurs-1mm-on-cleanup-but-ct-says-no-due-care-owner-waited-too-long-to-act.

40 808 F. Supp. 2d 417 (N.D.N.Y. 2011). For a more detailed discussion, see Review of Recent CERCLA Third Party Defense “Due Care” Caselaw—Part 1, *Schnapf LLC*, www.environmental-law.net/2012/02/review-of-recent-cercla-third-party-defense-due-care-caselaw-part-1.

41 Other examples of property owners in New York failing to assert the defense because they failed to comply with the other prongs of the third party defense include *Idylwoods Assoc.*, 956 F. Supp. at 419–20 (property owner’s decision to do nothing resulting in spread of contamination to neighboring creek was not due care); *Shapiro v. Alexanderson*, 741 F. Supp. 472 (S.D.N.Y. 1990) (issues of fact material to whether the owners exercised due care and took precautions against both foreseeable acts and foreseeable consequences because did not take any action to halt leachate for five years).

sor or tenant will be required to ensure that the institutional controls are properly maintained to be able to assert the third party defense. This is because the failure of a seller or lessor to properly maintain the institutional controls may be construed as a foreseeable omission. Moreover, if the property owner or lessee fails to monitor the condition of the controls or fails to maintain the controls if the other party fails to do so, this omission could constitute failing to exercise due care regarding the contaminants at the site. This is particularly harsh in cases of absentee landlords where the owner would have to establish that it took precautions against the foreseeable contamination by their tenant's operations.

[14.6] 3. CERCLA Innocent Landowner defense

Because the third-party defense was largely unavailable to purchasers or tenants of contaminated property, Congress enacted the innocent purchaser defense in 1986. Under this defense, a purchaser (or tenant) who "did not know or had no reason to know" of contamination would not be liable as a CERCLA owner or operator.⁴² To establish that it had no reason to know of the contamination, a defendant must demonstrate that it took "all appropriate inquiries . . . into the previous ownership and uses of the facility in accordance with generally accepted good commercial and customary standards and practices."⁴³ In determining if there was an "appropriate inquiry," the 1986 amendments contained five criteria that courts could use in determining if a landowner had implemented an all appropriate inquiry.⁴⁴ Courts did not uniformly apply these criteria and often found that if a property owner did not identify contamination during a pre-acquisition investigation, it probably did not perform an appropriate inquiry.

Since it relies on an affirmative defense, the innocent purchaser has the burden of establishing that it satisfied the elements of the defense. Not surprisingly, most courts narrowly construed the innocent purchaser defense. If a purchaser did not discover contamination before taking title but contamination was subsequently discovered, courts generally concluded that the purchaser did not conduct an adequate inquiry and, therefore, could not avail itself of the defense.

42 42 U.S.C. § 9601(35)(A).

43 42 U.S.C. § 9601(35)(B)(i)(I).

44 The criteria were any specialized knowledge or experience of the innocent purchaser must be taken into account as well as the relationship of the purchase price to the value of the property if it were not contaminated, and whether the presence of contamination was obvious or could be detected by an appropriate site inspection.

Further complicating the burden of the purchaser was that CERCLA did not establish specific requirements for what constituted an appropriate inquiry. As part of the 2002 amendments to CERCLA, EPA was required to promulgate an All Appropriate Inquiries (AAI) rule. Until EPA completed its AAI rule, Congress indicated that the parties could use the ASTM E1527 Phase 1 standard to demonstrate that they complied with the all appropriate inquiries requirement of the innocent purchasers defense.⁴⁵ EPA's AAI rule became effective on November 1, 2006.⁴⁶ A more detailed discussion on environmental due diligence appears later in this chapter.

Practice Note: The innocent purchaser defense is technically part of the third-party defense. By complying with AAI, the owner or tenant will be able to satisfy the second prong of the third party defense that it does not a “contractual relationship” with the party that is solely responsible for the contamination. Thus, even after satisfying AAI, an owner or tenant still has to satisfy the “due care” and “precautionary” prongs to be able to assert the third-party defense.

[14.7] 4. CERCLA Bona Fide Prospective Purchaser (BFPP) Defense

The principal drawback of the CERCLA innocent purchaser defense is that a purchaser or tenant cannot know or have reason to know that the property was contaminated. To incentivize the redevelopment of contaminated properties, Congress added the BFPP to CERCLA as part of the 2002 CERCLA amendments.⁴⁷ This defense allows a landowner or tenant to knowingly acquire or lease contaminated property after January 11, 2002 without incurring liability for remediation if it could establish the following pre-acquisition requirements:

- All disposal of hazardous substances occurred before the purchaser acquired the facility;⁴⁸

45 On May 9, 2003, EPA published a final rule clarifying that for the purposes of achieving the all appropriate inquiries standards of CERCLA, and until the effective date of the EPA AAI rule, persons who purchase or occupied property on or after May 31, 1997 could use either the procedures provided in ASTM E1527-2000, or the ASTM E1527-97.

46 40 C.F.R. § 312.

47 42 U.S.C. § 9607(r).

48 42 U.S.C. § 9601(40)(A).

- The purchaser is not a potentially responsible party (PRP) or affiliated with any other PRP for the property through any direct or indirect familial relationship, any contractual or corporate relationship, or as a result of a reorganization of a business entity that was a PRP;⁴⁹
- The purchaser conducted “all appropriate inquiries” into the past use and ownership of the site.⁵⁰

After taking title, a purchaser must comply with number of “continuing obligations” to maintain its BFPP status. The “continuing obligations” include “taking reasonable steps” to

- stop any continuing release;
- prevent any threatened future release; and
- prevent or limit human, environmental, or natural resource exposure to any previously released hazardous substance.⁵¹

A tenant can attain BFPP status in two ways. First, the tenant can independently comply with the BFP by performing AAI and then satisfying the post-acquisition continuing obligations. Alternatively, a tenant can achieve derivative BFPP status by entering into a lease with a landlord that is already a BFPP.

Practice Note: As an affirmative defense, the party seeking liability protection has the burden that it meets all of the elements of the BFPP. The BFPP is self-implementing, meaning a property owner can assert the liability protection without formal determination by EPA. Of course, the downside of the self-implementing nature of the BFPP is that a party that thinks it may have achieved BFPP status may later learn that a court holds otherwise.

49 42 U.S.C. § 9601(40)(H).

50 42 U.S.C. § 9601(40)(B). EPA promulgated its AAI rule at 40 C.F.R. 312.

51 42 U.S.C. § 9601(40)(D). The other continuing obligations are complying with all release reporting requirements; cooperating, assisting, and providing access to persons authorized to conduct response actions or natural resource restoration at the property; complying with any land use restrictions established as part of a response action and not impeding the effectiveness or integrity of any institutional control used at the site; providing access to persons authorized to operate, maintain, or otherwise ensure the integrity of land use controls at the site; and complying with any EPA request for information or administrative subpoena issued under CERCLA. *See* 42 U.S.C. § 9601(40)(C), (E)-(G).

There have not been any decisions by any of the federal courts in New York interpreting the BFPP defense. However, based on two federal appeals courts it appears that the BFPP is beginning to resemble the car reservation in the famous Seinfeld episode “The Alternate Side”: The BFPP may be easy to achieve but hard to maintain.⁵² For example, in *PCS Nitrogen Inc. v. Ashley II of Charleston LLC*,⁵³ a purchaser was found not to be a BFPP because it failed to implement recommendations in a Phase I report and had failed to maintain protective cover on the property, and in *Voggenthaler v. Maryland Square LLC*, a purchaser was unable to assert the BFPP defense because it did not comply with the appropriate care obligations when it demolished a dry cleaner without taking steps to remove contaminated soil or prevent the contamination from migration.⁵⁴

An example of a property owner that was able to successfully obtain BFPP status is *3000 E. Imperial v. Robertshaw Controls*.⁵⁵ The purchaser drained USTs within six months of taking title but did not remove them until it commenced redevelopment three years later. Because it had enrolled in the state voluntary cleanup program and was working under the supervision of the state environmental agency, the court ruled that the plaintiff had satisfied its post-acquisition continuing obligations.

[14.8] 5. CERCLA Contiguous Property Owner (CPO) Defense

Congress also added the CPO⁵⁶ defense with the 2002 CERCLA amendments. This defense provides liability protection to a person own-

52 In this episode, Jerry Seinfeld walks up to a car rental counter to and is informed by the rental car agent that the mid-sized car he reserved is not available:

Jerry: “I don’t understand. Do you have my reservation?”

Rental Car Agent: “We have your reservation, we just ran out of cars.”

Jerry: “But the reservation keeps the car here. That’s why you have the reservation.”

Rental Car Agent: “I think I know why we have reservations.”

Jerry: “I don’t think you do. You see, you know how to take the reservation, you just don’t know how to hold the reservation. And that’s really the most important part of the reservation: the holding. Anybody can just take them.”

53 714 F.3d 161 (4th Cir. 2013).

54 724 F.3d 1050 (9th Cir. 2013).

55 2010 WL 5464296 (C.D. Ca. 2010).

56 42 U.S.C. § 9607(q).

ing or leasing property that has been contaminated originating from a contiguous or adjacent property. A party that qualifies for CPO status will not be required to conduct ground water investigations or to install ground water remediation systems unless it would otherwise be required to conduct such activity under the EPA 1995 policy “Final Policy Toward Owners of Property With Contaminated Aquifers.”⁵⁷

A person seeking to qualify for the CPO defense must comply with the same pre- and post-acquisition obligations as a BFPP. However, while the BFPP can knowingly acquire contaminated property, a CPO must not know or have reason to know of the contamination after it has completed its pre-acquisition AAI investigation. On the other hand, EPA is authorized to issue assurance letters to CPOs that no enforcement action will be initiated under CERCLA and to provide protection against claims for contribution or cost recovery. If an owner cannot qualify for the CPO defense because, for example, it had knowledge of the contamination from an adjacent property, it may still be able to qualify for the BFPP defense.

Practice Note: Many owners and occupants do not focus on environmental conditions at nearby properties during due diligence. They will now need to have to perform thorough Phase I ESAs so that they will be in a position to exercise their post-closing or occupancy “appropriate care” requirements.

[14.9] 6. Innocent Seller’s Defense

An innocent purchaser who then becomes a seller can assert this defense if it discloses the existence of hazardous substances that may have occurred after taking title and complied with the “due care” and “precautionary” prongs of the third-party defense.⁵⁸

[14.10] 7. CERCLA Secured Creditor Exemption

Lenders who, without participating in the management of a facility, hold indicia of ownership to protect a security interest in the facility are also exempt from liability.⁵⁹ However, banks who have foreclosed on property or have been overly involved in the management of a borrower’s operation have been held liable as owners or operators of the property.

57 60 FR 34790 (July 3, 1995).

58 *Westwood Pharm. v. National Fuel Gas Dist. Corp.*, 964 F.2d 85 (2d Cir. 1992).

59 42 U.S.C. § 9601(20)(A).

[14.11] 8. Contractual and Equitable Defenses

While the statutory defenses are the only ones available to defendants in government cost recovery actions, traditional equitable defenses are available to defendants in private party cost recovery actions or contribution actions, such as laches, release, waiver, or unclean hands, to reduce liability in private cost recovery actions. Defendants may also raise procedural defenses to government cost recovery actions, such as “the response costs were not consistent with the National Contingency Plan”⁶⁰ and “the remedy was not cost-effective.”

[14.12] 9. CERCLA Liens

CERCLA provides EPA with two types of statutory liens. EPA may impose a non-priority lien on property where it has performed response actions. The lien becomes effective when EPA incurs response costs or notifies the owner of the property of its potential liability, whichever is later. The lien is subject to the rights of holders of previously perfected security interests.⁶¹

EPA may also file a windfall lien when it has performed a response action at a site owned or operated by a BFPP and the response actions have increased the fair market value of the property above the fair market value that existed before the response action was initiated.⁶² The windfall lien is to be measured by the increase in fair market value of the property attributable to the response action at the time of a sale or other disposition of the property. The lien will arise at the time EPA incurs its costs and shall continue until the lien is satisfied by sale or other means, or EPA recovers all of its response costs incurred at the property. In lieu of EPA imposing a windfall lien on the property, the BFPP may agree to grant EPA a lien on any other property that the BFP owns or provide some other assurance of payment in the amount of the unrecovered response costs that is satisfactory to EPA.

[14.13] B. RCRA

Under this law, owners or operators of facilities that treat, store or dispose of hazardous wastes must comply with certain operating standards and may also be required to undertake corrective action to clean up con-

60 40 C.F.R. § 300.

61 42 U.S.C. § 9607(l).

62 42 U.S.C. § 9607(r).

tamination caused by hazardous or solid wastes. The federal government may also issue a corrective action order to an owner or operator of a TSDF or generators of hazardous waste subject to RCRA.⁶³ The government may also issue orders for injunctive relief to address hazardous wastes posing an “imminent and substantial endangerment” to public health and the environment.⁶⁴

RCRA also imposes a full range of regulatory requirements on owners and operators of USTs that are used to store petroleum or hazardous substances.⁶⁵ Some parts of the UST program are administered by the NYS-DEC in lieu of EPA enforcement (see the state environmental law section).

Unlike CERCLA, private parties are not entitled to recover their cleanup costs. Private parties may also seek injunctive relief to compel persons who contributed to the past or present handling, storage, treatment, transportation or disposal of hazardous waste that is posing or “imminent and substantial endangerment” to public health and the environment.⁶⁶ Indeed, this provision is becoming a powerful litigation tool particularly for sites contaminated from gas stations⁶⁷ and the notorious dry cleaners.

Practice Note: The phrase “imminent and substantial endangerment” does not mean there is an immediate risk but simply that actual harm may occur. Some courts have held that contaminants above groundwater levels are sufficient to constitute an “imminent and substantial endangerment,” while others require that there be completed pathways of exposure.⁶⁸ If an approved remedy has been installed and is operating, some courts in New York have found that there is no injunctive relief that can be awarded even

63 42 U.S.C. § 6928(h).

64 42 U.S.C. § 6973.

65 42 U.S.C. § 6991–6991m.

66 42 U.S.C. § 6972(a)(1)(B).

67 Because petroleum is excluded from the CERCLA definition of hazardous substances, RCRA section 7002 is often the only federal remedy available to owners or operators of property contaminated with petroleum.

68 *See Interfaith Community Organization v. Honeywell Int'l*, 263 F. Supp.2d 796 (D.N.J. 2003), *aff'd*, 399 F. 3d 248 (3d Cir. 2005).

if the remedy allows the residual contaminant to remain in place and does not restore the property to its pre-spill condition.⁶⁹

[14.14] IV. SUMMARY OF PRINCIPAL NEW YORK ENVIRONMENTAL LAWS AFFECTING COMMERCIAL LEASING TRANSACTIONS

[14.15] A. New York Inactive Hazardous Waste Disposal Site Law (State Superfund or SSF)

Under the SSF,⁷⁰ the NYSDEC is authorized to establish a registry of sites contaminated with hazardous wastes.⁷¹ The NYSDEC must notify owners of sites that are proposed to be placed on the registry. Owners or operators of sites that are listed on the registry may petition the NYSDEC to have the site de-listed or to have the classification changed. The NYSDEC is required to convene an adjudicatory hearing within 90 days of receiving a de-listing petition and provide at least 30 days' notice of a scheduled hearing. The NYSDEC is required to issue a ruling within 30 days after the hearing.⁷²

If the NYSDEC determines that a site poses a "significant threat" to the environment, it may order the owner of the site and/or any other person responsible for the disposal of the hazardous wastes to develop a remedial program acceptable to the NYSDEC and to implement the remedial program.⁷³ However, the NYSDEC cannot issue a cleanup order until after the alleged responsible party is provided with a hearing. Moreover, a party who has been issued an order after an administrative hearing may seek

69 *Kara Holding Corp. v. Getty Petroleum*, 2004 WL 1811427 (S.D.N.Y. 2004); *87th St. Owners Corp. v. Carnegie Hill-87th St. Corp.*, 251 F. Supp.2d 1215 (S.D.N.Y. 2000).

70 ECL § 27-1301 *et seq.*

71 There are five classifications of sites on the SSF list: The sites are to be classified as follows: Class 1 (poses an imminent danger of causing irreversible or irreparable damage to the public health and the environment. Immediate actions is required. The only class 1 site that was assigned this designation was the infamous Love Canal site); Class 2 (poses significant threat to public health or the environment. Action is required. This is equivalent to the federal NPL); Class 3 (does not present a significant threat to public health or the environment. Action may be deferred); Class 4 (site properly closes but continued management is required); and Class 5 (site is properly closed and there is no evidence of present or adverse impact so no further action is required).

72 ECL § 27-1305(4)(d).

73 ECL § 27-1313.3.a.

judicial review of that decision.⁷⁴ If the NYSDEC cannot identify or locate the responsible person, the agency may implement the remedial action.

Practice Note: The inability to order a PRP to clean up a site without first conducting an administrative hearing has substantially limited the usefulness of the state superfund program.⁷⁵

The categories of PRPs under the SSF are similar to CERCLA since PRPs include anyone who might be liable under statutory or common law liability scheme. The SSF has the same third-party and innocent land-owner defense, but no BFPP or CPO protections. However, because NYSDEC does not have authority to seek cost recovery under the SSF, the agency and private parties use CERCLA and common law theories of liability to seek reimbursement of their response costs.

Practice Note: If NYSDEC determines that contamination at a site poses a significant threat and therefore is eligible for listing, a purchaser/lessor of the site might be able to defer the listing by enrolling the site in the state Brownfield Cleanup Program (see discussion below). However, this must be done before a final listing decision is made.

[14.16] B. New York Oil Spill Law

Petroleum-contaminated sites comprise the largest category of contaminated sites in New York. Indeed, there are approximately 15,000 to 20,000 new petroleum spills each year in New York. Because of the universe of sites that are potentially subject to the Article 12 of the Navigation Law,⁷⁶ this law may be the most significant source of liability to owners and operators of commercial properties in New York.

The Oil Spill Law prohibits the unpermitted discharge of petroleum into the waters of the state or onto land from which the petroleum might drain into state waters.⁷⁷ Dischargers of petroleum are strictly liable without regard to fault for all cleanup and removal costs as well as direct and

74 ECL § 27-1313.4.

75 The DOH may also order a responsible party to cleanup a significant threat under the Public Health Law which will supersede any order issued by DEC. ECL § 27-1313.3.a.

76 Nav. Law §§ 170–197.

77 Nav. Law § 173.

indirect damages.⁷⁸ The statute does not define term “discharger” and the courts have broadly the term so that it has been applied to owners and possessors of land. However, mere ownership of contaminated land is not by itself to impose liability on a property owner.⁷⁹

The NYSDEC is authorized to clean up discharges of petroleum and may enter contaminated property without first obtaining a warrant or other court order.⁸⁰ Usually, the NYSDEC will first offer the alleged discharger an opportunity to implement a cleanup by entering into a short-form Stipulation Agreement (STIP), which is a short-form order in which the party does not admit liability and will not be assessed any penalty. If the person declines to enter into the STIP, the NYSDEC may commence formal administrative proceedings to require cleanups and collect fines for failure to report or clean a site. Frequently, these cases are settled using a traditional consent order, but the settling party has to pay fines, which can be significant.⁸¹

For more complex remediation projects, the NYSDEC may require the responsible party to enter into a long-form consent order. The long-form order is drafted to address site-specific issues, and its terms are subject to negotiation. While the STIP will address only the cleanup portion of a spill site, the long-form order may address other aspects of the situation, including possible fines and/or penalties.

There are older cases that have held owners who unwittingly purchased property with abandoned USTs that had previously leaked to be liable as dischargers.⁸² The leading case on liability of lessors under the Navigation Law is *State of New York v. Green*.⁸³ This case involved a discharge of oil from a 275-gallon aboveground storage tank (AST) owned by a tenant at a mobile home park. In holding the lessor liable for the cleanup costs, the Court of Appeals ruled that a landowner could be liable as a dis-

78 Nav. Law § 181.

79 The same third party defense contained in CERCLA and the SSF was added to the Oil Spill Law in 2003. However, state courts have not had an opportunity to address this defense.

80 Nav. Law § 176.

81 Indeed, some apartment buildings have paid fines in excess of \$1MM for failing to promptly report and cleanup spills from their heating oil tanks.

82 *State v. Tartan Oil Corp*, 219 A.D.2d 111, 638 N.Y.S.2d 989 (3d Dep’t 1996); *White v. Regan*, 171 A.D.2d 197, 575 N.Y.S.2d 375 (3d Dep’t 1991); *State v. King Service Inc.*, 167 A.D.2d 777, 563 N.Y.S.2d 331 (3d Dep’t 1991).

83 96 N.Y.2d 403, 729 N.Y.S.2d 420 (2001).

charger where it had both control over activities occurring on their property and reason to believe that their tenants will be using petroleum products. The court found that the owner of the trailer park had, through its lease, the ability to control potential sources of contamination on its property, including the maintenance of a 275-gallon AST, and that the owner's "failure, unintentional or otherwise, to take any action in controlling the events that led to the spill or to effect an immediate cleanup renders it liable as a discharger."

In *State of New York v. Speonk Fuel Inc.*,⁸⁴ the Court of Appeals reaffirmed that liability may be imposed on property owners not just for active conduct, but rather based on their "**capacity to take action** to prevent an oil spill or to clean up contamination resulting from a spill" (emphasis added). As a result, the court found Speonk liable as a discharge because it knew about the spill, but failed to clean it up.

A number of appellate courts have held lessors liable for tanks operated by their tenants under a "capacity to control" analysis even in the absence of any evidence that the lessor caused or contributed to the discharge.⁸⁵ Others courts have found that lessors may be owners of the USTs since they become trade fixtures, usually after tenants have vacated the premises. Many of these cases tend to involve former gas stations.⁸⁶ A couple of courts have even held lessors liable even where they were not aware of the existence of the USTs or failed to remediate the contamination after purchasing the property and discovering the contamination.⁸⁷

84 3 N.Y.3d 720, 786 N.Y.S.2d 375 (2004).

85 Subsequent cases finding lessors liable as discharges based on sufficient control. See *Huntington & Kildare v. Grannis*, 89 A.D.3d 1195, 932 N.Y.S.2d 558 (3d Dep't 2011); *State of New York v. C.J. Burth Servs.*, 79 A.D.3d 1298, 915 N.Y.S.2d 174 (3d Dep't 2010); *State v. LVF Realty Co.*, 59 A.D.3d 519, 873 N.Y.S.2d 664 (2d Dep't 2009); *State v. B & P Auto Service Center, Inc.*, 29 A.D.3d 1045, 814 N.Y.S.2d 367 (3d Dep't 2006); *State v. Dennin*, 17 A.D.3d 744, 792 N.Y.S.2d 682 (3d Dep't 2005); *Roosa v. Campbell*, 291 A.D.2d 901, 737 N.Y.S.2d 461 (4th Dep't 2002).

86 *Veltri v. New York State Off. of State Comptroller*, 81 A.D.3d 1050, 916 N.Y.S.2d 315 (3d Dep't 2011); *Golovach v. Belmont L.M., Inc.*, 4 A.D.3d 730, 773 N.Y.S.2d 139 (3d Dep't 2004); *In re 310 S. Broadway Corp. v. McCall*, 275 A.D.2d 549, 712 N.Y.S.2d 206 (3d Dep't 2000).

87 *Sunrise Harbor Realty, LLC v. 35th Sunrise Corp.*, 86 A.D.3d 562, 927 N.Y.S.2d 145 (2d Dep't 2011).

Dischargers are required to report any unauthorized spills of petroleum within two hours of discovery to the N.Y.S. Spill Hotline.⁸⁸ The NYSDEC spill reporting regulations also impose reporting obligations on the owner or operator of the facility where the spill occurred as well as the person who was in actual or constructive control of the petroleum.⁸⁹

A “faultless landowner” who is liable as a discharger simply because of its status as the owner of the property impacted by the discharge may seek contribution.⁹⁰ Innocent parties may also seek reimbursement from the Oil Spill Fund. However, lessors or tenants who are considered dischargers may not obtain reimbursement from the Oil Spill Fund even if they paid more than their fair share of the cleanup costs. Claims for reimbursement must be made within three years after discovery of the damage and no later than ten years after the incident.⁹¹

The Navigation Law also authorizes the state to file a lien against the land where the discharge took place when the Oil Spill Fund incurs costs to clean up or remove a discharge or makes payment to satisfy claims asserted by injured parties and a landowner fails to make payment within 90 days of a demand. The lien is a non-priority lien that does not subordinate previously perfected security interests.⁹²

[14.17] C. Petroleum Bulk Storage Act (PBSA)

The PBSA⁹³ complements the Oil Spill Law. Like the federal UST program, owners and operators of USTs and ASTs with a combined storage capacity of 1100 gallons of petroleum are required to register their tanks, and comply with certain design and operation standards requirements as well as closure requirements.⁹⁴

88 1-800-457-7362. The reporting requirement does not apply to spills that meet all of the following criteria: (i) the quantity is known to be less than five gallons; (ii) the spill is contained and under the control of the spiller; (iii) the spill has not and will not reach the state’s water or any land; and (iv) the spill is cleaned up within two hours of discovery. Navigation Law § 175.

89 7 N.Y.C.R.R. pt. 32.3.

90 Nav. Law § 181(5).

91 Nav. Law § 182.

92 Nav. Law § 181-a. The notice of lien is indexed in the same manner as a lien under Lien Law § 10. An action to vacate an environmental lien is governed by Lien Law § 59, and should not be brought as an Article 78 proceeding. *Art-Tex Petroleum, Inc. v. New York State Dep’t of Audit & Control*, 93 N.Y.2d 830, 687 N.Y.S.2d 619 (1999).

93 “Control of the Bulk Storage of Petroleum,” ECL § 17-0101.

94 6 N.Y.C.R.R. pts. 613–614.

For purposes of determining if a property is regulated by the PBSA, heating oil tanks that have capacities less than 1100 gallons are not counted. This property with three 500-gallon heating tanks would not be subject to the PBSA even though the total storage capacity of the tanks is 1500 gallons.

The PBSA imposes reporting obligations on “any person with knowledge of a spill leak or discharge” of petroleum that exceeds 25 gallons or creates sheen on nearby surface water.⁹⁵ While this reporting obligation was traditionally viewed as applying only parties who own or operate facilities that store more than 1100 gallons of petroleum, an administrative law decision extended the reporting obligation to environmental consultants.⁹⁶ Reporting obligations for smaller facilities are governed by the Oil Spill Law.

If the NYSDEC suspects or believes that a UST is leaking, it may order the owner to perform a tightness test. If the owner fails to conduct the test within ten days, the NYSDEC may conduct the test and seek reimbursement of its reasonable expenses.⁹⁷

USTs that are temporarily out of service (30 days or more) must be drained of product to the lowest draw-off point. Fill lines and gauge openings must be capped or plugged. Inspection and registration must continue. Those tanks that are permanently out of service must be emptied of liquid, sludge and vapors. They must then either be removed or, if left in place, they must be filled with solid inert material such as sand or concrete slurry. NYSDEC must be notified 30 days prior to filling or removal.

The performance and operating standards for regulated USTs under the PBS program are considerably more extensive than those for ASTs. However, the rules for classifying a tank as an UST or AST are quirky. A tank located in a building basement or below-grade floor that is encased in a vault that does not have any “weep holes” or a manway so that the tank cannot be observed will be considered a UST. Owners and operators of such tanks would be subject to the full panoply of UST requirements under the PBSA regulatory program such as periodic tightness testing. Thus, it is particularly important to ensure that tanks in commercial buildings are properly registered.

95 6 N.Y.C.R.R. pt. 613.8.

96 *In re Middletown Kontokosta Associates, Ltd.*, NYSDEC Case No. R1-6039.

97 ECL § 17-1007(2).

Nassau, Suffolk, Rockland, Westchester and Cortland Counties have been authorized by the NYSDEC to administer the program for tanks located in those areas. Because these counties may have more stringent requirements than the state, owners and operators should contact the county to learn of specific local requirements.

Practice Note: NYSDEC PBS program has some quirk rules for heating oil tanks. Regulated PBS tanks that are out-of-service for more than one year must undergo closure. However, unlike the federal UST program, the NYSDEC PBS program does not require an environmental assessment to close heating oil tanks. The tank has to be cleaned out and visually inspected for holes but soil or groundwater samples are not ordinarily required to achieve closure of heating oil tanks unless there is visual evidence or a leak. Thus, it is possible that a heating oil tank that was closed in place and obtained regulatory closure by the NYSDEC may have impacted the property. Accordingly, it is advisable for purchasers and prospective tenants of property with abandoned heating oil tanks to review the closure documentation to see if sampling was conducted. In the absence of such documentation, the purchaser should consider conducting its own sampling since the purchaser could be strictly liable under the state Navigation Law if an abandoned tank that was closed in place has impacted the environment.

In New York City, chapter 34 of the Fire Code establishes requirements for Out-of-Service Storage Systems storage tanks.⁹⁸ Closure of storage tank systems that have not been used for one year must be closed a certain licensed individuals. The owner or operator of a permanently out-of-service storage system or the permit holder for the tank system must also file an affidavit with the Fire Department certifying that the tank system was removed and disposed or abandoned in place in compliance with the requirements of Fire Code. If an environmental site assessment is required by federal or state law or regulations, the owner/operator of the storage system, the permit holder for the system or the person filing the affidavit of compliance must submit a written statement to the Fire Department that such environmental site assessment has been performed in accordance with such law and regulations.

Finally, the New York City Department of Environmental Protection (NYSDEP) has issued regulations to phase out the use of Number 6 (No. 6) and Number 4 (No. 4) fuel oil that is burned at approximately 10,000 buildings to reduce the quantity of fine particulates emitted by buildings.

⁹⁸ 3 R.C.N.Y. § 3404-01.

Studies had shown that 1% of the buildings in the city produce 86% of the total soot pollution from buildings.

[14.18] D. Brownfield Cleanup Program (BCP)

The BCP is the state voluntary cleanup program.⁹⁹ To be eligible for the BCP, a site must have documented contamination that requires remediation. Sites that are already subject to an enforcement order, are operating under a RCRA permit or have been listed as Class 2 sites on the state superfund list are not eligible for the BCP.

Applicants may include current property owners, prospective purchasers, developers and tenants. There are two types of applicants and the applicant category influences the potential scope of the cleanup. A “volunteer” is an applicant that is not responsible for the contamination. This could include purchasers, new tenants and developers. It could also include existing owners or tenants provided that they did not cause or contribute to the contamination. Applicants that would be considered “responsible parties” would be accepted as “participants.” The key distinction between a “volunteer” and an “participant” is that the volunteer is only required to cleanup on-site contamination while participants have to remediate off-site contamination as well as on-site contamination. The ability to confine the cleanup to the brownfield site is an extremely important benefit since it not only limits the cleanup costs but also because it helps eliminate uncertainty about the ultimate cleanup costs since parties can develop worst case scenarios on the volume of soil that would have to be removed from a site.

Another important benefit of the BCP is that applicants will receive a no further action known as a Certificate of Completion (COC) after they complete a NYSDEC-approved cleanup. The COC contains a covenant not to sue from the State of New York that runs with the land and will also provide contribution protection.

In addition to the liability protections, the BCP offers the most generous tax credits in the country. Applicants can claim three types of tax credits. The BCP tax credits are refundable so to the extent that the brownfield tax credits exceeds the applicant’s tax liability, the tax credit is treated as a tax overpayment and the state will issue a check.

⁹⁹ ECL § 27-1401 *et seq.*

The first tax credit is known as the Site Preparation Cost (Site Prep). It includes all costs necessary incurred to make the property ready for development. The Site Prep credit includes not only cleanup costs but also costs of demolition, excavation, soil disposal, sheeting, shoring and dewatering. The amount of the Site Prep tax credit that may be claimed depends on the level of cleanup and ranges from 28% to 50% of the costs. The Site Prep tax credit may be claimed in the tax year following the issuance of the COC. The buildings on BCP sites do not have to be constructed or occupied to claim the Site Prep tax credit. Instead, only the remedy has to be completed and a COC issued to be able to claim the Site Prep tax credit.

The second tax credit is available for post-COC groundwater monitoring costs at the same percentage of the Site Prep tax credit. This credit may be claimed annually for the five year period following the issuance of the COC.

The third (and most valuable) BCP tax credit that is available is the qualified tangible property (QTP) tax credit which ranges from 10% to 24% of the value of the improvements constructed on the brownfield site subject to a cap of \$35million or three times the Site Prep costs (whichever is less). BCP applicants have ten years from the issuance of the COC to put the building into service and claim the tangible property tax credit. For example, a \$200 million project with \$10million in Site Prep costs (mainly from excavation) could be eligible for \$5million in Site Prep costs for a track 1 (unrestricted) cleanup and \$30 million in tangible property tax credit (3 x \$10 million) for a total of \$35 million in BCP tax credits.

Practice Note: The potential for BCP eligibility raises a number of issues in commercial transactions. The challenges are different for a new lease where the parties contemplate submission of a BCP application than an existing lease where the tenant may want to take advantage of the BCP to help finance building renovations or expansions.

The first obvious question is going to be who can claim the tax credits. Remember that only the party that actually incurs eligible costs and that is named on the COC may claim the BCP tax credits. If the lessee would be the logical party for submitting the application if it is going to be incurring the costs of the project.

However, as explained below, because the applicant has to obtain the consent and cooperation of the property owner at several stages in the

BCP process, the lessor may have leverage to seek to participate in the BCP tax credits. If the lessor is going to participate in the BCP tax credits, this can be accomplished in a number of ways. The parties can submit a joint application so that both the lessee and lessor sign the Brownfield Cleanup Agreement (BCA). If the lessee already submitted the BCP application and has executed the BCA, the lessor can be added to the BCA by filing a BCA amendment. This would have to be done before the COC is issued. Finally, the application could be submitted by a joint venture of the lessor and lessee, or by an entity in which the lessor owns or purchases membership interests.

Since a Phase 2 will have to be included in the BCP application, a new tenant considering applying to the BCP will have to negotiate the right to collect soil and groundwater before it takes possession of the premises. If acceptance into the BCP will be a condition to entering into the lease, this work may have to be scheduled several months before the commencement date of the lease because of the time it takes for an application to be accepted by the NYSDEC.

If the cleanup does not achieve an unrestricted residential standard, NYSDEC will require the use of institutional and engineering controls. These controls will be memorialized in an environment easement that must be executed and recorded by the lessor. The environmental easement must be recorded before the NYSDEC issues its COC. If the lessor refuses to execute or record what amounts to use restrictions on its fee, the lessee/BCP applicant will have to implement a more costly unrestricted cleanup to obtain a COC. Thus, the lease should contain a covenant requiring the lessor to cooperate and execute any documents required by NYSDEC in connection with the BCP.

When the applicant does not own the land, NYSDEC will require that the applicant has access to the site to implement all requirements of the BCP. The tenant can demonstrate access by either having the access set forth in the lease or a separate access agreement. Obviously, the standard environmental contingency clause that prohibits the tenant from notifying NYSDEC of the sampling results will be inadequate. For existing leases and long-term ground leases that were executed before the potential for a BCP application was contemplated, a separate access agreement will probably be the easiest route for satisfying this requirement.

There is an important cautionary note about including the property owner on the application or the BCA. If the NYSDEC considers the lessor to be a responsible party, this could expand the scope and complexity of

the cleanup, though. The reason is that if an application is jointly submitted by a “volunteer” applicant (i.e., the tenant) and a participant (property owner), the application will be treated as one submitted by a participant and the BCA would identify the applicants as participants. As explained previously, this means that the applicants would have to address any off-site contamination that may be emanating from the site. Thus, the lessor status should be considered and discussed with NYSDEC before including the lessor in the application or on the BCA.

Of course, the reverse situation could also occur where there is a purchaser but an existing lessee who would be considered a participant. Likewise, if a seller wants to participate in a proposed brownfield application by a purchaser.

[14.19] E. Vapor Intrusion Disclosure Law

Vapor intrusion refers to the vertical or lateral migration of volatile organic compounds (VOCs) from soil or groundwater into buildings. In extreme cases, these vapors can accumulate at levels that create immediate safety hazards (such as explosions), illness, or aesthetic problems (such as odors). More typically, however, when VOC vapors migrate into buildings, the levels are much lower, creating the more insidious risk of chronic health problems arising from long-term exposure. The contaminants that typically pose a risk of vapor intrusion are chlorinated solvents like those used in dry cleaners, benzene from gasoline, naphthalene from heating oil and mercury.

Historically, the NYSDEC focused primarily on soil and groundwater contamination. NYSDEC did not regard vapor intrusion as a significant potential risk unless VOC contamination occurred directly next to an occupied building or directly below its foundation. Therefore, NYSDEC remediation programs usually focused on reducing soil or groundwater contamination, or at least eliminating pathways by which such contamination could reach people.

The regulatory landscape changed a few years ago after NYSDEC discovered significant levels of VOCs in residences near a number of contaminated sites. NYSDEC subsequently announced that it would re-evaluate up to 721 sites across the state where cleanups had been considered completed. In addition, both the NYSDEC and the New York State Department of Health (NYSDOH) have issued guidance on evaluating the vapor intrusion pathway.

Title 24 of the New York Environmental Conservation Law¹⁰⁰ requires responsible parties remediating a site under the state Superfund program or some other remedial programs to give landowners copies of air contamination reports. Originally, this law did not require property owners to disclose those reports to tenants and occupants. In 2008, the law was amended to require landlords to disclose to existing and prospective tenants “test results” received from responsible parties indicating exceedances of New York State Department of Health (NYSDOH) or federal Occupational Safety and Health Administration (OSHA) guidelines for indoor air quality. The disclosure statute does not distinguish between residential and commercial property.

Within 15 days of receiving an “air contamination report” from the responsible party, the property owner must provide a fact sheet (generic fact sheets are to be developed by NYSDOH) identifying the contaminant of concern and a means to obtain more information, as well as timely notice of any required public meetings to be held to discuss such results. In addition, if a tenant requests a copy of the test results and any closure letter, the property owner must provide the documents within 15 days of receipt of such results.

If a property has an “engineering control” in place to mitigate indoor air contamination, or a monitoring program as part of a continuing remediation program, the property owner must provide the same notice. The property owner must do this before a prospective tenant signs any “binding lease or rental agreement.”

In addition, the property owner subject to the disclosure obligation must include a disclosure notice in their “rental or lease agreement these locations must include the following language in 12-point bold face type on the first page of any lease or rental agreement:

**NOTIFICATION OF TEST RESULTS: The Property
Has Been Tested for Contamination of Indoor Air:
Test Results and Additional Information Are Avail-
able Upon Request.**

A property owner that violates the new disclosure requirement could face the general criminal or civil penalties provided by the ECL. If the indoor air contamination is determined to create an imminent and substantial endangerment, the property owner could face injunctive relief as

100 ECL § 27-2405.

well as fines of up to \$2,500 for each violation and \$500 per day for each day it continues. If the property owner becomes a responsible party under the state Superfund law, the violations could cost as much as \$37,500 per day.

Practice Note: The disclosure law does not require property owners to conduct their own tests or to perform any retesting. In cases where test results did not use actual indoor air samples but instead were extrapolated using modeling based on soil or groundwater samples, a property owner may (but also may not) want to take samples to confirm that air within the building complies with applicable guidelines.

The vapor intrusion disclosure law does not seem to apply if a property owner unilaterally discovers air contamination problems such as from public records or transactional due diligence. Of course, the property owner might have disclosure obligations under other environmental laws or the common law. Moreover, a violation of the new statute might serve as evidence of breach of duty in a negligence action against the property owner.

To avoid liability to its own tenants, the property owner might need to take abatement measures to prevent vapors from migrating into its building. When the vapors are migrating from an off-site source or the current owner is not considered a responsible party, the owner will not typically be required to remediate the contaminated soil or groundwater but simply have a vapor venting system installed which captures the fumes and redirects into the outside air. These venting systems can be relatively inexpensive if installed as part of new construction. Retrofitting an older building can be more challenging and expensive, though. If the responsible party is subject to a CERCLA or SSF order, it will often be required to install the venting system. For voluntary cleanups, though, the property owner would have to install the system and then decide if it wants to try to recover the costs from a responsible party in a CERCLA contribution or cost-recovery action, or common law theory. Alternatively, the owner could try to treat the costs of the venting system as operating expenses for purposes of operating expense escalations in its leases. Whether tenants will accept that may represent another issue entirely.

[14.20] F. New York City Voluntary Cleanup Program (VCP) and “E” Designation Program

The New York City Office of Environmental Remediation (OER) administers a local VCP that can be used to address minimally-contami-

nated sites such as contaminated fill sites, the “E” program and oil spills that are confined to the property. OER has entered into a Memorandum of Understanding with NYSDEC so that NYSDEC will honor cleanups completed by OER under its VCP.

OER also administers the E-Designation program, which began as a land-use program but has morphed into an important source of cleanup obligations in New York City. An E-Designation is a N.Y.C. zoning map designation that indicates the presence of an environmental requirement pertaining to potential Hazardous Materials Contamination, Window/Wall Noise Attenuation, or Air Quality impacts on a particular tax lot. The E-Designation is assigned to property lots as part of a zoning action under the City Environmental Quality Review (CEQR) Act. If the CEQR review process indicates that development on a property may be adversely affected by noise, air emissions, or hazardous materials, then the Lead Agency may assign an E-Designation on the property lot to ensure that the E-Designation requirements are satisfied prior to or during a new development or new use of the property.

A Hazardous Materials E-Designation for may be assigned for a variety of reasons including that the property

- was used as or is in close proximity to a gas station or some other underground fuel oil tank;
- is located in or contiguous to a manufacturing district;
- has a history of manufacturing uses;
- is located next to a building with a history of manufacturing uses;
- is located on a heavily trafficked street or highway;
- is located next to a railroad; or
- has some other environmental condition on the property or nearby that is a cause for concern.

The Department of Buildings (DOB) incorporates the E-Designations in its Buildings Information System (BIS). The DOB examiner cannot issue a building permit for new development, changes of use, enlargements or certain other alternations to existing structures until DOB receives either a Notice to Proceed (NTP) or Notice of No Objection (NNO) from OER. To obtain an NTP from OER, the applicant has to sub-

mit an acceptable investigation and remedial plan to OER. OER may issue NNOs for actions that do not raise potential exposure to hazardous materials, or air quality or noise impacts. Indeed, approximately 50% of the E-Designation projects OER reviews result in NNOs.

When the applicant wants to obtain a Certificate of Occupancy from DOB, it must obtain a Notice of Satisfaction (NOS) from OER demonstrating that the applicant has complied with OER requirements. If an applicant wants to *remove* the E-Designation from the property, it would have to implement a track 1 (unrestricted) cleanup. Parties can also comply or remove the E-Designation by enrolling the site in the state BCP as well as the NYC VCP.

It is important to note that when lots with an E-Designation are merged or subdivided, the E-Designation will apply to all portions of the merged lot or to each subdivided lot.¹⁰¹

A similar approach is used for Restrictive Declarations (RD) that impose an institutional control against a property to ensure that environmental mitigation or requirements that were imposed as a condition of a land use approval are implemented. The RD runs with the land so that it binds current and future owners to comply with certain investigation and remedial requirements that may be required by OER.

Historically, RDs were used when private applicants who owned or controlled a property sought a rezoning or other action under section 11-15 of the Zoning Resolution of the City of New York. This proved to be a cumbersome process because all parties with a property interest in property, including lenders, had to execute an RD. Moreover, the NYCDEP and a city agency approving the discretionary action had to expend resources reviewing the RD.

In 2012, the City Council adopted an amendment to the Zoning Resolution that authorized lead agencies to assign E-Designations for any actions including those sought by private applicants such as rezoning, special permits or variances. Because of the zoning resolution amendments, RDs will no longer be used to impose environmental conditions on properties. However, owners and developers will have to comply with existing RDs.

¹⁰¹ For more information on the E-Designation program, visit www.nyc.gov/html/oer/html/e-designation/e-designation.shtml.

[14.21] V. ENVIRONMENTAL DUE DILIGENCE

There may be many reasons why a property owner or tenant may perform an environmental site assessment. The parties to a transaction can use the information to help negotiate an appropriate price for the property. A purchaser or tenant can use the information to “draw a white line” around the facility to show what conditions existed prior to the closing. Sellers and lessors are increasingly performing pre-marketing due diligence to pre-position a property as well as to expedite the due diligence process.

It is important to recall that EPA’s AAI Rule only satisfies one of the pre-acquisition obligations that parties must satisfy to assert the CERCLA landowner defenses. To fully understand if AAI is appropriate for a transaction, it is important to understand what it does not cover. The AAI Rule does not address the following:

- What constitutes the “reasonable steps” obligations that all landowners must comply with after acquiring property;¹⁰²
- Real estate transactions that occurred prior to May 31, 1997;¹⁰³
- The CERCLA third-party defense;¹⁰⁴
- The CERCLA secured creditor exemption;¹⁰⁵
- The RCRA secured creditor exemption for underground storage tanks;¹⁰⁶
- Residential real estate acquired by a nongovernmental entity or non-commercial entity where a site inspection and title search indicated there was no basis for further investigation;¹⁰⁷

102 Persons seeking to assert the landowner defenses are required to comply with all applicable federal and state reporting obligations as part of their “continuing obligations.”

103 Parties to such transactions would be required to comply with the requirements of the innocent purchaser defense added to CERCLA in 1986 and codified at 42 U.S.C. § 9601(35)(B)(iv)(I).

104 42 U.S.C. § 9607(b)(3).

105 42 U.S.C. § 9601(20)(E). However, lenders who do not qualify for the secured creditor exemption and therefore want to qualify for one of the CERCLA landowner defenses prior to taking title or possession to contaminated property would have to comply with the AAI Rule.

106 42 U.S.C. § 6991(b)(h)(9).

107 42 U.S.C. § 9601(35)(B)(v).

- Acquisition of title by state and local governments to properties involuntarily through tax foreclosure or by eminent domain;¹⁰⁸
- Petroleum-contaminated sites;¹⁰⁹
- Facilities subject to RCRA corrective action;¹¹⁰
- Protection against claims for injunctive relief under the RCRA citizen suit provision;¹¹¹
- Liability relief for cleanup of PCBs under TSCA;¹¹²
- Persons seeking to establish liability defenses under state environmental or common law;¹¹³
- A requirement to identify small quantities of contaminants that do not pose a threat to human health or the environment;
- A requirement to sample or to indicate when a phase 2 should be performed;¹¹⁴
- Vapor intrusion, asbestos, lead-based paint, radon, and other indoor air quality issues.

Practice Note: Many clients and their business lawyers feel that they do not need the services of environmental lawyers but simply rely on an

108 42 U.S.C. § 9601(20)(D); 9601(35)(A)(ii).

109 The CERCLA definition of a brownfield site includes properties contaminated or potentially contaminated with hazardous substances, petroleum and petroleum products, controlled substances, and pollutants and contaminants. Thus, persons who receive a brownfields grant awarded under CERCLA § 104(k)(2)(B) must comply with the AAI Rule when conducting site characterization or assessment activities at brownfield sites contaminated with petroleum or contaminants specified in the cooperative agreement between EPA and the grantee.

110 42 U.S.C. § 6924(u), (v); 6928(h).

111 42 U.S.C. § 6972.

112 15 U.S.C. § 2601 *et seq.*; 40 C.F.R. pt. 761.

113 Owners and tenants wishing to establish liability protection under state Superfund or other laws must comply with all criteria established under state laws, including any criteria for conducting site assessments or all appropriate inquiries established under applicable state statutes or regulations. 70 FR at 66073.

114 While stating that sampling and analysis is not required to comply with the AAI requirements, EPA did suggest that sampling may be valuable to determine the possible presence and extent of potential contamination at a property as well as informing the landowner how to best fulfill its post-acquisition continuing obligations. 70 FR at 66089.

environmental consultant to prepare a Phase 1. However, the environmental due diligence process is both a technical and legal exercise and requires input from specialists to ensure that the scope of the diligence is sufficient for the transaction and the risk threshold of the client.

[14.22] A. Overview of the E1527-13 Phase 1 Standard

The ASTM Standard Practice for Environmental Site Assessments: Phase 1 Environmental Site Assessment Process (ASTM E1527) was initially published in 1993 to define “good commercial and customary practice” for establishing the innocent landowner defense. Since then, E1527 has become the accepted industry standard for satisfying the pre-acquisition AAI Rule. The current version that is used to comply with AAI is designated E1527-13.

[14.23] 1. Recognized Environmental Conditions (REC)

The goal of an ASTM E1527 Phase 1 is to determine if a Recognized Environmental Condition (REC) exists at the property. This term does not appear in CERCLA but was developed by ASTM to help consultants distinguish minor spills from conditions that would be required to be investigated or remediated. Unfortunately, the REC definition was not artfully drafted and has led to much confusion. As a result, it is not unusual for a property owner or its counsel to disagree with an environmental consultant if a certain condition rises to the level of a REC. To minimize such disagreements, the REC definition was revised in the latest revision so that it more closely tracks the CERCLA definition of release.¹¹⁵

If particular issues are important to a specific commercial leasing transaction, the party ordering the Phase 1 must tell the environment consultant and ensure that the additional non-scope items are included in the engagement letter.

Practice Note: The fact that an issue is not identified as a REC does not mean that there is no potential environmental liability associated with the property but just that there are no releases of hazardous substances

¹¹⁵ The revised REC definition now refers to “the presence or likely presence of any hazardous substances or petroleum products in, on or at a property: (1) due to any release to the environment; (2) under conditions indicative of a release to the environment; or (3) under conditions that pose a material threat of future release to the environment.”

that could lead to CERCLA liability. Unfortunately, many real estate owners, investors and even courts are not aware of this distinction.¹¹⁶

[14.24] 2. Historic Recognized Environmental Conditions (HREC)

The term Historical Recognized Environmental Conditions (HREC) was added to E1527 in 2000 for sites where contamination was remediated to applicable standards. Instead of labeling the former contamination as an REC, consultants could now identify the former spill as an HREC, confirming that it has been remediated and no longer poses a risk to human health of the environment.

Although the HREC term can be a useful tool, many consultants were unclear on when they could make an HREC determination. Some made HREC determinations without verifying if the cleanup standard used in the past was still valid and that the remedy (i.e., engineering or institutional controls) was still protective and functioning as designed. Other consultants maintained that the continuing presence of residual contamination was an REC notwithstanding regulatory approval. This was a significant concern since most cleanups now employ risk-based approaches where some remnant of contamination is allowed to remain so long as institutional or engineering controls are used to prevent unreasonable exposure to the residual contamination.

The HREC definition was amended in the new version of E1527 so that it now only applies to contamination that has been remediated to an unrestricted cleanup standard.¹¹⁷ If the cleanup utilized engineering or institutional controls, such as deed use restrictions or prohibiting use of groundwater, the consultant may no longer use HREC but instead use the new term Controlled Recognized Environmental Conditions (CRECs).

116 An example of how sophisticated parties may not understand the significance of non-REC issues was the decision in *Bank of N.Y. Mellon Trust Co. v. Morgan Stanley Mortg. Capital, Inc.*, 2011 WL 2610661 (S.D.N.Y. 2011), in which the federal district court for the Southern District of New York denied a motion to dismiss filed by a mortgage originator who was alleged to have failed to adequately disclose environmental conditions at a shopping center because the potential presence of methane was not disclosed as a REC. However, methane is not a hazardous substance as defined by CERCLA and therefore could not be a REC. Moreover, the consultant had identified methane as an Environmental Issue of Concern.

117 E1527-13 § 3.2.41.

[14.25] 3. Controlled Recognized Environmental Conditions (CREC)

If a cleanup does not meet the unrestricted cleanup standards and relies on engineering or institutional controls, the consultant must now identify this remediated spill as a CREC.¹¹⁸ This new term is technically a type of REC and must be listed in the “Findings” section of the Phase 1 report.

A CREC will not require further action as long as the “controlled” conditions remain in effect. At first glance, this would seem to provide comfort to lenders and purchasers. However, E1527-13 states that consultants do not have to confirm the adequacy or continued effectiveness of the control when making its CREC determination. This undermines the usefulness of the CREC since the client will not know if the remedy is protective or if further action is required. This limitation also appears to conflict with the revisions to the file review obligations. As a result, purchasers and lenders should consider requiring consultants to confirm the effectiveness of controls before making a CREC determination.

Practice Note: Decisions on HRECs and CRECs may require input from lawyers. In fact, consultants are struggling with the new CREC and HREC definitions. Frequently, consultants are improperly identifying conditions as RECs which obviously can have consequences for contractual contingencies and unduly alarm lenders or investors. For example, if an adjoining site has impacted the property but a cleanup was completed at the adjacent property based on the fact that groundwater will not be used, some consultants identify this as a REC for the property when it should probably be a CREC.

The value of the HREC or CREC designation is to inform the property owner or lessee if it is likely to incur remediation costs. For example, a cleanup may have been completed years ago that does not meet current standards or the cleanup may have relied on an engineering cap or institutional control preventing disturbance of the soil. If the property owner or tenant plans to expand a building footprint or install new utilities that will disturb the cap, additional cleanup may be required. Likewise, if the plans call for a change in use that will trigger a more stringent cleanup standard, this could trigger a reopener in the NFA letter and require additional cleanup. It is difficult to see how an environmental professional could make decisions about HRECs and CRECs in these situations without assistance from an environmental attorney.

¹¹⁸ E1527-13 § 3.2.18.

[14.26] 4. Agency File Reviews

Agency files can contain critical information about historic contamination and adequacy of the cleanup. However, many consultants have exploited ambiguities in E1527-05 and have not routinely include file reviews in the standard Phase 1 scopes of work. Instead, they have been charging clients an additional fee for this work as an additional task.

One of the more significant changes to the ASTM standard now creates a presumption that consultants should review agency files when the property or adjacent properties are identified on one of the standard databases that are required to be searched to determine if a REC, CREC, HREC or *de minimis* condition exists at the property. A consultant that believes a file review is not required must provide a detailed explanation why the review was not performed. Alternatively, the consultant can rely on records provided from other sources (e.g., user-provided records or interviews with regulatory officials) to determine if there is sufficient information for identifying RECs and thereby avoid the time and cost of reviewing regulatory files. Depending on the accessibility of state files and their size, the agency file review may result increased Phase 1 costs and delays.

Practice Note: Many consultants have revised their standard terms to either exclude file agency reviews from the quoted price for the Phase 1 or providing that they will charge an extra fee after a set number of hours.

[14.27] 5. Searches for Cleanup Liens and Institutional Control

The existence of a cleanup lien can be of particular importance to lenders.¹¹⁹ AAI requires that the environmental site assessment include searches for cleanup liens that are filed or recorded against the property.¹²⁰ However, the rule does not require the environmental professional to obtain a chain of title. Instead, the rule provides that the environmental professional should exercise its professional judgment in determining what types of historical may provide useful information. EPA mentioned in the preamble to the rule that while the chain of title may provide important information, it may not be the only source of this information. One of the reasons for reviewing chains of titles is to obtain information

119 Many consultants took the position that these records were not reasonably ascertainable because they did not know where to search for cleanup liens and did not have the experience or training to evaluate the existence of such liens.

120 40 C.F.R. § 312.25.

about land use controls. However, EPA indicated in the preamble that there may be other sources of information that the environmental professional is required to review that could yield this information as well.

Either the prospective property owner or the environmental professional may conduct the search under AAI.¹²¹ If the environmental professional is not instructed to conduct a cleanup lien search, the person seeking the liability protection is required to perform the lien search.¹²² If the lien search is performed by the prospective property owner or tenant and it does not provide the search results to the environmental professional, the environmental professional should assess the impact of the missing information and determine if it represents a data gap. The environmental professional should also comment on the significance of the data gap on its ability to identify conditions indicative of releases or threatened releases.¹²³

[14.28] 6. Using Prior Reports

Parties to commercial leasing transaction are often tempted to rely on existing environmental due diligence materials. However, a party seeking to assert one of the CERCLA landowner liability protections must complete its environmental site assessment within one year of taking title to the property.¹²⁴

The AAI Rule allows prospective purchasers to use previously completed Phase I ESA reports under certain circumstances.

First, purchasers may use reports prepared within 180 days prior to the date of acquisition of the property that otherwise must comply with AAI.

Second, reports older than six months may be used provided that the following AAI components are updated to ensure that the report accurately reflects the current environmental conditions at a property:

- Interviews with past and present owners, operators, and occupants;¹²⁵

121 40 C.F.R. § 312.22(a)(1).

122 However, the prospective purchaser is not required to disclose the information about the cleanup lien to the environmental professional. 40 C.F.R. § 312.25(b).

123 40 C.F.R. § 312.20(g); 312.21(b).

124 40 C.F.R. § 312.20(a).

125 40 C.F.R. § 312.23.

- Searches for recorded environmental cleanup liens;¹²⁶
- Reviews of federal, tribal, state, and local government records;¹²⁷
- Visual inspections of the facility and of adjoining properties;¹²⁸ and
- The declaration by the environmental professional.¹²⁹

Third, when the updated report is using previously collected information, the report prepared for the proposed purchase must include a summary of any relevant changes to the conditions of the property and any specialized knowledge of the prospective landowner.

Practice Note: It is important to note that 180-day and one year shelf life is not measured by the date of the report but the date that the individual diligence components were completed.

[14.29] 7. Findings and Opinions

ASTM E1527 provides that the Phase 1 report have a “Findings” section that identifies known and suspected environmental conditions associated with the property, including REC, HREC, and *de minimis* conditions. In addition, the environmental professional should discuss in a separate “Opinion” section the logic and reasoning used in evaluating the effects of the known or suspect environmental conditions on the property. The opinion section must include the specific rationale for concluding that a known or suspect environmental condition such as a HREC is not currently a REC. Known or suspected environmental conditions that are identified as an ERC must also be listed in the conclusions section.

[14.30] 8. Recommendations Are Not Required

E1527-13 clarifies that recommendations are not required.¹³⁰ All the consultant is required to do is to express an opinion and conclusion on the presence or potential presence of a REC or CREC.

126 40 C.F.R. § 312.25.

127 40 C.F.R. § 312.26.

128 40 C.F.R. § 312.27.

129 40 C.F.R. § 312.21(d).

130 E1527-13 § 12.15.

Many users, particularly lenders, often require a consultant to include a recommendation in the Phase 1 report. However, failure to comply with recommendations can cause a property owner to be deemed to have failed to comply with its post-acquisition “appropriate care” obligations and fail to qualify as a BFPP or satisfy the “due care” requirement of the third party defense.¹³¹ Thus, if a client wants a recommendation, it should be prepared to timely implement the recommendation or risk losing its BFPP status. The better approach would be to have all recommendations (including those involving any non-scope items addressed by the report) contained in a separate letter addressed to counsel.

[14.31] 9. When Is Additional Investigation or Sampling Required?

One of the more vexing aspects of the due diligence process for consultants, lawyers, and clients is when further investigation is required or should be recommended. The preamble to the AAI Rule specifically states that sampling and analysis is not required for an investigation to satisfy AAI but then provides a number of caveats.¹³² However, EPA goes on to say that sampling and analysis may be valuable in determining the possible presence of potential contamination at a property or the obviousness or extent of the contamination. The Agency also indicates that sampling and analysis may help explain existing data gaps.¹³³ Moreover, EPA emphasized that the pre-acquisition AAIs is only one requirement of the CERCLA landowner liability protections. The Agency said that sampling may be valuable for determining how a landowner may best fulfill its post-acquisition continuing obligations and that prospective landowners should be mindful of their need to comply with their post-acquisition continuing obligations when considering whether to conduct sampling and analysis.¹³⁴

131 *Vogenthaler v. Md. Square LLC*, 724 F.3d 1050 (9th Cir. 2013) (see 9th Circuit Finds Shopping Center Owner Did Not Establish BFPP Status for Dry Cleaner Contamination, *Schopf LLC*, www.environmental-law.net/2013/07/9th-circuit-finds-shopping-center-owner-did-not-establish-bfpp-status-for-dry-cleaner-contamination, for a full discussion of this case); *PCS Nitrogen Inc. v. Ashley II of Charleston LLC*, 714 F.3d 161 (4th Cir. 2013) (see Fourth Circuit Affirms Ashley Rulings, *Schnapf LLC*, www.environmental-law.net/2013/04/fourth-circuit-affirms-ashley-rulings, for a full discussion of this case).

132 70 FR at 66101.

133 40 C.F.R. § 312.20(g).

134 70 FR at 66102.

Depending upon site-specific circumstances and the totality of the information collected during AAI, EPA warned that it may be necessary to conduct sampling and analysis, either pre- or post-acquisition, to fully understand the conditions at a property, and to fully comply with the statutory requirements for the CERCLA liability protections. EPA also cautioned that the fact that the AAI Rule does not require sampling would not prevent a court from concluding that, under the circumstances of a particular case, sampling should have been conducted to meet “the degree of obviousness of the presence or likely presence of contamination at the property, and the ability to detect the contamination by appropriate investigation” criterion and obtain protection from CERCLA liability.¹³⁵

Many lenders have established their own due diligence protocols which frequently require evaluation of issues that were not covered by E1527-05 and are not addressed by the AAI Rule. A list of potential non-scope items are set forth in ASTM and typically are more important for transactions involving residential properties. In any event, it is important for parties contemplating financing for a transaction to determine if their lender/investors have their own environmental due diligence requirements.

[14.32] B. Hiring the Environmental Consultant

When hiring an environmental consultant, clients are often asked to execute an engagement letter which usually contains the pricing for the Phase 1 and other logistical information. Attached to the engagement letter will be what often looks like a pre-printed form of terms and conditions that govern the performance of the services to be provided by the consulting firm.

Clients rarely examine the standard terms since they tend to focus on the price of the Phase 1 as well as timing for the delivery of the report. However, it is critically important that the terms and conditions provisions be carefully reviewed before executing the engagement letter since the boilerplate language can severely restrict the rights of the client in any dispute with the consultant. This section reviews the key contractual issues that should be considered when retaining the consultant

[14.33] 1. Scope of Work

It is important for a property owner or lessee to understand that the standard ASTM E1527 Phase 1 is not a comprehensive or exhaustive

¹³⁵ 70 FR at 66101.

investigation of all of the possible environmental conditions that might exist at a particular property. A Phase 1 environmental site assessment (ESA) has the limited purpose of identifying the presence or potential presence of hazardous substances at a property so that the party ordering the report (the “user”) to satisfy the AAI requirement that is necessary to qualify for one of the CERCLA landowner liability protections.

As a result, the AAI Rule or ASTM E1527-13 Phase 1 ESA often serve as the departure point for conducting environmental due diligence in transactions. Depending on the particular transaction, the nature of the business, the number of facilities, cost and timing issues, the risk tolerance of the parties performing the due diligence, and other factors, parties to a transaction may go beyond the requirements of AAI/ASTM E1527-13 or use some hybrid version of these practices to shape the scope of their environmental due diligence.

Indeed, over the years, though, the use of Phase 1 reports have evolved so that they frequently include environmental issues (e.g., asbestos-containing materials, lead-based paint, radon, and mold) that do not fall within the definition of a REC because they do not involve releases of hazardous substances but could still be a concern to a property owner, tenant or lender. Many lenders require consultants to evaluate issues that go beyond those that would qualify as a REC. In the ASTM terminology, these additional environmental issues are called non-scope items or business environmental risks (BERs). Section 13 of ASTM 1527 contains a non-exhaustive list of issues that could impact commercial real estate but that are not required to satisfy the AAI Rule.¹³⁶ The presence of these conditions would not be identified as a REC because they do not involve releases of hazardous substances as defined under CERCLA. Depending on the preferences of the person ordering the report, these non-RECs may be identified in the Phase 1 report as a separate category.

Practice Note: Many property owners simply rely on Phase 1 ESA reports that are ordered by the lender that is financing the particular transaction. However, lenders may have different risk tolerances than users.

Lenders have long played a role as “surrogate regulator” in transactions. In many cases, lenders force potential borrowers to investigate sus-

136 These considerations include asbestos-containing materials, radon, lead in drinking water, lead-based paint, wetlands, endangered species, regulatory compliance, ecological resources, industrial hygiene and indoor air quality, health and safety, power lines and electromagnetic fields, and cultural and historical resources.

pected contamination and frequently require remediation under state oversight. Borrowers often balk at these requests and may even retain their own independent consultants to try to convince lenders that the work is not required or necessary.

However, borrowers usually do not exhibit such independence when the lenders are comfortable with the site conditions. Borrowers typically believe that a site is “clean” if a bank determines that a Phase 1 is acceptable. However, what many borrowers do not realize is that lenders are positioned differently than property owners or operators from a liability standpoint and therefore may have risk tolerances that are different from those who take title to potentially contaminated property.

Because of the secured creditor exemption under CERCLA and most state superfund laws, lenders will not be liable for remediation unless the borrower encounters financial difficulties and the bank either takes over the borrower’s operations or forecloses on the property. As a result, the bank’s liability for environmental conditions is generally limited to the value of the loan. When banks held loans on their balance sheets, this potential loss was often enough to incentivize lenders to perform thorough Phase 1 reports. However, in this era of securitization, originating lenders may not be as concerned about the long-term environmental risks associated with a property. So long as the loan has been originated in accordance with the loan procedures and underwriting that is acceptable to the trusts that sell the CMBS loans to investors, the risk of a “comeback” to the originating lender is minimal.

Moreover, the Phase 1 ESA is just one component of a credit analysis performed by a lender. For example, a Phase 1 might identify environmental issues that a borrower may have to incur costs to address but the lender might be comfortable based on the credit of the borrower or other credit enhancements.

Since the property owner or tenant will be first in line for any enforcement actions that may result if the land turns out to be contaminated, they should independently evaluate the scope of the proposed Phase 1 that is ordered by its lender to confirm that the proposed Phase 1 will meet the needs of the property owner. There have been a number of recent cases where borrowers relied on a Phase 1 that was acceptable to its lender only

to find out after the borrower acquired title that the site was contaminated.¹³⁷

[14.34] 2. Insurance

The consultant should be required to maintain the following types and minimum amounts of insurance coverage: Professional Liability of \$1 million per claim; Comprehensive General Liability \$1 million per occurrence for damage to property; Compensation and Statutorily Required Amounts, Employer's Liability, \$500,000 per person; and Automobile Liability of \$1 million per occurrence for bodily injury; \$1 million per occurrence for damage to property. All insurance policies should be provided by an insurer rated at least "AA" by AM Best & Company. All insurance policies should be non-cancelable, except upon 30 days' advance written notice to the client. The consultant should be required to arrange for replacement insurance before cancellation of any insurance policy. The consultant should be required provide certificates evidencing all lines of insurance to the client before commencement of any work. It is recommended that the client be made an additional insured on the Commercial General and Automobile Liability insurance policies.

[14.35] 3. Limitation of Liability (LOL)

Many consultants typically seek to limit liability for negligence or breach of contract claims to the amount of the fee for the Phase 1 ESA, though some provide for higher liability caps ranging from \$50,000 to \$100,000. If the client has negotiated the insurance limits discussed above, the client should try to increase the liability cap to the amount of the insurance limits, especially where there are suspected environmental issues at the property.

It should be noted, though, that even if a client is able to increase the liability limit to the amount of the consultant's insurance coverage, this does not necessarily mean that full amount of the insurance coverage will be available if a claim arises. This is because prior claims could have depleted some or all of the coverage funds. Even if the consultant agrees to use its insurance limits as the LOL, the contract should provide that unavailability of the full insurance coverage will not affect any rights the client may have to pursue its rights under the agreement.

¹³⁷ For example, see *Ridge Seneca Plaza v. BP Products North America*, 820 F. Supp.2d 461 (W.D.N.Y. 2011).

Some consultants also try to impose a time limitation on the client's right to bring a claim. While certain AAI components have to be updated after 180 days, this so-called "shelf life" should not be confused with the statute of limitations for a negligence or breach of contract action. Some consultant forms attempt to shorten the period for asserting claims to one year or provide that the report may not be used or relied upon after six months. Clients should not agree to a shorter period than the applicable statute of limitations for bringing a professional negligence or breach of contract claim.

The standard terms and conditions will also provide that the consultant will not be liable for consequential damages flowing from any negligence or breach of contract. If the client can obtain concessions on the other issues discussed, this provision can be acceptable.

[14.36] 4. Indemnity

Consulting agreements frequently request that the client indemnify the consultant for any injuries or losses resulting from site conditions. If the client is a lender or other party who is not in control of the site, the client should not agree to such a provision.

[14.37] 5. Reliance

The question of who is entitled to rely on ESAs has proved to be a hotly contested issue in due diligence litigation. In the absence of any limitation in the agreement, many courts may use a "reasonably foreseeable" test to determine what parties that consultant may owe a duty. For example, if a lender orders a Phase 1 to finance the acquisition of a property, the purchaser/borrower might try to argue that it was foreseeable that it would rely on the report so that it should be able to seek damages from a consultant who might have failed to identify a REC. As a result, the standard terms and condition will usually specify the parties who may be able to rely on the ESA and create a time limitation on how long those parties can rely on the Phase 1 ESA. Courts have generally upheld such reliance provisions.

Some consultants will issue a reliance letter to additional parties for a fee. Consultants who regularly work with lenders will often agree to broader reliance language, especially where the loan is to be securitized without an additional charge.

[14.38] 6. Miscellaneous Documentation and Reporting Issues

The standard terms and conditions typically provide that all reports and documents generated during the performance of the work are the property of the consultant. This can be problematic for clients who are concerned about confidentiality and inadvertent disclosure of information developed during the investigation. Thus, property owners should insist that all materials, including drafts, drawings, photographs, and field notes, are the property of the client and that the consultant will not release any information obtained in the investigation to any third party without the express written consent of the client. Furthermore, the consultant should agree to destroy any draft reports and field notes at the conclusion of the project. It is advisable that the first written report be marked as a draft report so the client can make changes to the report without having to incur additional fees or charges.

Clients are also often asked to be responsible for obtaining permits or to be responsible for disposal of any hazardous residues generated from laboratory analysis. The consultant should be responsible for obtaining permits, complying with the conditions of such permits, and disposing of any sampling residues. However, the client should be willing to sign the manifests as the generator of the waste.

[14.39] 7. Information To Be Provided By Client

Under AAI, the person seeking the benefit of the CERCLA landowner defenses has the responsibility for the providing the following information:

- Cleanup liens;
- Specialized knowledge or experience of the person;
- Relationship of purchase price to fair market value if uncontaminated; and
- Commonly known or ascertainable information.

As a result, consultants will often provide a questionnaire to the client to complete. However, the client does not actually have to provide this additional information to the environmental professional. Indeed, when the client is the lender, they will tend not to have this information. If the client does not provide the information, the environmental consultant has

to determine if the information not furnished by the person may affect the ability of the consultant to render an opinion about the potential for conditions at the property that are indicative of a release. If so, the consultant could identify this as a “data gap” and then comment on the significance of this data gap.

A related area of confusion for consultants has been whether the environmental professional needs to review the chain of title. The AAI rule does not require the environmental professional to obtain a chain of title. Instead, the rule provides that the environmental professional should exercise its professional judgment in determining what types of historical may provide useful information. One of the reasons for reviewing chains of titles is to obtain information about land use controls. The chain of title can be a problem for an environmental consultant because it is usually not ordered until the transaction is about to close and after the Phase 1 had been ordered and completed. In addition, chain of title often can cost \$300 or more per parcel and can take several weeks to obtain, depending on the county where the records are retained. In addition, multiple chains of titles might have to be ordered if the property had been subdivided in the past or was part of a larger tract of land.

There may be other sources of information that the environmental professional is required to review that could yield the information required to satisfy AAI or ASTM E1527-05. Thus, the client and environmental professional should clarify if and who will be ordering chain of title reports.

[14.40] 8. Warranties

The typical standard terms and conditions will provide that the consultant is not warranting the accuracy, completeness, or validity of information provided by third parties. In other words, the consultants will discuss the information contained in database reports but not guarantee that the information is accurate. ASTM generally requires that if an environmental consultant uses a third party database company to provide historic regulatory database as opposed to obtaining the information directly from the regulatory agency, the database must updated at least every 90 days to be considered current. To minimize the risk that third party database is inaccurate, the user should verify that environmental consultant has used current information.

[14.41] 9. Payment

Many consulting agreements provide for accrual of interest after 30 days. If the client is a large corporation that cannot generate payments rapidly, it is advisable to request a longer accrual period of 60 to 90 days.

[14.42] 10. Termination

The client should also seek the right to terminate the contract for any reason and have the consultant agree not to incur any further charges upon receipt of the termination notice. Many agreements normally provide that the consultant may finish the particular Phase of the work following receipt of the termination notice.

[14.43] C. Common Sources of Cleanup Liability for Commercial Property

Commercial buildings, office spaces and shopping centers do not generally have the same kind of environmental issues as industrial facilities. However, these properties can nevertheless have significant environmental problems that could impair the value of the properties and create liability for owners or operators of these properties. The scope of the environmental due diligence should be tailored to the specific environmental history of the property, the risk tolerance of the person requesting the due diligence and other transaction-specific issues.

[14.44] 1. Historical Uses

The single most important task for due diligence on commercial properties is performing thorough historical investigations into the prior use of the property. Yet this is the aspect of due diligence that many so-called “commodity-type reports” tend to give short shrift. It is important to perform comprehensive historical due diligence even on properties with current uses that do not appear to present a significant risk to human health or the environment. The current use of a property can mask environmental impacts from prior uses. For example, a fast food restaurant at a shopping mall may have formerly been a gasoline station whose former tanks might remain in the ground. A property may currently be connected to the public sewer system but may have had on-site septic systems that could have discharged contaminants from prior problematic uses such as a dry cleaner.

Thus, it is important that the client and its counsel ensure that the environmental professional has adequately reviewed local records, interviewed local officials and used appropriate time intervals when researching historical information.

One of the challenges of performing due diligence at older shopping centers or commercial properties is the lack of adequate historical information on dry cleaners. The ASTM E1527 requires environmental professionals to review historical records with no more than five-year intervals. However, many so-called commodity style reports frequently use gaps of ten years or more. Even when state and local records are searched, these reviews often do not yield much information since dry cleaners were not required to obtain permits in the past.

[14.45] 2. Underground Storage Tanks (USTs)

USTs are a leading source of groundwater contamination. Indeed, because of their widespread use in New York, USTs are probably the most common source of liability for commercial properties.

From the early 1900s to the late 1980s, USTs typically had single-walled steel construction that inevitably corroded after 10 to 20 years. When tanks developed leaks, owners and operators either simply replaced the tanks or abandoned them in-place. Under the rules in effect at the time, tanks were usually allowed to be closed by simply filling them with water, sand or concrete without any investigation, much less removal of contaminated soil without any investigation or cleanup.

As a result, commercial properties may have unknown tanks that do not appear on any environmental databases or agency records because they were closed tanks that had to be registered. Frequently, these “rogue” tanks are old heating oil tanks but they may also have been used to store chemical products or wastes.

It is not uncommon for abandoned tanks to be discovered during construction or renovation of buildings. When this happens, the property owner or developer has to notify NYSDEC, register the tank and then comply with NYSDEC tank closure requirements. Frequently, contamination that may have been thought to be rather limited turns out to be more extensive. Old tanks sometimes are also discovered during installation of new utility services.

Practice Note: The NYDEP has issued regulations to phase-out the use of Number 6 (No. 6) and Number 4 (No. 4) fuel oil. Beginning July 1, 2012, building owners are required to convert to a cleaner fuel (No. 4 oil or cleaner) before their three-year certificate of operation expires. Building owners will not be able to renew Certificate of Operation for a boiler burning No. 6 heating oil unless the applicant demonstrates that the No. 6 fuel that will be used will emit the same or less PM and NOx than No. 4 on an annual basis. All boilers must be converted to low sulfur No. 4 heating oil or an equivalent cleaner fuel by mid-2015. By 2030, existing boilers that have not been replaced must be modified to meet the equivalent emissions of burning low sulfur No. 2 oil or natural gas.

[14.46] 3. Dry Cleaners

Real estate professionals are generally aware of the risks posed by gas stations and tend to exclude these parcels or implement risk management strategies prior to acquiring title or control over properties containing these businesses. In contrast, the environmental risks of dry cleaners are often overlooked. Worse yet, dry cleaners tend to be small businesses with limited resources and usually do not have environmental insurance. As a result, dry cleaners are the leading source of environmental liability at commercial retail properties.

While dry cleaners are small businesses, they generate relatively large volumes of hazardous substances. EPA estimates the average dry cleaner generates 660 gallons of hazardous waste a year. Moreover, due to poor housekeeping, dry cleaners have historically had a high frequency of spills and discharges.

Historic dry cleaners pose a particular risk to property owners because the former operations used considerably more solvents and suffered from a high frequency of spills and discharges because of poor housekeeping and business practices. Yet, the existence of former dry cleaners is often overlooked in due diligence, or potential impacts from these operations are frequently discounted by consultants and property owners.

Studies by EPA, the State Coalition for Remediation of Dry Cleaners (SCRD), and others have estimated that 75% of the approximately 30,000 dry cleaners currently in operation have contamination (i.e., 22,500 actively contaminated sites). California studies in 1992 and 2007 found that dry cleaners are a major contributor to groundwater contamination with the leading cause of the groundwater contamination being wastewater discharges to sewers and septic systems. Over 150 dry cleaners are

listed in the EPA CERCLIS and over 200 dry cleaners appear in the New York environmental remediation database. EPA estimates there may be an additional 9,000 to 90,000 former dry cleaner sites that likely present a significant risk of contamination. According to EPA, the average dry cleaner cleanup ranges from \$400,000 to \$500,000 but can be as high \$3 million when groundwater is impacted. EPA has estimated that the total national cleanup cost for dry cleaners could approach \$7.6 billion.

Unlike petroleum contamination, which may naturally degrade over time, the chlorinated solvents that are used by dry cleaners are resistant to biodegradation. As a result, groundwater contamination from dry cleaners has a greater potential to migrate off-site, which can be problematic since dry cleaners are often located within proximity to residential neighborhoods. Indeed, a 2002 Florida study found that dry cleaner contamination had migrated off-site at 57% of the contaminated sites. A 1999 Livermore study found that the median dry cleaner plume length was approximately 1600 feet while another study found the average plume to be 1270 feet. EPA reported that the 90th percentile plume length was 2585 feet and that 89% of dry cleaner plumes exceeded 100 feet.

It does not take a lot of solvent to contaminate soil or groundwater. A solvent leak dripping at a rate of one drop per second will result in one gallon of solvent discharged during an eight-hour work day and 320 gallons per year. One tablespoon of PCE is enough to contaminate two Olympic-sized swimming pools. Just one gallon of PCE can cause a 200,000,000 gallon drinking water reservoir to exceed the drinking water standard of 5 parts per billion (ppb).

In addition to cleanup costs, contaminated dry cleaner sites can expose property owners to significant toxic tort liability because these business tend to be located in densely populated areas, the contaminants do not easily degrade, are highly volatile and can migrate considerable distances. In the past, regulators were not concerned about plumes when groundwater was not used for drinking water purposes. Often times the regulators did not even delineate the extent of the plume. Now, though, many regulators are concerned about the potential for vapor intrusion when solvent plumes extend from the former dry cleaner location to residential communities. As a result, owners of property that formerly contained a dry cleaner have finding themselves subject to toxic tort litigation because of risk of vapor intrusion to residences, schools and other buildings located above the plumes.

While current dry cleaners use significantly less solvent and equipment that is less prone to leaks, improper maintenance and operational practices can still result in releases to the environment. Property owners should ensure that dry cleaning tenants use best management practices such as having solvent-grade epoxy floor coating and secondary containment for the drum storage areas as well as the dry cleaning equipment.

[14.47] 4. Sewer System Discharges

Many businesses do not discharge wastewater directly into rivers or other water bodies but instead into the local sewer system. Sewer pipes have a tendency to leak so that contaminants discharged into the system can end up seeping into soil and groundwater. Many superfund sites have been a result of discharges from dry cleaners into leaky sewer lines. Contaminants discharged into sewers can travel as much as one mile from the source.

[14.48] 5. Septic Systems and Sanitary Cesspools

Where sanitary sewers are not available, commercial buildings may rely on septic systems or leach fields. These structures can be sources of contamination if they receive wastewater from high-risk tenants, such as auto maintenance shops, dry cleaners and laboratories, even if the particular business does not discharge large quantities of wastewater or use significant volumes of hazardous materials. Many commercial properties in Long Island, Westchester and other suburban areas have been placed on the federal or state superfund lists because of these types of discharges.

Even if a property is currently connected to a public sewer, it is important to determine if the property was serviced by septic systems in the past and if high-risk tenants or businesses operated at that time.

[14.49] 6. Dry Wells

Dry wells receive stormwater from surface runoff and catch basins. The storm water then drains into the ground. Stormwater can become contaminated from a variety of pollutants, such as roads, parking lots, and other paved surfaces where materials have spilled or accumulated; outdoor equipment or material storage areas; commercial properties where fertilizers and pesticides are used; and outdoor cleaning and maintenance activities that produce large volumes of wastewater like power washing, sandblasting and vehicle washing.

As a result, dry wells and leaching pools can be a common source of groundwater contamination in Long Island and other suburban areas. If properties are served by dry wells, due diligence should identify all storm-water containment structures and determine if maintenance or cleanout should be performed. An interesting case illustrating the risks posed by these structures is *Southern Wine & Spirits of America vs. Impact Environmental Engineering*.¹³⁸

[14.50] 7. Hydraulic or Electrical Equipment

This equipment may contain fluids with PCBs. While the manufacture and distribution of PCBs were banned in 1977, electrical equipment with PCBs can continue to be used for the useful life of the equipment. PCB spills can result in significant cleanup costs.

PCBs are regulated under the Toxic Substance Control Act (TSCA). This law does not have any of the landowner defenses that are available under CERCLA. Indeed, an administrative law judge recently denied a motion filed by a landlord that mere ownership of property was insufficient to impose liability on a landlord for a PCB spill on its property.¹³⁹

During due diligence, consultants should identify the presence of transformers and capacitors, their location, their condition, and labeling. The Phase 1 report should determine whether the local utility owns the transformers. If the utility owns the transformers, it is useful but not necessary to ask the utility if the transformers contain PCBs (especially where no PCB label is visible). The consultant should also note the presence of hydraulic equipment, capacitors, and ballast that might contain or once have contained PCB-contaminated fluid.

[14.51] 8. Vehicle Maintenance Areas

Spillage from fuel transfers or poor waste oil management can lead to soil and groundwater contamination. Look for signs of staining or deterioration of pavement or concrete and determine the purpose and discharge point of all drains located in these areas. If there is an oil/water separator,

138 104 A.D.3d 613, 962 N.Y.S.2d 118 (App. Div. 1st Dept. 2013). A detailed discussion of this litigation is available at www.environmental-law.net/2013/07/failure-to-identify-dry-wells-and-review-building-dept-file-at-heart-of-consultant-malpractice-case.

139 The ALJ said ownership or control of the PCB source was not the only path for liability for violations of the PCB regulations, and that liability could be predicated on the ability or obligation to prevent the spill, or influence or control the disposition of the contaminated soil. See *In re Burlington Northern and Santa Fe Railway Co.*, TSCA No. 10-99-0051.

ascertain its capacity, age, and construction, and review all permits and any inspection reports. Malfunctioning oil/water separators can result in soil or groundwater contamination.

[14.52] 9. Chemical and Waste Storage Areas

Improper waste storage disposal may lead to extensive groundwater and soil contamination requiring expensive remediation. Wastes that are commonly stored in commercial buildings include photographic developing solutions from photo processing shops, x-ray solutions and biohazardous wastes from medical offices, and waste solvents from dry cleaners. Costs may also be incurred to upgrade inadequate storage areas to meet design standards such as impervious surfacing and secondary containment. Accordingly, the consultant should identify all waste storage areas locate and examine the condition of the waste management facilities such as lagoons, impoundments and holding ponds. These areas should be inspected, and the condition and contents of drums, barrels and cans should be verified. Unlabeled, deteriorating or open hazardous waste containers may not only indicate poor housekeeping but possibly may be signs of noncompliance with state and federal environmental, safety and health regulations and codes. Note signs of spillage from overloading or leakage from poor construction. Also look for discolored soil, stretches of bare soil, or dead or distressed vegetation, which may indicate the site of former waste storage units.

[14.53] 10. Loading Docks, Shipping Areas and Railroad Sidings

Spills of hazardous materials commonly occur in these areas when raw materials or products are transferred.

[14.54] 11. Asbestos-Containing Materials (ACM)

Until the dangers of asbestos became known, asbestos was used in a wide variety of products used in commercial and residential buildings constructed from 1920 to 1970, and was often mandated by municipal building codes. ACM is usually found in three forms in buildings: Thermal Insulation (e.g., pipe insulation, boiler insulation or duct insulation); surfacing materials (e.g., troweled and sprayed decorative plaster, acoustical ACM under decking and fireproofing on structural components); and miscellaneous materials (e.g., sheet flooring, ceiling tile, roofing materials, concrete panels, asbestos sidings used for duct insulation, pipes and siding). ACM may be further classified as friable or non-friable. Friability

refers to material that can be crumbled, pulverized or otherwise reduced to powder by hand pressure when dry.¹⁴⁰

Although EPA has implemented a series of bans on certain types of ACM, there are still other types that continue to be used in building materials. These include vinyl-asbestos tile, roofing felt, roofing coatings, caulking putties, construction mastics, textured coatings, asbestos-cement shingle, asbestos-cement flat sheet, asbestos-cement pipe, and asbestos-cement, millboard, and corrugated sheet.

Owners or operators commencing renovation or demolition projects that will disturb certain thresholds of regulated ACM (RACM) are required to provide ten-day notices to EPA, must use asbestos-licensed contractors and must follow certain work practices. The thresholds amounts of RACM are more than 260 linear feet of on piping, 160 square feet of RACM on other building components, or at least 35 cubic feet of RACM when the length or area cannot be measured. EPA aggressively enforces its ACM rules and frequently brings criminal actions for failing to comply with the ACM renovation or demolition requirements.

It is not necessary to remove ACM that is in good condition. Indeed, EPA suggests that in-place management of ACM is preferred over removal. EPA recommends that building owners should initiate asbestos control programs using its publication, *Managing Asbestos in Place: A Building Owner's Guide to Operations and Maintenance for Asbestos-Containing Materials* (also known as the "Green Book"). However, the Green Book suggests that ACM that is highly accessible may have to undergo some form of abatement by encapsulation or removal.

Practice Note: ACM sampling that is done as part of a Phase 1 is generally very limited and should not be relied upon for renovation or demolition work. Before engaging in such activities, it is important to perform a comprehensive ACM survey.

It is also advisable to take samples of suspect ACM prior to disturbing the material for minor repair work to minimize risk of exposure to workers and building occupants unless the building owner can establish that the building was constructed of asbestos-free materials. Owners should also consider inserting requirements in their construction contracts requiring contractors and architects to use asbestos-free materials.

140 40 C.F.R. § 61.141.

[14.55] 12. Lead-Based Paint (LBP)

This is usually a concern in residential buildings constructed before 1978. However, older commercial buildings with day care centers or private schools will need to ensure that painted surfaces are in good condition. Indeed, child day care centers will not be issued permits unless all LBP has been removed.¹⁴¹

[14.56] VI. ENVIRONMENTAL PROVISIONS FOR LEASES

Before discussing environmental provisions for commercial leases, it is important to review some long-standing contractual interpretations that have been adopted by federal and state courts.

[14.57] A. “As Is” Provisions

Prior to the enactment of CERCLA, environmental liability in real estate transactions was governed solely by contract and tort principles and, particularly, the doctrine of *caveat emptor*. Once a vendor parted with title, possession or control of the property, responsibility for conditions on the land was shifted to the vendee.

In the absence of an express agreement or some misrepresentation, the purchaser was expected to make its own careful examination of the conditions of the property and the vendor would not be liable for any harm or defects existing in the property. Thus, where a purchaser acquired the property in an “as is” condition or expressly covenanted that it had not relied on any representations or warranties of the seller, the risk of loss passed with the transfer of title or possession and the purchaser would be precluded from recovering any damages from the seller. If a defect, such as contamination, discovered after title was transferred constituted a breach of a contractual warranty or representation, the buyer might be able to recover damages under a fraud cause of action.

However, federal and state courts in New York have consistently rejected “as is” clauses or *caveat emptor* as a defense to CERCLA liability. These courts hold an “as is” clause simply bars a breach of warranty action and will not preclude contribution or cost recovery claims under

141 24 R.C.N.Y. § 47.63(b).

environmental laws.¹⁴² To effectively eliminate CERCLA liability, a contract or lease will have to contain a waiver whereby the lessee or purchaser expressly waives all of its statutory and common law rights that it may have to seek damages for preexisting contamination whether it is known or unknown. However, the existence of the breach of warranty may be an equitable consideration in the allocation of response costs in a contribution action.

[14.58] B. Contractual Allocation of Environmental Liability

However, courts have universally held that CERCLA does not permit contracting parties to transfer their potential obligations to EPA. In other words, an indemnity or release cannot be asserted as a defense in a government cost recovery.¹⁴³ However, courts generally agree that CERCLA section 107(e)¹⁴⁴ allows private parties to contractually transfer or release each other from financial responsibility arising under CERCLA and to rely on release or indemnity clauses as a defenses.

Second, courts may enforce contractual allocations even if the agreements were executed prior to the enactment of CERCLA or other environmental laws. However, courts will narrowly construe these provisions and will require language referring to CERCLA-like liability before enforcing these agreements. It is more likely that an agreement containing broad general releases will be held to apply to CERCLA liability than a release or indemnity that is limited to particular disputes or liability unless there is an unmistakable intent that there is a waiver of CERCLA-like environmental liabilities. This is a particularly difficult problem in pre-CERCLA agreements where courts are loathe to say that parties bargained away rights that had not yet existed. However, courts do appear more willing to honor such indemnity or releases when there is evidence that the parties knew of the existence of environmental conditions.

[14.59] C. Problems with Older or Traditional Commercial Leases

Allocation of environmental liability in leases has proven to be problematic since many leases do not specifically address the environmental obligations of lessors and lessees. It is surprising how often contracting

142 *Westwood Pharm. Inc. v. National Fuel Gas Dist. Corp.*, 964 F.2d. 85 (2d Cir. 1992).

143 *See Purolator Products Corp. v. Allied-Signal, Inc.*, 772 F. Supp. 124 (W.D.N.Y. 1991).

144 42 U.S.C. § 9607(e).

parties will resort to form agreements. Many forms that are publicly available today were drafted decades ago and are out of date, difficult to understand, and contain antiquated language. They are almost always too generic. They can sometimes serve as a decent starting point but are generally not a good ending point.

For example, older leases usually prohibit tenants from engaging in activities that will result in “waste or injury” to the demised premises. Since the discharge of hazardous substances can impair the property value and result in cleanup costs that exceed the value of the property, these anti-waste provisions could be relied upon to impose an obligation on a tenant to refrain from releasing hazardous substances onto the property and to remedy such contamination. However, because these provisions usually apply to only structures and the use or occupancy of the demised premises, arguably this obligation does not extend to subsurface or groundwater contamination that is technically not a part of the demised premises as well as USTs or PCB transformers that are excluded from the definition of the demised premises.

In addition, leases often have a general compliance with law clause, requiring tenants to abate any nuisances and to keep the premises in good repair. These provisions probably do not apply to contamination that predates the lease or contamination that migrates onto the site from adjacent properties, and probably are not broad enough to extend to friable asbestos, USTs, or PCBs in the building electrical system since these issues may be considered structural defects that are not within the contemplation of the ordinary repair provision of most leases. Furthermore, it is unclear if the compliance with laws requirement applies to cleanup obligations that arise after the tenancy is terminated.

One of the more common drawbacks with older leases was how they failed to adequately deal with underground storage tanks. Leases often allow tenants to construct or install equipment that is necessary for the operation of the tenant’s business, including USTs. Many of the older leases simply provided that such equipment and fixtures are the personal property of the tenants and provide the tenants with the right to remove such personal property at the termination of the lease.

However, these leases often provided that any personality or fixtures (such as USTs) that tenant left behind when it vacated the premises automatically became the property of the owner. In other words, the lease operated to convey ownership of the tanks to the lessor. Former tenants have argued that they abandoned the USTs which then became fixtures for

which the owners were responsible.¹⁴⁵ Indeed, there have been a number of cases that have held that the USTs are trade fixtures that become part of the real estate, thereby making the property owner the owner of the tanks for purposes of complying with the closure and cleanup obligations.¹⁴⁶ For example, the New York State Oil Spill Compensation Fund has denied claims where USTs had been installed by prior operators or owners, and where the lease provided that all improvements and equipment installed on the property would be deemed to become part of the property and that the claimant would be considered the sole and absolute owner of the improvements.¹⁴⁷

A frequent issue that arises in landlord/tenant situations is who is responsible for leaking USTs that are not currently being used by a tenant.¹⁴⁸ Where the tenant leases or occupies the entire property, the landlord will argue that the tenant has complete control over the site and should be considered the operator of the leaking USTs, particularly where the lease defines the demised premises as being the four corners of the site. Indeed, in such circumstances some tenants have been held to be owners whose liability does not require active participation in hazardous waste sites. The tenant, in turn, will argue that it never actually operated the leaking USTs, so it cannot be held liable as an operator. An interesting case turned on whether the USTs were included within the definition of “demised premises.”¹⁴⁹

Further complicating the situation is that the leases are often assigned or subleased to successive operators who use the USTs, but ownership of the USTs are rarely addressed in the consents issued by the landlord. After the last tenant vacates the premises, a dispute arises over who is responsible for removing the USTs and remediating the contamination associated with the USTs.

145 Cutting against this argument at least for purposes of federal regulatory purposes is RCRA provides that tanks the owner of tank that was no longer in use as of November 8, 1984 is the person who owned the tank immediately before the discontinuation of its use.42 U.S.C. 6991(3) (B).

146 *Golovach v. Belmont L.M., Inc.*, 4 A.D.3d 730, 773 N.Y.S.2d 139 (3d Dep’t 2004).

147 *310 South Broadway Corp. v. McCall*, 275 A.D.2d 549, 712 N.Y.S.2d 206 (3d Dep’t 2000).

148 For an interesting case involving an inactive tank that was shared by two properties, see *C & J Cleaners v. GACO Fashioned Furniture, Inc.*, 85 A.D.3d 1079, 927 N.Y.S.2d 663 (2d Dep’t 2011).

149 See *South Road Assocs., LLC v. International Business Machines Corp.*, 2 A.D.3d 829, 770 N.Y.S.2d 126 (2d Dep’t 2003), *aff’d*, 4 N.Y.3d 272, 793 N.Y.S.2d 835 (2005).

Less clear is what happens if tanks were properly closed in place in the past under the requirements in effect at the time and a purchaser discovers contamination. Some cases have held owners or buyers liable as dischargers where they could have known about the existence of contamination through the exercise of reasonable diligence or should have known about the presence of USTs from the use of the property.¹⁵⁰

In sum, leases for commercial or industrial properties should contain specific environmental provisions that clearly allocate the responsibilities and obligations of the parties for environmental issues based on the specific facts and the intent of the parties. Since the contract may eventually be interpreted by a court, the lease should include within its four corners all of the information that may be useful to explain the parties' contractual relationship, any past history. The parties do not want a judge to try to guess what their intentions were when they executed the contract.

[14.60] D. Environmental Lease Definitions

To clarify the obligations of the parties and prevent inadvertent drafting discrepancies, leases should have well-drafted environmental definitions that are incorporated in the body of the lease clauses describing the obligations of the parties. Well-crafted definitions will eliminate superfluous language in the operative language of the lease, and result in crisper and cleaner language. Following are suggested definitions.

“De Minimis Amounts” refers to chemicals and products containing hazardous materials in quantities customary and necessary for the intended use of the premises including, but not limited to, cleaning supplies, insecticides, paints, paint removers, toner for copiers, etc., provided the use, storing or handling of such de minimis amounts of hazardous materials are in compliance with environmental laws.

Practice Note: Commercial tenants, especially retailers, store or use products that contain chemicals that qualify as “hazardous materials.” It is not practical to prohibit tenants from using hazardous materials. This definition recognizes this fact of everyday life. It allows the tenant to use quantities of chemicals that (1) are to be expected for the particular use; and (2) so long as the tenant uses them in accordance with environmental laws. However, this definition should not be used for high-risk uses as dry cleaners, gas stations or tenants that would be RCRA-regulated facilities.

150 *State v. Robin Operating Corp.*, 3 A.D.3d 767, 773 N.Y.S.2d 135 (3rd Dept. 2004); *Oliver Chevrolet, Inc. v. Mobil Oil Corp.*, 249 A.D.2d 793, 671 N.Y.S.2d 850 (3d Dep’t 1998).

“*Environmental Claim*” refers to any complaint, summons, citation, notice, directive, order, claim, litigation, investigation, judicial or administrative proceeding, judgment, letter or other communication from any governmental authority or any third party involving violations of environmental laws or releases of hazardous materials at or from the premises.

Practice Note: This definition consolidates the numerous types of legal proceedings that can clutter a clause into one definition. It not only applies to violations of law and releases of hazardous chemicals, but also to claims filed by third parties.

“*Environmental Conditions*” refers to releases of hazardous materials at or from the premises requiring a remedial action based on the contemplated use or violations of environmental laws.

[more specific alternative: refers to the presence of Hazardous Materials resulting from Releases at the Property exceeding the concentrations set forth at 6 N.Y.C.R.R. Table 375-6.8(b) for the commercial use category set forth in 6 N.Y.C.R.R. 375-1.8(g)(ii).]

Practice Note: This definition can be used to describe the kind of condition that will trigger obligations under the lease. Notice that the contamination must be present at levels that require remediation. This can be used to prevent a party from making a claim for a de minimis environmental condition. It can also be linked to an environmental due diligence contingency so that the lessee cannot opt out of the lease for environmental reasons unless there is contamination that has to be remediated based on the proposed use. In other words, the contingency could not be exercised where contamination may exceed a residential cleanup (stricter) standard but is below a commercial (more lenient) cleanup standard since the property will be used for commercial purposes. The alternative language provides the specific cleanup standard.

“*Environmental Laws*” includes the Comprehensive Environmental Response, Compensation and Liability Act (CERCLA), 42 U.S.C. § 9601 *et seq.*, as amended; the Resource Conservation and Recovery Act (RCRA), 42 U.S.C. § 6901 *et seq.*, as amended; the Clean Air Act (CAA), 42 U.S.C. § 7401 *et seq.*, as amended; the Clean Water Act (CWA), 33 U.S.C. § 1251 *et seq.*, as amended; the Occupational Safety and Health Act (OSHA), 29 U.S.C. 655 *et seq.*, the New York Inactive Hazardous Waste Disposal Sites Law, N.Y. ECL § 27-1301 *et seq.*; the New York Control of the Bulk Storage of Petroleum Law, N.Y. ECL § 17-1001 *et*

seq.; the New York Oil Spill Prevention, Control and Compensation Act, Navigation Law § 170-202; the N.Y. Labor Law § 241; the New York City Hazardous Materials Emergency Response Law, New York City Administrative Code § 24-601 *et seq.*; Control of Lead Poisoning, N.Y. Pub. Health Law § 1370 *et seq.* and any other federal, state, local or municipal laws, statutes, regulations, rules or ordinances imposing liability or establishing standards of conduct for protection of the environment.

Practice Note: This definition incorporates the principal federal and New York environmental laws that may apply to commercial property. OSHA is usually considered a health and safety/employee issue, but parties sometimes included it in the definition of environmental laws. This can create a slippery slope of obligations, though, and inclusion in this definition should be resisted.

“*Environmental Liabilities*” means any monetary obligations, losses, liabilities (including strict liability), damages, punitive damages, consequential damages, treble damages, costs and expenses (including all reasonable out-of-pocket fees, disbursements and expenses of counsel, out-of-pocket expert and consulting fees and out-of-pocket costs for environmental site assessments, remedial investigation and feasibility studies), fines, penalties, sanctions and interest incurred or imposed under environmental laws.

Practice Note: This consolidates the kinds of damages into one definition. Notice that strict liability is referenced in parentheses. Courts generally will not read into contracts that a party has agreed to assume or indemnify for claims based on strict liability. The party taking on responsibility for environmental liabilities may consider omitting the references to punitive damages, consequential damages and treble damages.

“*Environmental Lien*” means any lien, security interest, charge or other encumbrance for environmental liabilities incurred by a government authority.

Practice Note: This definition clarifies that an environmental lien is limited to a lien filed by a government agency to secure cleanup costs so that it does not include mechanics liens that may be filed by environmental contractors, etc.

“*Environmental Permits*” refers to any federal, state or municipal permits, licenses or approvals from a governmental authority having jurisdic-

tion over the premises which are necessary to operate the premises in compliance with environmental laws.

Practice Note: This definition is limited to permits that are required to conduct the contemplated operation at the premises. If the tenant is not using a UST, the tenant would not be required to maintain registration of the tank or comply with other UST requirements.

“Hazardous Materials” shall include any element, compound, or chemical that is defined, listed or otherwise classified as a contaminant, pollutant, toxic pollutant, toxic or hazardous substance, extremely hazardous substance or chemical, hazardous waste, special waste, or solid waste under environmental laws; petroleum and its refined products; polychlorinated biphenyls; lead-based paints; any substance exhibiting a hazardous waste characteristic including but not limited to corrosivity, ignitability, toxicity or reactivity as well as any radioactive or explosive materials; any asbestos-containing materials; and any manufactured products containing hazardous materials.

Practice Note: The term refers to “hazardous materials” to reinforce that it is intended to apply to substances that may not necessarily fall within the CERCLA definition of hazardous substance such as petroleum. The definition incorporate terms of other types of substances that are regulated by other environmental laws. If a landlord is making reps and warranties, it may consider deleting references to LBP, and asbestos-containing materials to narrow the scope of the representation.

“Release” means any spilling, leaking, pumping, emitting, emptying, discharging, injecting, escaping, leaching, dumping, or disposing (including the abandonment or discarding of barrels, containers or other closed receptacles containing hazardous materials) of hazardous materials into the environment.

Practice Note: This definition tracks the CERCLA definition of release.

“Remedial Action” means all actions taken to clean up, remove, remediate, contain, treat, monitor, assess, evaluate or in any other way address hazardous materials in the indoor or outdoor environment which are necessary to prevent, contain, remove or minimize a release or threatened release of hazardous materials so they do not migrate or endanger or threaten to endanger public health or welfare. The term “Remedial Action” also includes any pre-remedial studies and investigations and

post-remedial operation and maintenance activities or any other actions authorized by 42 U.S.C. § 9601.

Practice Note: This definition incorporates concepts in the CERCLA definition of Remedial Action. Notice that it refers to hazardous materials that may be present in the indoor environment. Contaminants that can escape to the exterior environment by being tracked outside, escaping through windows or seeping through concrete floors can result in CERCLA liability as well as contaminants in the outside environment that migrates via vapors into a building. However, spills that are confined solely within a workplace are ordinarily outside the scope of the CERCLA. If the lessor is making a representation or warranty about the conditions of the premises or providing an indemnity, it should consider omitting “indoor.”

[14.61] E. Pre-Occupancy Environmental Due Diligence Contingency

Pre-occupation due diligence is not only essential for a tenant to evaluate the environmental conditions of the property but can also enable the parties to establish a baseline of environmental conditions. A sophisticated tenant can use a pre-occupancy environmental assessment to allocate responsibility for preexisting environmental conditions to the lessor. The pre-occupancy assessment can be used by a lessor to determine environmental impacts of a tenant at the termination of the lease, support claims that the tenant is responsible for the contamination as well as defend claims by the tenant that certain environmental conditions or contaminated preexisted its occupancy.

Following are some examples of pre-occupancy due diligence provisions.

[XX.] Tenant shall have thirty (30) days from the execution of this lease to conduct its own environmental inspection of the Premises and unless Tenant objects to any Environmental Conditions in writing within forty-five (45) days of the execution of this lease, Tenant shall be deemed to have accepted the Premises on an “As Is” basis.

Practice Note: This is a fairly simple clause that may provide considerable discretion to the tenant depending on how the term “Environmental Condition” is defined.

[XX.] If the Phase I ESA identifies Recognized Environmental Conditions as that term is defined in ASTM E1527-13 and Lessee desires to further assess by collecting soil or groundwater samples (the “Additional Investigation”), Lessee will provide Lessor with copies of the Phase I ESA recommending further investigation and a work plan for the Additional Investigation which shall identify the number and locations of the proposed sampling, the depth of the sampling, the parameters to be analyzed, the schedule for the sampling and the name of the environmental consultant who would perform the work.

Lessor shall review the proposed work plan and after consulting with the Lessee shall either (i) permit the Lessee to perform the Additional Investigation, or (ii) propose modifications to the work plan or reject the work plan and refuse to permit the Lessee to conduct the Additional Investigation. If Lessor requests a modification to or rejects the work plan, the Lessee shall have the option to (x) not perform an Additional Investigation and proceed to closing, (y) submit a revised work plan to Lessor or (z) cancel this Lease. Lessor’s approval, modification or rejection of the Additional Investigation shall be at Lessor’s sole discretion.

If Lessor approves the Additional Investigation, Lessor will have thirty (30) days to complete the Additional Investigation. If Lessee proceeds with the Additional Investigation, Lessee shall not be required to provide Lessor with copies of all reports and data generated during the Additional Investigation. However, if Lessee fails to provide the results of the Additional Investigation to Lessor, Lessee will waive its rights set forth in paragraph _____ herein to terminate this Lease because of the existence of Environmental Conditions. Lessee will give Lessor no less than ten (10) days advance written notice of the date Lessee will have the Additional Investigation, if any, performed and evidence of all necessary permits at least two (2) business days in advance of any Additional Investigation so that Lessor may have the opportunity to have a representative on-site or available for monitoring purposes. Lessor may but shall have no obligation to obtain split samples taken by Purchaser.

Practice Note: This variation allows the Tenant to perform a phase 2 to further investigate RECs identified in the Phase 1 provided the lessor consents to the investigation. The lessee is not required to disclose the results to the Lessor but if it fails to do so, it waives the environmental contingency.

[XX.] If the Additional Investigation reveals Releases of Hazardous Materials at the Property in concentrations that exceed Cleanup Standards

and that are likely to include Remediation Action that will exceed \$____, (“Pre-Existing Conditions”) Lessee may notify the Lessor in writing prior to the expiration of the Environmental Inspection Period and the parties shall have seven (7) days to discuss a resolution of the Pre-Existing Conditions (the “Environmental Consultation Period”). If the parties cannot reach an acceptable resolution regarding the Pre-Existing Condition upon the expiration of the Environmental Consultation Period, then either party may terminate this Agreement (“Termination Notice”). If Lessee fails to deliver the Termination Notice because of the presence of Contamination or Lessee fails to provide Lessor with a copy of any such Additional Investigation, Lessee shall be deemed to have waived its right to terminate the Lease because of the Pre-Existing Conditions.

Practice Note: This variation links the environmental contingency to a dollar threshold of cleanup costs and tenant notifying the Lessor of the contamination. If the parties cannot reach an agreement on how to resolve the issue, either party may be terminate the lease. Estimating cleanups can be fraught with assumptions and uncertainty on the extent of the contamination, what the regulator will require to complete the cleanup and sometimes just as important, how soon the cleanup may be completed so that the tenant may assume occupancy.

[14.62] F. Tenant Affirmative Environmental Covenants

[XX.] Commencing on the Commencement Date and continuing throughout the Term, Tenant shall, at Tenant’s expense, will comply with and maintain the Premises in [full] [material] compliance with Environmental Laws at all times and shall obtain all Environmental Permits. Tenant shall not allow any Hazardous Materials to be used, stored, generated, disposed or otherwise handled on the Premises except in *De Minimis* Amounts. Tenant warrants or represents that throughout the term of the lease, its operations shall be in full [material] compliance with Environmental Permits and Environmental Laws.

Practice Note: This is a fairly standard covenant. A lessor sometimes requires “full” compliance with environmental laws but this means that tenant could be in breach of the lease for minor violations such as failing to timely file paperwork that do not pose any risk to human health or the environment. In response, a tenant may amend this covenant to provide for “material” compliance.

[XX.] Tenant acknowledges that is has the right to exercise control all of and operate all of the Premises. Tenant shall, at its own cost and

expenses, perform all Remedial Actions which are necessary for addressing any Releases of Hazardous Materials on or migrating from the Premises that are discovered after the Tenant has assumed occupancy of the Premises including but not limited to the abatement of friable asbestos-containing materials and leaded paint. In the event that the Tenant undertakes any renovation or remodeling of the Premises, Tenant shall be responsible, at its sole cost and expense, for complying with all asbestos notification, work practice and disposal requirements established under Environmental Laws.

Practice Note: This covenant has been used for triple net leases where the tenant is the sole occupant, has accepted the premises in an “as is” condition and lessor has not agreed to assume responsibility for preexisting conditions. The first sentence is designed to prevent the tenant from arguing it should not be deemed a “de facto” owner of the premises.

[XX.] In the event that Tenant receives any notice of an Environmental Claim or becomes aware or should have become aware of any Release [in excess of any reportable quantity], Tenant shall immediately orally notify Landlord of such Release or Environmental Claim and shall forward written notice to Landlord within 24 hours. If the Tenant becomes aware of a Release which Tenant believes must be reported, Tenant shall not disclose such contamination until first consulting with the Landlord. Tenant shall promptly furnish to the Landlord copies of notices, reports correspondence, submissions, made by Tenant to Government Authorities regarding any Releases of Hazardous Materials.

Practice Note: This covenant requires Tenant to immediately notify lessor of any Releases as well as any violations of law or other communication from a regulator. Notice that the covenant provides that Tenant shall not disclose the existence of the Release to the regulator until it first consults with the Lessor. Tenant may want to add the bracketed language to ensure that failure to notify tiny spills will not trigger an event of default. Some reporting requirements impose a 2-hour notification while others provide for a 24-hour reporting period. Significant civil (and possibly criminal) penalties can be assessed for untimely reporting of spills. Thus, if Tenant believes the spill is reportable, it should be prepared to report a spill within the applicable period if the Lessor fails to do so or disagrees that the spill is a reportable event.

[XX.] Upon discovery of a Release requiring Remedial Actions, Tenant shall implement any Remedial Actions required by Environmental Law and under supervision of the NYSDEC [or the NYC Office of Envi-

ronmental Remediation (OER)] to abate said Release and obtain a No Further Action letter or its equivalent from the NYSDEC [or OER]. If Tenant fails to immediately undertake any Remedial Actions that are required under Environmental Law, Landlord shall have the right but not the obligation to enter onto the Premises during regular business hours or during other hours, and to take such Remedial Actions as it deems necessary to eliminate or abate such Release. All costs and expenses incurred by Landlord in the exercise of such rights shall be deemed to be additional rent hereunder and should be payable by Tenant to Landlord upon demand.

Practice Note: This covenant requires the Tenant to implement remedial actions under the supervision of the NYSDEC so that a no further action letter can be issued. Tenants might prefer to do what is commonly called a “self-directed” cleanup where the work is done by a consultant without any involvement by the NYSDEC. The consultant uses its best professional judgment in determining when the cleanup is completed. The Lessor should resist this suggestion even though it may result in a less expensive and quicker cleanup since the NYSDEC frowns on the use of self-directed cleanups and failing to report the Release could result in penalties to both the Tenant and the Lessor.

The bracketed reference to OER could be used for a moderately contaminated site in NYC. Such sites can be enrolled in the OER voluntary cleanup program. Cleanups supervised by OER are generally accepted by NYSDEC and can usually be completed on a more expedited basis.

[XX.] Tenant shall not assign nor sublet any portion of the Premises nor permit persons to occupy the Premises nor grant any license or concession to other persons without the prior written consent of the Landlord which consent shall not be unreasonably withheld *provided, however*, that Landlord shall be entitled to withhold its consent in its absolute discretion if the proposed transfer of the Premises will involve operations that use, storage, generation or disposal of Hazardous Materials.

[XX.] No consent of the Landlord shall be deemed to be a waiver of the requirement to obtain consent for any future assignment or consent or an extension of the present lease term nor shall the consent of the Landlord waive the assignee’s obligation to comply with any provision contained within this Lease. If any of the corporate shares of Tenant are transferred or if any partnership interest is conveyed by sale, assignment, bequest, inheritance or operation of law which results in a change in the control or ownership of the Tenant, such a transfer shall be deemed to be an assign-

ment for purposes of this paragraph and shall require Landlord's prior consent.

Practice Note: This covenant prevents tenants from subleasing space to business such as dry cleaners that may not fit the lessor's risk profile. It also confirms that the tenant who presumably satisfied lessor financial requirements shall remain responsible for compliance with environmental laws and implementing remedial actions in response to releases of hazardous substances during the term of the lease whether caused by the tenant or subtenant.

[XX.] Tenant shall keep the Premises free and clear of any Environmental Liens. In the event that Tenant receives a notice that an Environmental Lien will be or has been filed against the Premises, Tenant shall immediately take whatever steps are necessary to satisfy the Environmental Lien, provided however that Tenant shall have the right at its cost and expense, and acting in good faith, to contest, object or appeal by appropriate legal proceeding the validity of any Environmental Lien. The contest, objection or appeal with respect to the validity of an Environmental Lien shall suspend Tenant's obligation to eliminate such Environmental Lien under this paragraph pending a final determination by appropriate administrative or judicial authority of the legality, enforceability or status of such Environmental Lien. If Tenant challenges the imposition of such Environmental Lien, it must furnish to the Lessor good and sufficient bond, surety, letter of credit or other security satisfactory to Lessor equal to the amount (including any interest and penalty) secured by the Environmental Lien on or before the filing of such challenge.

Practice Note: If the NYSDEC responds to an oil spill, the Oil Spill Fund will record a spill lien against the property. The Spill Fund does not have to obtain a judicial determination that the property owner is liable under the Oil Spill law before recording the lien.¹⁵¹

[14.63] G. Lessor Environmental Reps and Warranties

[XX.] Landlord represents, warrants and covenants to Tenant that as of the Effective Date and as of the Rent Commencement Date(a) the Premises are in compliance with all applicable Environmental Laws; (b) the Landlord has not received and has no knowledge of any pending Environmental Claims in connection with current or past operations at the Premises; (c) There have not been any Releases of Hazardous Materials at,

¹⁵¹ *State v. Getty Petroleum Corp.*, 89 A.D.3d 262, 933 N.Y.S.2d 114 (3d Dep't 2011).

from [or onto] Premises as a result of any prior past or current operations at the Premises; (d) Landlord has not installed, used or operated, and has no knowledge of the presence or existence any active or inactive USTs at, under or around the Premises; and, (e) Landlord shall continue to comply with all applicable Environmental Laws throughout the term of the Lease.

Practice Note: These are the fairly standard Lessor environmental representation and warranties. The bracketed phrase is intended to address contamination that may be migrating onto the property from an off-site source. If tenant insists on this phrase, Lessor may want to consider a knowledge qualifier. In response, Tenant may want to further qualify the knowledge qualifier with the phrase “after diligent inquiry”.

[14.64] H. Lessor Affirmative Covenant Relating to USTs

[XX.] Landlord shall, at Landlord’s sole cost and expense, remove the underground storage tanks currently located at the Premises, including piping and ancillary equipment used in connection with the operation of same in accordance with all applicable Environmental Laws prior to the Commencement Date and complete any Remedial Actions required by NYSDEC so that a no further action letter will be issued or its equivalent by NYSDEC. If underground storage tanks are discovered after the Commencement Date, Landlord shall remain responsible for their removal in accordance with all applicable Environmental Laws and completing any Remedial Actions required by NYSDEC so that a no further action letter will be issued or its equivalent by NYSDEC. Any underground tanks and equipment [not used by Tenant] shall be and remain the exclusive property of Landlord, and Tenant shall not be required to take any actions with regard thereto. Landlord shall promptly deliver to Tenant all documents relating to the removal and proper closure of the USTs including but limited to the NFA letter.

Practice Note: Notice this covenant expressly provides that any USTs at the property whether known or unknown, active or inactive, are the property of the landlord. This is more appropriate where for a multi-tenant building or warehouse where tenant does not use any of the USTs.

[XX.] In the event that a Release of Hazardous Substances is found within, on or under the Premises other than as a result of the acts of Tenant, its agents, contractors or employees, [that requires Remediation based on the commercial use of the Premises] [poses an imminent and substantial endangerment to human health], Landlord covenants to use commercial reasonable efforts to implement the Remedial Actions that

may be required by the NYSDEC in a manner that will minimize interference with Tenant's use of the Premises. In the event that Tenant's use of the Premises shall be disturbed because of the need to complete the required Remedial Actions, or such action requires that Tenant be closed for business or access to Tenant be denied, then, in addition to Tenant's remedies in this Lease, at law or in equity (x) Landlord shall provide, at Landlord's sole expense, alternative space for Tenant, satisfactory to Tenant, during the course of the Remedial Actions and (y) Landlord shall abate the Rent for the Premises during the period that Tenant's use of the Premises is disturbed or Tenant's business is closed for business or Tenant's access to the Premises is denied. In the event that Landlord fails to promptly implement the Remedial Action, Tenant may also terminate this Lease.

Practice Note: This covenant may be used for contamination that is discovered during the term of the lease that is caused by other tenants, from an off-site source or that predates the lease provided lessor has assumed responsibility for preexisting contamination. Bracketed language may be used to narrow Landlord's remedial obligations to so that tenant cannot use minor spills as an excuse to abate rent or terminate the lease.

[14.65] I. Tenant UST Covenants Upon Surrender of Premises

[XX.] Upon the expiration or other termination of this Lease, Lessee shall remove all of its property, including, but not limited to, Lessee's Fixtures and Inventory, underground storage tanks, associated piping and dispenser equipment, and shall repair all damages to the Premises caused by such removal and restore same to the condition in which they were prior to the installation of the articles so removed. Any property not so removed shall be deemed to have been abandoned by Lessee and may be retained or disposed of by Lessor, as Lessor shall desire at Lessee's sole cost and expense. Lessee's obligation to observe or perform this covenant shall survive the expiration or termination of this Agreement, provided, however, that any underground storage tanks, associated piping and dispenser equipment that are not removed by the Lessee shall not be considered abandoned and Lessee shall continue to be responsible for removing such property in accordance with Environmental Laws. Immediately upon the failure of Lessee to perform any covenant of this Article, Lessor may, without notice, do so, and shall be entitled to receive from Lessee the then cost of performance of such covenant, such damages to be paid in addition to and separate and independently from damages accruing by reason of breach of any other covenant of this Agreement.

[XX.] Lessee shall, upon the expiration or earlier termination of this Agreement, comply with the closure requirements of the New York State Department of Environmental Conservation (NYSDEC) of 6 N.Y.C.R.R. Part 613 including, without limitation, removing all fuel, fuel tanks, product piping, fuel dispensers and other equipment, and backfill any areas from which the fuel tanks were removed and conducting any Remedial Actions required by NYSDEC, (collectively, the “UST Closure”). Lessee shall, within the time frames mandated by Environmental Laws, following its satisfaction of the UST Closure, deliver to Lessor a written report confirming completion of the UST Closure in accordance with the terms of this License and approved in writing by the NYSDEC (the “UST Closure Report. Lessee shall be responsible for remediating any Releases of Hazardous Materials at, under or emanating from the Premises in accordance with Environmental Laws. If Lessee fails to remediate such Releases of Hazardous Materials upon expiration or sooner termination of this Lease, Lessor shall be entitled to all remedies in respect thereof hereunder, including, without limitation, following applicable notice and cure period, the right to remove or otherwise remediate same at Lessee’s cost and expense in accordance with this Lease.

Practice Note: This provision clarifies that any USTs abandoned by the tenant remains the property of the tenant and if the tenant fails to remove them, lessor shall be entitled to costs of such work. The second paragraph describes the tenant’s closure and corrective action requirements by linking those obligations to the specific NYSDEC closure regulations and approval of specific requirements of the NYSDEC.

[14.66] J. Occupancy and Pre-Termination Diligence Covenants

[XX.] Landlord may from time to time require Tenant to perform, at Tenant’s sole cost and expense, an environmental site assessment (ESA) of the Premises to confirm that the Premises are in compliance with Environmental Laws and to determine if any Releases have occurred at the Premises.

No later than ninety (90) days prior to the Termination Date of this lease or any early termination date, the Tenant shall, at its sole cost and expense, have an environmental site assessment (ESA) conducted at the property. The ESA shall be in a scope acceptable to Landlord and shall be performed by an environmental consultant approved by the Landlord. A report discussing the results of the ESA (the ESA Report) shall be furnished to the Landlord within one week of the completion of the ESA.

Based on the results of the ESA Report, the Landlord may, in its own discretion, require the Tenant to undertake Remedial Actions to eliminate the Environmental Conditions disclosed in the ESA Report. It is understood that in the event the ESA Report reveals Environmental Conditions, the Landlord may elect not to take possession of the Premises until the Remedial Actions have completed and approved by the applicable state or federal regulatory authorities. If the Landlord so elects, the Tenant shall pay, during such period, monthly in advance, an amount equal to Basic Rent paid on the Basic Rent Payment Date immediately preceding the scheduled expiration date of the Term or the Termination Date, as the case may be. Nothing contained herein shall in any way constitute a waiver of, or diminish or limit the provisions of the Tenant's environmental indemnity.

Practice Note: This covenant allows landlord to perform a pre-termination Phase 1 well enough before the end of the lease term so that landlord can advise tenant of specific environmental issues before tenant vacates the premises and take appropriate legal action if tenant contests the conclusions before tenant vacates the premises.

[14.67] K. Tenant Environmental Indemnity

[XX.] Tenant hereby agrees to defend, indemnify, and hold harmless the Landlord from and against any Environmental Liabilities arising out of (i) any Releases or threatened Releases of Hazardous Materials at or from the Premises; (ii) any violations of Environmental Laws [attributable to the Tenant's operation or use of the Premises]; (iii) Remedial Action costs or other Environmental Liabilities incurred by Landlord as a result of violations of Environmental Laws or Releases of Hazardous Materials [attributable to the Tenant's operation or use of the Premises]; (iv) any Environmental Liens, (v) any wrongful death, personal injury or property damage caused or resulting from Environmental Conditions at the Premises [attributable to the Tenant's operation or use of the Premises]; and (vi) any breach of any warranty or representation or covenant regarding environmental matters made by the Tenant. The foregoing indemnity shall survive the expiration or termination of this Lease and/or any transfer of all or any portion of the Premises, and/or any transfer of all or any portion of any interest in this Lease and shall be governed by the laws of the state in which the Premises are located.

Practice Note: The indemnity makes use of the defined terms to make a clear statement on the scope of the tenant's indemnity. The bracketed limits the scope of tenant's indemnity obligations to contamination or vio-

lations of law that were caused by its operations and not related to pre-existing contamination or operations of other tenants.

[XX.] Notwithstanding anything to the contrary herein, in no event shall Tenant be responsible for, and Tenant's indemnification obligations herein shall not apply with respect to any Release of Hazardous Materials on, in, under or about the Premises, or common areas commencing or existing before the Commencement Date (including, without limitation, such conditions set forth in that certain Phase I dated _____ and prepared by _____ with respect to the Premises) (the "Preexisting Conditions"), whether or not such Preexisting Conditions have been discovered as of the Commencement Date.

Practice Note: this is another way for the tenant to clarify that it indemnity obligations do not include preexisting contamination. The parties rely on a Phase I report to establish the baseline of preexisting contamination. It is important that the baseline report be sufficiently comprehensive in scope. There have been instances particularly involving active or recently closed gas stations where tenants relied on reports that were limited to the area where the tanks were located and that did not assess impacts throughout the site. Later when there is a dispute, the prior operator or lessor argued that since the conditions were not disclosed in the baseline report, the former operator or lessor have no obligation to indemnity the tenant for this contamination even though it was preexisting.

[14.68] L. Tenant Release of All Claims

[XX.] Lessee on behalf of itself and any successors and assigns hereby releases and holds Lessor harmless from any Environmental Liabilities at or from the Property and shall be responsible, at its sole cost and expense, for conducting any Remedial Actions to address Releases of Hazardous Materials at the Property regardless if such Releases were known prior to the closing or are first discovered by the Lessee in connection with Lessee's development of the Property. Lessee on behalf of itself and any successors and assigns also waives all contractual, statutory or common law rights and remedies that it might be able to assert against the Seller for any such Environmental Liabilities.

Practice Note: The last sentence is the magical phrase to ensure that an "as is" agreement will have the effect that the Lessor intended and cuts off its environmental liability regardless of when it occurred and by whom.

[14.69] M. Landlord Environmental Indemnity

[XX.] Landlord hereby agrees and does indemnify and holds Tenant, its directors, officers, employees and agents harmless from and against (a) any and all Environmental Liability imposed on or incurred by Tenant in any way relating to or arising out of the existence or presence of any Hazardous Materials [or underground storage tank(s)] on, under, from or onto the Premises unless the Hazardous Substances are as a result of the operations of Tenant, its contractors or employees; and (b) any and all Environmental related to or arising out Releases of Hazardous Substances or violations of Environmental Law attributable to the operations of the Tenant, its contractors or employees at the Premises. This indemnification shall include, without limitation, Environmental Claims arising out of any violations of applicable Environmental Laws, regardless of any actual or alleged fault, negligence, willful misconduct, gross negligence, breach of warranty or strict liability on the part of Landlord. Without limitation, this indemnification shall also include any and all Environmental Claims incurred due to any Remedial Actions Premises mandated by Environmental Laws and conducted any NYSDEC. The foregoing indemnity shall survive the expiration or termination of this Lease and/or any transfer of all or any portion of the Premises, and/or any transfer of all or any portion of any interest in this Lease and shall be governed by the laws of New York.

Practice Note: In addition to the carve-out related to tenant operations, this indemnity specifically references strict liability. Notice the landlord's indemnity obligations survive the termination of the lease or transfer of interest in the leasehold.

CHAPTER FIFTEEN

IMPACT OF TECHNOLOGY ON COMMERCIAL LEASING

Kevin P. Groarke, Esq.
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[15.0] I. INTRODUCTION

This chapter covers the impact of technology on commercial real estate leasing generally and office and retail leasing in particular. It will cover issues that landlords and tenants need to keep in mind when leasing office space for Internet, digital media and other technology company uses and issues presented by technological forces on retail space leases.

[15.1] A. The National Tech Boom

Between 2010 and 2015, the booming high-tech sector has been one of the major drivers in the U.S. office market recovery, with the industry accounting for 34% of all new office-using jobs created in the United States. High tech was also the top industry leasing office space in the U.S., accounting for 20% of major leasing activity by square footage in 2015. By comparison, the second place industry was financial services at 12%.

The “Tech-Thirty Office Markets” are the top 30 large cities with a high concentration of high-tech software/services and digital media jobs. Ranked by city overall market office rent growth rates for the last two years, the clear leaders were the San Francisco Bay area at 30.7%, Manhattan at 14%, San Diego at 12.7%, Denver at 11.8%, Austin at 11.4% and Boston at 14.4%. Within the Tech-Thirty markets, the primary tech-centric submarkets experienced exemplary rent growth, with eight of the 30 top submarkets experiencing two-year rent gains of over 20%.¹

[15.2] B. New York: New Tech City

Since 2000, New York’s tech sector has emerged as an increasingly powerful economic driver for the city economy. At a time when few other industries were growing in New York, more than 1,000 new tech start-ups were formed, which created thousands of well-paying jobs and attracted large amounts of capital. Unlike the fleeting dot-com era, New York City is building a sustainable tech ecosystem with dozens of incubators, co-working spaces and early stage accelerators. Venture accelerators generally provide short-term space as part of an eight- or 12-week start-up boot camp, and offer mentoring and coaching services in return for an equity stake in the company; incubators provide longer-term space for young companies still looking to put together a team.

¹ *U.S. Tech-Thirty: Measuring Office Market Impact in 2015*, CBRE, Inc. (2015).

Since 2000, many of the nation's largest tech companies have planted roots in New York. In 2010, Google purchased 111 Eighth Avenue, an approximately 2,900,000-square-foot mixed-use building, for \$1.9 billion. Google currently occupies and uses more than 700,000 square feet of the building with approximately 2,200,000 square feet occupied and used by other tech industry companies.

In 2014, Facebook relocated its New York City-based engineering division, marketing and other functions from midtown into 100,000 square feet of new space near Astor Place. In December 2014, Facebook leased an additional 170,000 square feet of space in the same building. Also in 2014, Amazon signed a 17-year lease for a 470,000-square-foot building across from the Empire State Building for offices and ground floor retail; and BuzzFeed, a fast-growing digital media company, signed a long term lease for 200,000 square feet, 40% of a building, on Park Avenue South.

In addition to the growth in rent rates, the phenomenal growth of the tech sector in New York and in the other Tech-Twenty cities has had the added impact of converting class B and class C office properties and former industrial properties into trendy and desirable locations for tech-sector companies with higher rents and substantial upgrades. This trend started a few years ago and has continued on an accelerated basis. One of the main reasons for this migration is that many older industrial and loft buildings, with their high ceilings and sound structure, are more easily renovated to accommodate "telecom hotels," data centers and colocation facilities, and include the wide-open style and manner of office space tech-sector companies strive for. Telecom hotels and data centers are generally located in buildings specially fitted and physically reinforced to house multiple technology tenants, whose business is to provide a location for data storage as well as transmission facilities and telecom-switching devices that route telephone calls between carriers and local networks.

As a result of the tech sector expansion and the unprecedented rate of conversion of such properties to residential uses, there are dramatically fewer class B and C office properties and industrial properties in Manhattan, Brooklyn and Queens than there were 10 years ago. This has recently led some real estate industry commentators to call upon city economic development officials to create a new set of incentives, including tax exemptions, aimed at making it financially attractive for the owners of such properties to preserve their buildings as office spaces or convert their industrial buildings to office uses.

High tech's rapid expansion has been, and continues to be, fueled by venture capital (VC) funding, which enables companies to quickly scale their operations by adding talent and increasing their office and other space footprints. Nationally, and in New York City, VC funding to the technology sector has been strong, averaging \$26 billion per year between 2009 and 2013. VC funding for technology (defined as including the media and entertainment, networking and equipment, biotechnology, IT services, computers and peripherals, electronics/instrumentation and software sectors) in the first half of 2016 was \$27.9 billion nationally, and \$3.1 billion in metro New York, according to data from Thompson Reuters for the Pricewaterhouse/National Venture Capital Association Money Tree Report Q2 (July 2016). This all indicates that the tech industry continues to grow at a very strong pace and its need for commercial space also is growing.

From the beginning of his mayoralty in 2002, Mayor Michael Bloomberg sounded the alarm that New York City was overly dependent on Wall Street and needed to diversify its economy. The Bloomberg Administration made unprecedented commitments to help the tech sector grow in New York.

In 2011, the Bloomberg Administration announced a high-profile contest to attract a new applied sciences and engineering campus to New York. Seventeen leading universities from around the world filed seven applications. The process culminated in the selection of Cornell University and Technion–Israel Institute of Technology to commit to build 2 million square feet of applied science and engineering labs, classrooms and conference facilities on an 11-acre campus site on Roosevelt Island in the middle of the East River.

In April 2012, the Bloomberg Administration and New York University announced another agreement to create The Center for Urban Science and Progress (CUSP), a new post-graduate applied science and engineering center in downtown Brooklyn. CUSP is a consortium of top educational institutions and leading companies, including IBM and Cisco, led by NYU and NYU Polytechnic School of Engineering, which will focus on research and development of technology to address the critical challenges facing cities. NYU will transform the former MTA headquarters building into a cutting edge research facility.

[15.3] C. Upstate New York Tech

The growth of the high-tech industry in New York is not confined to the metro New York City area. With sponsorship from SUNY Polytechnic Institute and the College of Nanoscale Science and Engineering (CNSE), there is the CNSE NanoTech Complex in Albany, a 1,300,000-square-foot complex that houses advanced high-tech labs for state-of-the-art R&D and prototype manufacturing facilities, the Solar Energy Development Center in Halfmoon, New York, and other CNSE-sponsored high tech labs and facilities in Rochester and Buffalo. Rensselaer Polytechnic Institute owns and operates the Rensselaer Technology Park which consists of 23 buildings on 450 acres with a lot of room to expand for technology development. The park houses over 70 technology industry tenants, ranging from electronics to physics research to biotechnology to software.

Notably, VC funding for technology in upstate New York in the first half of 2016 was \$49 million according to the PriceWaterhouse/National Venture Capital Q2 Report.

[15.4] D. So Why Is It Different This Time?

All of this leads one to ponder whether the growth in the tech industry nationally, and in New York, is sustainable or will meet a fate similar to so many “dot-com” companies that fizzled out when the tech bubble burst in 2000. That question is far beyond the scope of this chapter on the impact of technology on leasing, although the question will inevitably overhang and influence investment and leasing decisions. Nonetheless, the following differentiations have been identified by business commentators and are worth noting by landlords, lenders, tenants and investors alike.

- The euphoria of the dot-com frenzy of 1997–2000 came largely from one industry trend: the Internet.
- The tech industry exuberance today is dispersed across several industries: mobile technology, cloud computing, social media, on-demand services, digital media, financial tech, health tech, and ad tech. Today’s tech sector is much more diverse than 16 years ago.
- More than that, technology is playing a far larger role in our economy and culture than 16 years ago.
- In 1998, 308 out of 480 Initial Public Offerings (IPOs) were of Internet and tech-related companies, 75% of which had no earnings.

- Today, we have a more rational IPO market. In 2013, the average tech IPO company had been around for nine years and had revenue of \$200 million or more.
- Today's technology revolution is much less about creating the infrastructure and plumbing for the Internet than about applying technology to traditional industries like advertising, media, financial institutions, fashion, and health care and bioscience to deliver content, sell products, deliver services, provide entertainment and simplify life for individuals and businesses.

Looking forward, commentators have noted that as long as there is strong demand from consumers and businesses for high-tech products and services, and the trend lines suggest that demand may be insatiable, the high-tech industry, and the office markets they are concentrated in, should continue to grow in the years to come.

[15.5] II. OFFICE LEASES FOR TECHNOLOGY COMPANIES

Critical factors which impact the selection of space for any tenant, not just technology companies, include pricing of the space (such as build-out costs, landlord concessions and the effective rent), location, the term of the prospective lease, and the general suitability of the space for the tenant's use today and for the foreseeable future. Tech companies, whether a start-up or a well-capitalized mature company, are different, however, because of their particular uses of space, rapid growth demands and the special technology needs they face.

[15.6] A. Pricing

Pricing is always an upfront determinative factor. Rents in high-tech submarkets are likely to churn higher for the foreseeable future, particularly for well-maintained buildings in desirable neighborhoods. Some tech tenants may face sticker shock when shopping for new office space. For start-up tech companies, tech accelerators and incubators are an excellent transitional alternative. For smaller tenants (1,000–2,000 square feet), communal working arrangements like General Assembly, New Work City, Hive 55 and others may be a viable alternative. The price is lower and generally all-inclusive in terms of utilities, Internet access, and other fringe costs.

[15.7] B. Location

For tech companies, aside from intangible image factors that drive the desirability of building location, determinative building location factors include the proximity to fiber-optic corridors, to the city's central business districts and to major transportation hubs.

High-tech tenants strive for locations with at least two fiber-optic, high-speed broadband service providers with diverse routes and points of entry to the building. One tech industry commentator indicated that commercial buildings serving tech companies, as well as other tenants, should strive to make available at least 150-megabit connections to each tenant.

[15.8] C. Electrical Power

Electrical power is equally important. Generally speaking, high-tech tenants seek 80–100 watts per usable square foot (by contrast a typical office utilizes 4–6 watts per square foot) with multiple levels of redundancy, on-site emergency power supply and the use of the landlord's generator and/or diesel fuel tanks. The prolonged problems some buildings in flood-prone areas in Manhattan, New Jersey and other areas experienced from flood damage caused by Hurricane Sandy in 2012 added new emphasis to the location, or relocation, of on-site emergency power generators and fiber-optic service points of entry on floor levels above recognized 100-year flood lines.

Related issues include whether there is adequate riser space for electrical and fiber-optic conduits (pipes, hollow on the inside, running through shafts from one part of a building to another, through which the landlord or tenant can run cabling and electrical wiring) at occupancy and reserved for future alterations or expansion; whether the tenant will have exclusive use of, or controlled access to, such risers; and who will have the right to sell any excess capacity. The lease should spell out rules relating to tenant access to equipment and risers (including those outside the premises); tenants presumably will want 24/7 access. Leases also should contain appropriate restrictions on third-party access to premises and conduits.

[15.9] D. Physical Infrastructure

Another issue is the building's physical infrastructure. Does it have large floor plates, high ceilings, wide column spaces, heavy floor load capability and freight elevators with extra weight capacity to meet the tech tenants' needs?

Tech tenants also require high-capacity condenser units for cooling, and non-water, chemical fire suppression systems. If not present or accessible to the leased premises, who will pay for installing such systems prior to occupancy? In addition, rooftop space for antennas (with adequate exposures) and, where necessary, supplemental air conditioning equipment must be considered. Landlords and tenants should ensure that all leases contain detailed provisions relating to these matters and specifically describe their respective obligations, if any.

High-tech tenants require extraordinarily expensive initial tenant build-outs. Their operators routinely argue that such an up-front investment should be recognized as the security deposit under lease, justification for “free” rent abatements and, moreover, a commitment by the landlord to protect that investment by obtaining a nondisturbance agreement in favor of the operator from any mortgage lender.

[15.10] E. The Changing Need of Tech Companies

Technology changes rapidly, and so do the needs of tech companies. What works today may not work next year, so the ability to expand and or reorganize office space is paramount when a technology company is negotiating the terms of a lease. While a savvy tech tenant and its design professionals will endeavor to allow for flexibility and future changes in space use and configuration in the initial design of the space (movable walls, modular furniture, reserved riser capacity and the like), invariably, they cannot foresee everything involved. Therefore, it is critical from the tenant’s perspective that the lease contains favorable alteration provisions covering, among other things, accelerated plan and contractor approval processes, cooperation and coordination by the landlord, where required.

By the same token, because technology companies may grow, merge, be acquired or may die, leases should set forth provisions relating to the assignment of the lease (and deemed assignment such as a merger), subletting some or all of the leased premises, and expansion or contraction of the leased premises. There must be some flexibility for the tenants’ future growth or contraction, or changes in control, albeit without limiting the landlords’ rights and options too significantly. Leases may include rights of first offer and first refusal, options for additional space, rights to give back space, and must-take puts. They also may contain a carve-out of any initial public offering or merger from the “change of control” clause, and permit tenants to sell all or substantially all of its assets or enter into joint ventures and effect capital restructurings, without landlord consent, under specified conditions.

On the flipside, landlords want to have adequate remedies and recourse to assure they get the benefit of the bargain. It is not uncommon for a landlord to require somewhat onerous security requirements in the form of an irrevocable, evergreen (self-renewing) letter of credit and/or significant lease payments up front from tech start-ups or other tech companies without a stable history and steady cash flow. Typically, the tech tenant will negotiate for one or more reductions in the amount of the security deposit upon the tenant achieving certain financial hurdles and/or over time as the lease term is naturally reduced.

Young start-ups are often idea-rich but cash poor, making it difficult for them to provide large security deposits. In such cases, landlords might obtain personal guaranties from individual investors or sponsors. Even in the case of a well-capitalized tech tenant with a steady cash flow, many landlords will insist on a “good guy” guaranty from company principals, investors or sponsors. Essentially, this type of guaranty is a limited form of personal guaranty: the guarantor agrees that, in the event the tenant defaults in performing its obligations under the lease, which would allow the landlord to terminate the lease, the guarantor will be personally responsible for paying the rent (and other monetary obligations) until the tenant vacates the entire premises and shall have performed obligations for restoration of the space on termination of the lease, if there are any.

Finally, there is what has come to be known as the “dog clause.” In essence, this provides tech tenants with the right to build out special-use areas (such as living room/kitchen areas and basketball courts) and the right to have pet dogs on the premises.

[15.11] F. Tech Industry Subsectors

A variety of tech industry subsectors engaged in the high-tech boom of the last five years lease office space in many of the Tech-Twenty Markets. First among them is digital media and publishing. These include start-up digital media companies (for example, The Huffington Post, Tumblr and Comixology), more mature ones such as Google, Facebook and Twitter, and the largest digital media companies which are, in fact, old media companies—IAC, NewsCorp, Fox, NBC Universal, Viacom, CBS, ESPN, *The Wall Street Journal* and *The New York Times*, to name just a few.

Ad tech is another booming tech subsector that is based primarily in New York. DoubleClick (bought by Google for \$3.1 billion), Right Media (acquired by Yahoo for \$850 million) and AdMeld (acquired by Google for \$390 million) are examples in this sector that are in leased office

space. New York's ad tech companies offer services to other businesses rather than consumers. They sell analytical tools to help ad buyers figure out what was once thought to be incalculable—what a person was doing before seeing an ad, where a person who responded to an ad pointed his or her browser next, and so on.

Like ad-tech companies, “fin-tech” companies have developed product and services for financial companies rather than consumers, including big data and analytics, payments and processing services, risk management, security services or some combination of the above. Two of the biggest fin tech companies are based, not surprisingly, in New York: ACI Worldwide and Moody's Analytics. Kickstarter, also based in New York offices, enabled \$1.49 billion in investments in 77,603 projects since its founding in 2009 through online crowd sourced funding. Easily the most recognizable brand in fin-tech, PayPal, founded in 1998, had annual revenue of \$7.9 billion and processed \$168 billion in total merchant services payment volume in 2014 in its massive operations center in Nebraska.² Its parent company, eBay, Inc., announced plans to spin off PayPal as a separate public company in 2015. In May 2015, PayPal inked a 12-year lease for approximately 100,000 square feet of office space in the West Village submarket of Manhattan.

The health-tech sector goes far beyond informational websites like WebMD to encompass health monitoring technology, e-prescribing, drug alert systems and health IT platforms designed to automate hospital and medical office recordkeeping and insurance payment processes. Health tech uses massive amounts of commercial real estate. Medical and life science facilities, such as the New York Genome Center and the Alexandria Center for Life Science-New York City, are examples of health-tech facilities on a large scale. The Genome Center, backed by most of the major medical schools and medical centers in New York, signed a 20-year lease for 170,000 square feet in a SoHo/Hudson Square area building (which also houses a major data center tenant) to establish one of the largest genetic sequencing and biotech research centers. The first phase of the Alexandria Center, located on the East Side between 28th and 30th Street, is a 310,000-square-foot, 15-floor Leadership in Energy and Environmental Design (LEED) Gold facility of class A biotech laboratory and office space. The second phase of development will include a 410,000-square-foot laboratory and office building. Alexandria, a NYSE-listed Real Estate Investment Trust (REIT), specializes in leasing office/laboratory spaces to bioscience, technology, pharmaceutical and medical research

² PayPal Information Center, www.paypal.com.

companies and offers a full range of on-site services including laboratory design, planning and construction and laboratory operations and management. It owns and operates other bioscience centers in the Greater Boston area, Rockville, MD, the Research Triangle Area (Raleigh-Durham-Chapel Hill, N.C.), San Diego, the San Francisco Bay area and Seattle.

The Cornell/Technion applied science center on Roosevelt Island discussed above will emphasize bioscience in addition to environmental science. Columbia University's new Manhattanville campus will have a heavy concentration in biotechnology as well.

[15.12] III. IMPACT OF TECHNOLOGY ON RETAIL LEASING

[15.13] A. The History of Retail

The retail industry is no stranger to changing trends in reaction to technological developments and cultural changes. At the start of the 20th century, retailing was mainly dominated by mail-order catalog merchants who offered a broad assortment of just about everything available on the market (Sears, Roebuck and Co., Montgomery Ward, Inc. and JCPenney Company, to name a few). Variety stores, such as F.W. Woolworths, W.T. Grant, and S.S. Kresge, lined the streets of small towns and urban residential neighborhoods, offering basic goods for everyday needs. Consumers traveled to the central business districts of large cities to shop at department stores, which offered clothing, accessories, furniture and other home goods plus sidewalk window shopping. Macy's, Gimbel's, B. Altman & Co., Bonwit Teller, Lord & Taylor and Wanamaker's were among the most famous department stores.

Following the end of World War II and the return of our soldiers and sailors, the U.S. entered a period of massive rebuilding and growth that impacted consumers' needs for everything. Eighty million "baby boomers" were born between 1946 and 1965, and became the defining force for the U.S. economy for the next 50 years. The retail industry followed consumers to the new suburbs and built large shopping centers near where they lived. These shopping centers became the new destinations for retailing, housing department stores, national chains and other smaller stores. By 1975, there were over 2,000 shopping centers and over 20 department store chains in the U.S.

In the 1960s, the widespread growth of modern credit cards (e.g., Visa, MasterCard) and the emergence of discount stores, brought on by the

repeal in the 1960s of fair trade laws that restricted discount pricing, fueled a new “mass market” economy. The discounters built no-frills big box stores with large parking lots, aimed at meeting the needs of consumers for branded household goods and apparel at prices below those suggested by manufacturers, the so-called manufacturer suggested retail price (MSRP).

In the 1970s and 1980s, specialty apparel stores and new “category killer” stores (like Toys ‘R Us, Home Depot, Best Buy) grew aggressively into many product segments, including toys, sporting goods, office supplies, electronics, home improvement, home furnishings, books, recorded music and video, and pet supplies. The discounters, specialty stores and the category killer merchants together took significant market share away from department stores, forcing many of them to consolidate, close or file for bankruptcy.

[15.14] B. Online Retailing

The World Wide Web launched in 1991. Online retailing, or e-commerce, began to show up in the marketplace. The explosion of personal computers, tablets, smartphones, wireless technology and the widespread availability of the Internet that followed has brought about revolutionary renovation not just in retailing, but in every other industry and business sector and in every aspect of consumers’ lives as well. The Internet changed consumer purchasing patterns. While big box stores and other bricks and mortar stores used to target mass consumerism, online stores cater to specific personal needs of consumers. Online stores are also viewed as more adaptive and flexible compared to physical stores, and are cheaper to manage and maintain.

As a result, online sales as a percentage of total retail has grown from 2% in 2004 to almost 10% of all retail sales in 2015, according to the U.S. Department of Commerce. Analysts are forecasting that it will be over \$500 billion, or 20% of nonfood retail sales, by 2020. The key drivers of such growth: the increased use of mobile devices, including tablets, wireless technology and the greater wallet share shift to web purchasing by online buyers.

Make no mistake, however: the physical store is certainly not dead. Here’s why:

- While analysts forecast \$150 billion more will be spent online between 2014 and 2018, they also forecast that \$300 billion more will be spent

in physical stores during that same period. Stated differently, while online sales were 6% of total retail sales in 2013, in-store sales were 94% of all retail sales in 2013.

- Occupancy rates for retail space in desirable city/high street locations and dominant shopping centers are nearly 100%. This factor could, in fact, lead to more retail developments being built and occupied by quality tenants.
- While old store concepts located in class B and class C centers are in peril, new fresh concepts in class A properties are doing well.
- Stores provide consumers with a sensory experience that allows them to touch and feel products, immerse in brand experiences, and engage with sales associates who provide tips and reaffirm shopper enthusiasm for their new purchases.
- Branded manufacturers, a sector of retail that is growing explosively, are leasing more floor space and show no signs of becoming online-only or primarily online brands.
- There are headwinds confronting e-commerce such as rising shipping costs, newly imposed sales taxes and other taxes for web pure plays.
- Landlords are embracing e-commerce and employing innovation to increase or maintain foot traffic and to attract new and retain existing quality tenants.

[15.15] C. The Retail Industry Today

One of the most significant impacts of e-commerce on brick-and-mortar retail is the changing retail mix. Owners of, and lenders to, malls and shopping centers are now emphasizing entertainment, food- and service-based businesses, technology retailers and retailers that are involved in multi-channel commerce and are de-emphasizing in-store only merchandise-based tenants. Illustrating this in-store trend, between 2005 and 2015, the number of Apple stores in North American malls has grown to 270, with average sales of \$4,789.82 in 2014 per square foot (by contrast, Tiffany's averages \$3,232.20 per square foot);³ Microsoft has opened 74 stores; and Tesla, the super-chic electric automobile manufacturer, has opened 25 stores in mall locations.

³ Philip Wahba, *Apple Extends Lead in US Top Retailers by Sales Per Square Foot*, Fortune (March 13, 2015), <http://fortune.com/2015/03/13/apples-holiday-top-10-retailers-iphone>.

A trend toward “showrooming,” particularly in market segments like fashion and clothing, consumer electronics, and home improvement, has led to many physical stores offering “click and collect” schemes where customers buy online but collect in-store at a location selected by the customer. It works well for customers, retailers and landlords. For customers, it offers instant gratification and the convenience of being able to pick up the goods at a time that suits them. For the retailer, it means passing on some of the cost of delivery to the shoppers, specifically the higher “last mile” to delivery point costs, as well as the opportunity to sell other products and services when the customer is in the store. For the landlord, click and collect is a great footfall generator and can often mean the sale is attributed to the pick-up store even though it was transacted online. More than 50% of Walmart’s online sales and 40% of Best Buy’s online sales are picked up in stores.⁴ Best Buy’s store-within-a-store partnerships with Microsoft, Samsung, and other tech product suppliers capitalize on the manufacturers’ need to show off their products in a physical store environment.

Certain in-store supermarket chains, such as Stop & Shop (through its Peapod website), Fairway Market, and Fresh Direct, provide customers the opportunity to shop online for groceries and other products found in their physical supermarkets and provide same-day or next-day delivery. Other retailers are moving toward same-day delivery to meet consumer demand. This trend may lead to changing uses in retail real estate, where the showroom or retail floor space is a much smaller part of the total footprint, and the inventory and distribution center becomes more of that footprint. For in-store adaptive reuse, the retailer generally would need to amend the permitted use clause of its lease. It is foreseeable that landlords may convert some or all of otherwise failing B and C shopping centers to accommodate retail inventory distribution centers. Some retail landlords may turn to developing logistics and warehousing facilities as part of their overall retail strategy.

Today, stores and malls are transforming to become highly technology enabled. It’s not just the retailers doing this—landlords and retailers are working together on these efforts. The Westfield Group, the owner of 38 regional shopping centers in the U.S., has experimented with various high-tech applications at some of its shopping centers. Westfield created “digital storefronts” at its Garden State Plaza Mall in Paramus, N.J. Shoppers are able to scroll, zoom and rotate through curated assortments of

4 McKinsey & Co. Report, “Making Stores Matter in a Multichannel World,” www.mckinsey.com/insights/consumer_and_retail/making_stores_matter_in_a_multichannel_world.

products offered by mall tenants displayed in ultra-high definition imagery. Once shoppers find a product they would like to buy, the digital storefront displays a map of exactly where the product may be purchased. The digital storefronts were developed by Westfield Labs, a subsidiary of Westfield Group, and serves as a global digital lab focused on innovation for the retail physical environment. Westfield Lab, in a partnership with eBay, Inc., also developed and deployed digital shoppable windows at its San Francisco Centre for three of the mall's high-tech tenants, which enable customers to view and buy merchandise from each brand via a shoppable window, pay with PayPal, and then arrange for free home delivery or pickup within the mall for select items. Another national shopping mall owner/operator, The Macerich Company, has similarly developed in-house and deployed at eight of its top performing malls double-sided, large format digital displays in highly trafficked areas affording tenants, brand manufacturers and advertisers a place to run digital or static ads, as well as interactive features such as live texting and crowd sourcing.

National retailers, like Lowes Companies, Inc., Walmart and others, have set up in-house innovation labs geared to develop and deploy technology solutions to link customers and their physical stores. Lowes has developed an app for in-store use to enable customers and Lowes personnel to plan a home improvement project based on photographs or floor plans of the room to be renovated. Visa also has an in-house innovation lab which has developed Visa Checkout, which speeds up in-store payment transactions via the retailer's mobile apps. In addition, Visa Innovation Lab has been involved in Apple Pay.

In general, retailers have been quick to adopt what is being called a multichannel approach—the digital channel and the physical channel—in which they complement their physical stores with their online stores, Twitter and Facebook pages to engage and attract customers. There is also a trend toward “omni-channel” marketing, which involves the retailer integrating its offline, in-store and online e-commerce channels to provide a consistent user experience. In other words, when a customer walks into a physical store they see the same merchandise and special offers, and are offered a consistent look and feel of the brand both offline and online. Burberry, the U.K. luxury goods retailer, is a prominent leader in omni-channel marketing.

Technology has been shrinking in size and increasing in speed and power at exponential rates in the age of mobile computing and wireless tech. iBeacon technology can give retailers and shopping mall owners the

opportunity to engage customers precisely when the time and place is right: when the consumer is in, or in the vicinity of, the mall or particular store. iBeacon technology⁵ allows mobile apps (running on Apple and Android devices) to “listen” for signals from beacons in the physical store or mall. It allows the mobile app to locate the consumer’s position on a micro-locale scale (think indoor GPS) and delivers contextual content to users based on location. The beacon signals may be tagged to a specific shop or aisle within the store. While small, medium and independent stores are unlikely to have their own mobile application, automatically excluding them from an iBeacon service offering, such retailers could form a collective with the shopping mall or on the high street and get a Beacon platform. Creative landlords will work with such merchants to facilitate such collective efforts.

Integrating mobile or point-of-sale payment applications, such as Apple Pay, into iBeacon-enabled mobile applications, will capture real return on investment for the retailer from iBeacon deployment.

As traditional retailers struggle to redefine the role of the physical store in a multichannel, increasingly millennial-led world, it is foreseeable that retailers in negotiating new leases, or in seeking to modify existing ones, will seek to allow it to terminate the lease early, go dark, give back space to facilitate downsizing, redefine gross and net sales subject to percentage rent or change permitted uses. How landlords will respond to this will be challenging.

The retail industry has gone through disruptive transformations in the past. Once again, the industry is being transformed by technological and cultural changes. Much like biological evolution, where environmental constraints shape biological traits, the profile of the successful retailer and retail property owner of the future will be shaped heavily by technological advances and changes in consumer behavior. The lessons of prior industry changes and appreciation of the vastness of the technology we have today, and its near term possibilities, tell us that the winners in this evolving ecosystem will be the retailers, brands and property owners who can blend the best practices of merchandizing and property ownership with techno-

5 iBeacons or Beacons are low-power, short range transmitters that work on Bluetooth Low Energy (BLE) and enable micro-location and context based services for mobile applications on smart phones and tablets. Apple brought the technology into the spotlight by announcing iBeacon support on its iOS7 platform in 2013. The term iBeacon is trademarked by Apple but it is used interchangeably with Beacons and is generally used to refer to BLE-based technology in the market place.

logical tools that will enhance consumer engagement within the brick-and-mortar store, thus providing a rationale for being there.

[15.16] IV. CONCLUSION

As long as there is strong demand from consumers and businesses for high-tech products and services, and the tech industry continues to bring out faster and more powerful innovations for business-to-business and for consumer use in this age of mobile computing and wireless tech, the tech industry and the office markets they are concentrated in will continue to see strong growth. Today, stores and malls are transforming to be highly technology-enabled. The retailers, brands and property owners who adapt and innovate in the constantly evolving retail ecosystem, blending the best practices of merchandising and property ownership with technological tools that enhance the overall shopping experience—online and in their physical stores—will likely prosper in the foreseeable future.

CHAPTER SIXTEEN

**INSURANCE ISSUES IN
COMMERCIAL LEASES**

**Curtis Lee
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[16.0] I. INTRODUCTION

This chapter provides an overview of the types of insurance coverage recommended for a commercial lease and, more important, why they are needed. While much of this chapter is written from the landlord's perspective, the reader can view the dialogue from the tenant's point of view as well.

[16.1] II. RISK MANAGEMENT—UNDERSTANDING WHY

The premises lease between the Landlord (who is often the Owner of the property) and Tenant should clearly set out the responsibilities of each party, including obligations such as maintenance, care, and cleaning of the premises, responsibilities for damage, and who is responsible should a claim occur. Typically the Tenant carries most of the responsibility within the walls of the leased space and the Landlord is responsible for the common area, building systems, and structural elements but, depending on the nature of the lease, this is not always the case. The responsibilities placed on each party and the indemnifications assumed must be carefully examined to understand the parties' exposures. The existing and contractually created exposures are the premise for requesting insurance under a lease. Each party is seeking protection from potential claims or damages and wants to ensure that such protection is backed by a company with the financial wherewithal to fund the loss, potentially well into the future when lawsuits are often resolved, and therefore require insurance from a financially sound provider.

The Landlord will usually provide insurance to cover physical loss to the building itself, the resulting rent loss, and the liability for the public areas (common areas) in and around the building. Similarly, the tenant should carry insurance to replace its property, including tenant's improvements and betterments, and any resulting loss of business income and liability emanating from its operations within the building. In addition, each party should purchase insurance to cover any injury to its own employees and to cover the use of automobiles in and around the premises. If the tenant's operations included any special risks additional coverage may also be requested; for example, a restaurant or hotel may be required to purchase coverage for any liability arising from the sale of alcoholic beverages or a valet parking service. Lease terms such as net leases and ground leases, especially a lease granting long-term rights to a developer for the construction of a building, may significantly impact which party is required to provide what forms of coverage.

Preleasing of buildings under construction presents several added elements to consider; especially if the landlord is constructing a building and obtaining financing, predicated on the occupancy by the tenant(s) when the building is completed. The terms should not allow the tenant to cancel the lease if there is a delay in completion of the project; this will be particularly important to any potential mortgagee. At minimum, the landlord in this situation may be forced into payment of financial penalties to the tenant in the event of a delay. The landlord may want to mitigate its financial exposure to loss under these types of leases by passing the financial penalties along to the general contractor erecting the building and/or purchasing insurance coverage adequate to cover contract penalties or the loss of the tenant(s).

No matter what type of lease is involved, there are typically two parties: the party that owns the property or the rights to the premises, and the party wishing to occupy the premises. In either case, each party has assets to protect from exposure to physical loss or damage, such as fires, and loss created by exposure to public liability. In addition, the party granting the lease will want the other party to not only insure the exposures created by its use of the premises, but also extend its coverage to the landlord. This extension of coverage to the landlord from the tenant's insurance coverage can be as simple as a contractual obligation naming the landlord as an additional insured or as complex as assuming the responsibility for all insurance on the premises, including all primary insurance on behalf of, and in protection of, the landlord.

[16.2] III. BASIC TYPES OF INSURANCE

Two major areas of insurance coverage that should be considered in every lease are property insurance (first party) and public liability insurance (third-party liability). Specialty coverages such as liquor liability (covering the sale and service of alcohol), garagekeepers liability (covering the care, custody, and control of a vehicle such as a valet or garage operator), and environmental liability insurance (covering both clean-up and public liability for environmental impairments), should be considered as well. This latter coverage is of particular importance in a lease of a premise for a manufacturing operation, storage of environmentally sensitive materials, automobile repair and service facilities, or dry cleaners where a Landlord could be ultimately liable for its Tenant's impact on the environment.

In a typical landlord-tenant lease the landlord would want the tenant to carry the following basic insurance coverages:

- *Property insurance.* Following basic risk management principles where each party is responsible for providing insurance coverage for its own property, the landlord might require the tenant to insure the following: “Tenant at Tenant’s own expense shall insure all its own personal property including but not limited to, improvements and betterments, personal property, stock and supplies, furniture and fixtures. In addition Tenant shall purchase business interruption insurance to cover interruption in its operations caused by an inability to use the Premises due to loss.”

The preferred type of property insurance coverage is the so-called “All Risk” insurance as opposed to the older, more restrictive “Fire and Broad Form Extended” coverage. The “All Risk” or ISO “Special Causes of Loss” policy form is the most prevalent coverage form in use today, and the limits of coverage in this area should be 100 percent of the replacement cost value of the tenant’s property. However, bear in mind that a ‘standard’ Special Causes of Loss policy form still has a number of exclusions that the Landlord may wish to have endorsed or separately required such as: Flood, Earthquake, Business Income, and Equipment Breakdown (Boiler and Machinery).

- *Rental income insurance.* Often misunderstood is the issue of which party provides the rental income insurance. The answer is simple: If rent abates, then the landlord purchases the insurance. If rent does not abate to the tenant, the tenant’s ongoing obligation to pay rent to the landlord can be covered by the tenant’s purchase of rental or business interruption insurance. Business interruption insurance can cover the tenant’s net profit plus continuing expenses; if the rents do not abate, this becomes a continuing expense and can be covered under the tenant’s policy. Coverage for the Rents aside, it is good risk management practice for each party to carry business income coverage for the same reason each party carries property coverage; in the event of a loss each party should look to their own property insurance to be made whole.
- *Public Liability insurance.* This is a broad coverage term more commonly used outside the U.S. that references all third party liabilities (claims made by members of the general public, such as a slip and fall case). The tenant should be contractually obligated to provide the following types and minimum levels of liability insurance coverage for the protection of itself and the landlord: *Commercial General Liability* insurance, covering liability emanating from the tenant’s use and occupancy of the premises, including that of tenant’s employees,

customers, agents and invitees. If the tenant is involved in providing a product that may potentially create an exposure itself, such as food or cosmetics, then coverage known as “products liability and completed operations” should also be provided. The amount of insurance customarily purchased under a Commercial General Liability policy is \$1 million per occurrence and \$2 million in the annual aggregate. If multiple locations are insured on the same policy, a per-location aggregate adds some depth to the coverage and should be specified in the lease to avoid the erosion of limits to the Landlord from a claim(s) at an unrelated site. (Please note that the often-referred-to *Comprehensive* General Liability insurance form has not been commonly used since the late 1980s; the current form is the *Commercial* General Liability policy.)

Other types of liability insurance coverage that should be purchased by the tenant include: commercial automobile insurance including Owned (if any), Hired and Non-Owned Autos; Workers’ Compensation and Employers’ Liability, as required by state law; and Umbrella or Excess Liability. It is this last coverage that provides meaningful limits of insurance coverage. For small tenants with exposure to the public, \$3 million to \$10 million per occurrence may be a reasonable minimum amount of insurance coverage to be provided. For a tenant occupying a large space for the purpose of public assembly, such as a restaurant, hotel or movie theater, the appropriate amount of liability insurance may be higher.

[16.3] IV. LANDLORD’S VIEW

The Landlord does not want exposure for claims due to Tenant’s occupancy of their premises, especially given that today’s losses will have a negative impact on Landlord’s future premiums.

Typically, the Landlord/Owner is ultimately responsible for the care and upkeep of its property; therefore if anyone is injured on that property, the Owner will bear at least a share of the liability. Since the Landlord usually carries the majority of this public risk and may often be seen as the “deep pocket” they seek to have the Tenant carry the broadest liability coverage possible to minimizing the exposure of loss to their own policies by transferring the risk back to the tenant’s insurer.

Landlord should require Tenant to name them as an additional insured on a primary basis under the tenant’s policy. It is *extremely* important to note (and an often misunderstood concept) that certificates of insurance

(most notably the ACORD 25) *do not* in themselves give the landlord Additional Insured status under the tenant's policy. This can only be accomplished by having the tenant contractually agree to indemnify the landlord and to name Landlord as Additional Insured, and only then by obtaining an endorsement to the tenant's actual liability policy. There are dozens of Additional Insured endorsements and some provide better coverage than others; however the three basic means by which to convey liability coverage to the Landlord in an insurance policy are:

1. Broad Additional Insured language, contained in some liability policies, extends Additional Insured status to anyone to whom the insured has agreed, in a *written contract*, to extend coverage, provided this obligation is made prior to the loss.
2. Similar to number 1, a blanket Additional Insured Endorsement amending the policy to add a class or type of counter parties (i.e. owners, mortgagees, contractors, etc.) as Additional Insureds when required by a *written contract*.
3. A specific Additional Insured Endorsement, naming a specific person or entity as Additional Insured can be attached to the tenant's policy.

The first item requires review of the tenant's liability policy. The next two can be evidenced on the actual endorsement. The last, the indemnification agreement, is crafted by the landlord's attorney. The carrier will usually defend any "Additional Insureds" that have been properly endorsed onto a policy granting such status to another party.

Caution: Additional Insured status extending coverage from the tenant's liability policy to the landlord typically only responds to a liability caused by the tenant at that location. The landlord's liability should still be covered only through a policy that specifically names the landlord as a "Named Insured."

In addition to the liability coverage, a Landlord would generally want a Tenant to get back into business following a loss, whether the loss is direct property damage, a business interruption or both. It's good business for the sake of continuity, and it saves the leasing costs and commissions involved in signing a new tenant as well as avoiding a loss of rents following restoration. Further, the Landlord does not want suits from its Tenants

for their property damage (i.e. water main breaks and floods the building and tenant sues for negligent maintenance). Therefore, a Landlord will require the Tenant to carry property insurance on all of its improvements, betterments and business personal property and should state in the lease that the tenant's sole right of recovery for damage to its personal property within the demised premises should be against its own property and business income insurer(s).¹

[16.4] V. OTHER CONSIDERATIONS

[16.5] A. Indemnity Agreement

It is important for every lease to have an indemnity clause establishing the liabilities of each party, and to understand those clauses prior to establishing the insurance provisions.² Also keep in mind that a general liability policy still only covers bodily injury and property damage, and has many other exclusions, so the indemnity clauses in the lease should not be limited "to the extent of liability insurance." The intent of requiring the liability insurance in a lease is to transfer the indemnities assumed by one company (landlord or Tenant) to its insurers' balance sheet. Contractual liability coverage is included under the current edition of the ISO CG 0001 form, and it will provide coverage for the contractual indemnities assumed (unless excluded elsewhere in the policy). This grant of coverage for the assumption of the tort liability of another party can be especially critical if the Landlord failed to secure appropriate Additional Insured status from the Tenant, as a standard Commercial Liability Policy that provides limited contractual liability will cover an agreement in the lease that "the tenant will indemnify the landlord for any and all liability costs and expenses emanating from the tenant's use and occupancy of the premises and that of their employees, agents and invitees, etc."

[16.6] B. Self-Insurance by Tenant

If a tenant customarily self-insures certain risks, it will request that this practice be acceptable in terms of meeting the lease requirements. In some cases it is a good idea to have parties claiming to be self-insured to demonstrate that they are truly self-insured and not merely self-assuming the risk. This may include a review of the parties' self-insurance program or, in some cases, certification that they are self-insured and approved by a State Insurance Department. Typically, the landlord will permit self-

1 See Waiver of Subrogation, § 16.9, *infra*.

2 See Ch. 4, "Model Commercial Lease," which sets forth sample language.

insurance only if the tenant maintains a minimum net worth requirement, but even then the landlord should proceed with care noting these cautionary scenarios:

- The tenant, a supermarket chain, provided the anchor in 18 of the client's 21 strip centers. Their leases provided for a \$250,000 General Liability Self-Insured Retention so long as the tenant's net worth exceeded \$100 million. (It was \$130 million at the time of signing.) Several years later, after a leveraged buy-out, the net worth disappeared and the balance sheet reflected top-heavy debt sitting over negative net worth. As this was a key tenant, the landlord was powerless to enforce this minimum net worth provision.
- The tenant had a net worth of \$1.9 billion and the client's counsel was pleased, having negotiated a minimum net worth requirement (in order to self-insure) of \$200 million. Imagine the disastrous operating losses that would diminish the net worth by \$1.7 billion! Where in the pecking order of payments for payroll, to vendors, etc., would payments to third-party claimants stand? Further, what attorney would want his or her client, the landlord, to be forced into the shoes of the liability insurer?
- The client owned and operated several community strip centers anchored by major chain stores. The client's centers were too small to support a full-time on-site employee, so most claims were reported to the management of the anchor store. Knowing of their SIR, and not wanting the cost to hit his store, the manager would on occasion [mis]-report the location of the claim from their demised premises to a common area, transferring the liability and defense costs to the landlord.

[16.7] C. Tenant's Share of Insurance Costs

In cases where the tenant pays part of the landlord's insurance costs as part of their common area maintenance (CAM) charges, the CAM charges should be expanded to include, but not be limited to:

- Service fees paid to brokers, consultants, and third-party administrators;
- Premiums for coverages and limits reasonably deemed necessary by landlord;

- Allocated costs derived from master policies with blanket coverages for numerous properties within a portfolio.

This is especially important if the use of contingent fee CAM auditors has not been precluded, as they tend to contest every single charge, due to the nature of their compensation. Even when the above fees are fair and reasonable, we have seen such auditors argue that they are not expressly allowed to be charged back under the lease agreement.

[16.8] D. Net Leases

Whereas an owner's insurance is coverage-oriented, designed to provide the most comprehensive coverages available, net tenants (especially on triple net leases) are often cost-driven. It therefore becomes extremely important to specify that the tenant fulfill the same insurance requirements as the landlord would for itself. Annual audits by the Landlord to ensure compliance are extremely important to protect Landlord as policies are renewed and changed by Tenants. We also recommend the Landlord maintain contingent coverage for itself in the event Tenant's policy fail to respond as expected to any given claims scenario (i.e. Tenant's carrier denies all coverage for a claim due to a Tenant's misrepresentation).

[16.9] E. Waiver of Subrogation

In most leases the Landlord and Tenant should agree to a waiver of their rights of recovery against each other for damage to the property of the other. Virtually all property policies permit this as part of their standard forms, but the actual waiver of recovery must be accomplished within the lease. Also, keep in mind that in most jurisdictions, the waiver must be mutual in order to be enforceable.

The first reason to waive subrogation is to reduce litigation; both parties are being made whole by the property insurance they are choosing to carry on their assets. The other party should not be a "lifeline" if they failed to carry appropriate coverage. Further, the Landlord benefits from the financial viability of the Tenant in their continued ability to pay rent, why disrupt that with litigation if the Landlord has been made whole by insurance (especially if the Tenant is contributing to the cost of Landlord's insurance through CAM charges). The Tenant, on the other hand, is in the best position to insure and protect its assets, and by holding the Landlord responsible would likely only increase rent charges over time as Landlord would determine to insure this added risk.

[16.10] F. Rents Insurance

Rents insurance is one of the most misunderstood clauses within a property insurance policy. Many documents (leases, mortgages, etc.) frequently contain a requirement that the other party maintain rents coverage for 12 months. Since underwriters need a base upon which to apply a rate for premium purposes, the insured will normally submit income values 12 months of rental income.

Most commonly the coverage in force is provided on an Actual Loss Sustained basis (the most desirable form), which provides ongoing indemnification for loss of rents until such time, with the exercise of due diligence and dispatch, as the premises are restored to the condition immediately prior to the loss (subject to the limit of coverage in the policy, but not limited to its expiration date). Parties should be wary of any policy that caps the period of indemnity (i.e., the period of time the carrier will pay for loss of income coverage during rebuilding). A partial loss, or total loss of a small structure, may only take six months to restore, but a large loss in October in the Snow Belt might take the insured through two winters to rebuild. Further, in cases like significant hurricane devastation, where there may be a shortage of materials, contractors and a labor force post-loss (demand surge), some rebuilding can take years.

Parties can also include under their coverage an “Extended Period of Indemnity,” which provides for a period of time of continued coverage for a loss of business income following restoration (subject to limits). Landlords may require this of Tenants in the event it takes them some time to return their business to pre-loss levels. This coverage is also strongly recommend for Landlords who may find unfavorable market conditions if a loss causes them to lose their tenants.

The governing clause in the lease as to which party is to provide rents insurance is the abatement clause. If the rent abates at time of loss, then the landlord should provide the insurance coverage. A tenant’s insurer will not pay for rents if its insured has no legal obligation to continue to pay Landlord (i.e., abatement of rent upon casualty). In the converse, if rents do not abate, the tenant should be maintaining this insurance and landlord should have a right to the proceeds (as a loss payee).

[16.11] G. Improvements and Betterments (I&Bs)

Typically, tenant-installed improvements and betterments are insured by the tenant, especially since the landlord may not even know their value

and the tenant's insurance policy will replace, by the terms of the policy, the destroyed property following a casualty. These I&Bs are the build-out of the space, slab-to-slab and wall-to-wall. Removable property (desks, copy machines, files, stock and supplies) are considered personal property, not I&Bs. Should the tenant decide not to rebuild the I&Bs, the tenant's policy only pays the depreciated or remaining asset value. If the I&B were installed as part of a 20-year lease and one year remained on the lease and the improvements were not restored, the policy might well pay only 5 percent of the replacement cost.

Regardless of the ownership and restoration clause in the lease, the owner should have in place a property insurance policy that states, "Improvements and betterments shall be deemed the property of the insured, any lease or contract to the contrary notwithstanding, and any loss shall be so adjusted." This feature, along with a top-flight replacement cost endorsement, can provide Landlord contingent coverage if Tenant fails to restore I&B and can give a landlord a decided competitive advantage when rebuilding in terms of offering prospective tenants fully improved space.

[16.12] H. Leasehold Interest

In cases where advantageous long-term leases, were signed at the bottom of a rental market the tenant may have a greater financial (and therefore insurable) interest in the premises than the owner. Tenants can insure the value of their leasehold interest under their property policies. A case in point involved an upscale beauty salon in midtown Manhattan. The entire 13,000 square foot building was leased in the mid-1970s at \$8 per square foot with four 12-year renewal options escalating at 25¢ per square foot increments to reach \$9. As the leasehold interest grew, the tenant purchased leasehold interest insurance by engaging the services of a rental appraiser and insuring the discounted present value of the difference between the projected fair rental value into the future and the lease obligations. The building was later completely destroyed by a fire, the tenant collected \$6 million and the landlord, only \$2 million.

[16.13] I. Demolition and Increased Cost of Construction

The typical replacement cost clause in a property policy provides for replacement with "like materials and workmanship." If, however, the local building codes have been tightened since original construction or, for example, the Americans with Disabilities Act points to certain non-conforming uses, then the additional cost to rebuild to code may be excluded

or limited. In the event of a significant partial loss of a building where local code officials require part or the entire undamaged portion of the building to be torn down and reconstructed, coverage under the policy will also be limited to the coverage available under this clause. This is especially important to a landlord in a net lease on an older or historical building.

Whether the building insurance is provided by the landlord or the tenant, it is important to obtain the broadest possible language for these enhancements. The standard ISO (Insurance Services Office) form provides only for compliance with minimum requirements in force at the time of loss. Following Hurricane Andrew in Florida and the Northridge, California, earthquake the affected localities passed much more restrictive building codes. Thus, when possible, the wording in this clause should be expanded to refer to all laws regulating rebuilding in effect at the time of reconstruction.

[16.14] VI. SUMMARY

There is not a “one size fits all” when negotiating the insurance provisions in any legal document. Parties must understand the structures of their own insurance programs, available coverages, and policy endorsements, and have a strong understanding of the deal’s business terms. A failure to do so could result in assuming more liability of exposure than intended or, worse, assuming uninsured exposures. That could result in an unprofitable commitment.

The legal and risk management teams should work together to understand the overall goals and risk tolerance acceptance to the deal. They should then draft clear language outlining the responsibilities of each party and ensure that the agreement allows for the enforcement of those responsibilities. The purpose of insurance is to deal with the unexpected. Make sure your contracts and leases don’t overlook unexpected events.

CHAPTER SEVENTEEN

**REAL PROPERTY TAX
CONSIDERATIONS FOR
LANDLORDS AND TENANTS IN
NEGOTIATING LEASES OF
COMMERCIAL PROPERTY**

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[17.0] I. TENANT ANALYSIS OF PROPERTY TAX CONSIDERATIONS PRIOR TO ENTERING INTO LEASE

The fundamental question for tenant's counsel in reviewing a commercial lease is whether or not the lease places any obligation for payment of real property taxes and assessments on the tenant. In a gross lease transaction, the landlord will bear the expense of real property taxes. In a true "net lease," the tenant will bear the cost directly. However, in the majority of instances involving commercial leases, liability for real property taxes falls somewhere between the two, with the landlord bearing the expense up to a certain base amount and the tenant bearing the expense for property taxes either relating to the improvements made upon the leased premises by or for the benefit of the tenant, or for all increases over a certain base amount. Such provisions are frequently referred to as tenant escalation clauses.

In the case of either a "net lease" or a lease involving an escalation clause, the lease should address several different concerns: the current base tax figure used in the escalation computation; the scope and type of improvements that would result in an escalation in taxes for which the tenant is liable; the history and computation of real property taxes for the subject parcel; and rights to grieve the assessed value of the leased property under Article 5 of the N.Y. Real Property Tax Law (RPTL) and, if necessary, to challenge the assessment through litigation under Article 7 of the RPTL.

[17.1] A. Basic Property Tax Terminology

The term "real property taxes," as the term is most often used in New York, refers to general municipal (county and town, city, or village) taxes and school district taxes imposed on a parcel of real property. The real property tax is an ad valorem tax, insofar as it is levied against all taxpayers within the municipality and school district (the "taxing jurisdictions") according to the proportionate share of the value of each parcel of property to the overall value of all properties within the taxing jurisdictions. However, the term real property taxes is often referred to in a more general sense, to also include special ad valorem taxes and special assessments (which are sometimes referred to as "charges"), all of which are generally reflected on the tax bill, but not characterized as real property taxes, per se.

A special ad valorem tax is “a charge imposed upon benefited real property in the same manner and at the same time as municipal taxes to defray the cost of a special district improvement or service . . . on a county or citywide basis and, like a tax, does not consider any direct benefit received by an individual parcel.”¹ Special ad valorem levies may include charges for water and sewer districts, highways, library districts, lighting districts, fire districts, and other municipal services for public works improvements.

Special assessments, “on the other hand, are impositions upon benefited real property in proportion to the benefit received by such property to defray the cost of a special district or service” that relate to the benefit received by a particular property from an improvement.²

For purposes of this article and the discussion of real property tax implications in the commercial leasing context, the terms “taxes” and “real property taxes” will include special ad valorem taxes and special assessments unless otherwise noted.

[17.2] B. Base Tax Year Considerations

Whether a lease is a “net lease” such that the tenant bears all real property tax liability, or the lease imposes liability on the tenant for increases beyond a given base year, tenant’s counsel should carefully review and consider the base year that is being used to compute the tenant’s tax liability. In either event, the tenant will be liable for increases in real property taxes in some manner. In the net lease scenario, the tenant must understand that all assessment increases affecting the tax parcel in question, whether the result of an increase in assessment based upon revaluation by the assessor, an increase in tax rates, overall market conditions, or improvements made to the leased premises, will result in an increase in real property tax liability.

Landlords and tenants must also be cognizant of the consequences of assessments applying to tax years which are not calendar years. For instance, the assessment roll filed on or about July 1 in most towns in New York State sets assessments which are used to determine the school tax from July 1 until the following June 30 although the school tax bill is generated on or about September 1. The county and town tax bill based on the same July 1 assessment roll is issued on or about January 1 of the fol-

1 Warren’s Weed, *New York Real Property* § 133.03 (2014).

2 *Id.*

lowing year, and applies to the period from January 1 through December 31 of the year *after* the July 1 assessment roll. Accordingly, the assessment roll applies to certain taxes over an 18-month period. But, more troublesome is the situation where, due to a revaluation or other circumstance, a property assessment changes on a successive July 1 tax roll. In such instance, during one calendar year the school tax is based on one assessment and the county and town tax is based on an entirely different assessment. The use of the calendar year as the base year, therefore, is fraught with peril. If the lease is executed prior to July 1 of the base year, it may be difficult or impossible to estimate what the base tax amount will be. Even if the property tax amounts that will constitute the base are known, the failure to understand the timing and impact of assessed value could have drastic negative consequences for a tenant. For a tenant, such a misunderstanding, especially in a lease escalation clause, could result in a large escalation payment commencing in year two of the lease term.

[17.3] C. Scope and Type of Improvements Resulting in Tax Escalation Liability for Tenant

In the case of a lease including a property tax escalation provision, the tenant should carefully define what improvements resulting in an increased assessment will result in property tax liability for the tenant. For instance, where the leased premises will benefit from substantial buildout prior to, or after, commencement, the tenant may be able to negotiate such that the base year for escalation purposes will be the year after which the improvements are completed, which factors in the cost of such improvements. Alternatively, should the base year for escalation purposes be a year before the date such improvements are made, the tenant should anticipate an immediate and significant tax liability upon completion of the improvements (the buildout will increase the fair market value of the leased premises, which may result in an increased assessment). In some cases, the cost of buildout by the landlord will be included in the base year tax figure, with later improvements done by or at the request of the tenant giving rise to escalation.

[17.4] D. Tax Parcel History and Tax Computation Considerations

In reviewing potential increases in real property tax liability by the tenant in a net lease or tax escalation scenario, the tenant should review the past history of the property tax assessment for the subject parcel. For example, in the case where the assessment as of the year of commencement is the base year for escalation purposes (which would of course bear

true in a net lease scenario as well), the tenant should investigate the assessment to determine whether it may be artificially low as a result of a prior settlement or judicial determination in a tax certiorari proceeding brought pursuant to Article 7 of the RPTL. A settlement or judicial determination reducing the assessment in a year prior to commencement of the lease may have prohibited an increase in assessment. Note that pursuant to RPTL § 727, a three-year freeze is placed on an assessment following a judicial determination, including a court order approving a settlement. However, such a stay on property tax increases will no longer be effective in the fourth year following settlement, in which case the assessment may be subject to an increase.³

The landlord and tenant should also understand the concept of equalization rates and their impact on escalation provisions. Equalization rates are percentages computed by the New York State Office of Real Property Services (ORPS) to ensure that the taxing jurisdictions within the state equitably allocate the overall state tax liability among the many taxing jurisdictions. Equalization rates are the ratio of total assessed value in the taxing jurisdiction to the total market value of properties within the jurisdiction. Assessed values are determined by the taxing jurisdiction, and the total market value of properties is determined by the state. The equalization rate formula is:

$$\frac{\text{Total Assessed Value (AV)}}{\text{Total Market Value (MV)}} = \text{Equalization Rate}$$

In many taxing jurisdictions, assessments are considered to be at full value (i.e., the assessed value equals the fair market value of the property), with a corresponding equalization rate of 1.0. However, a number of jurisdictions bear equalization rates of lesser percentages. In such instances, the assessed values for properties within the taxing jurisdiction are a percentage of the actual fair market value. Regardless of the equalization rate, in any year in which a revaluation does not occur, the actual equalization for a property will vary because assessments normally remain

3 RPTL § 727(1) provides that, “where an assessment is found to be unlawful, unequal, excessive or misclassified by final court order or judgment, the assessed valuation so determined shall not be changed . . . for the next three succeeding assessment rolls prepared on the basis of the three taxable status dates next occurring on or after the taxable status date of the most recent assessment under review.” Although the statute only pertains to final order, where the parties to the action incorporate the terms of Section 727 in the stipulated order pursuant to settlement, the same terms apply. See *In re Malta Town Ctr. I, Ltd v. Town of Malta Bd. of Assessment Review*, 3 N.Y.3d 563, 789 N.Y.S.2d 80 (2004).

static while actual fair market value changes. Historically, values have tended to increase over time. However, in the recessionary times beginning in the summer of 2008, values in many areas of New York State have fallen by 30 to 40 percent. In situations where the rate lowers but fair market values of commercial properties do not increase, the lower rate will still tax the property as if the value did increase. Where values of commercial properties have precipitously declined, the implications on equalization rates and upon actual value of the property assessed can create unintended consequences in a lease setting. As values decrease and assessments remain static, the equalization rate rises. The lower the equalization rate in the taxing jurisdiction in which the leased premises is located, the more volatile the value is, insofar as significant increases in value may occur with no increase in assessed value and, therefore, the commercial property owner may bear a disproportionate tax burden to properties assessed at their actual fair market value. In either event, an analysis as to whether assessments should be challenged and who has the right to commence the challenge come to the forefront.

Sophisticated tenants should determine the fair market value of the leased premises and, where applicable, the overall tax parcel in which the leased premises is located, and compare that value with the assessed value. In the event that the fair market value exceeds the current assessed value, the tenant should be concerned with a potential increase in the assessed value during the lease term.

A further consideration for the tenant in a “net lease” or escalation scenario is the allocation of tax liability between multiple tenants within the tax parcel of which the leased premises is a part. In a multiple tenant scenario, the tenant’s liability should only relate to the percentage of value pertaining to the tenant’s leased premises. Increases in assessed value relating to the premises of other tenants should not be included within the subject tenant’s tax obligations. In addition, the tenant’s percentage of tax liability should be computed as a percentage of the tenant’s leaseable square footage of the premises. If the tenant’s liability is a percentage of the actual leased square footage of the overall tax parcel, the tenant will ultimately bear a portion of the tax liability relating to vacant portions of the overall tax parcel.

[17.5] E. Tenant Rights to Contest Tax Assessments Through Grievance and Litigation Processes

[17.6] 1. Primer on Administrative Review and Tax Certiorari Proceedings

Where a tenant will bear liability for all or a portion of real property taxes throughout the term of the lease, the lease agreement should include a provision giving the tenant the right to contest the real property tax assessment for the leased premises. All of these rights granted should be understood in the context of what challenging an assessment includes. While the following treatment is not meant to be an exhaustive analysis of the procedures, it provides an outline of some minimal points to be aware of.

First, a party that is aggrieved by a real property tax assessment must seek administrative review and exhaust all such remedies before proceeding to the courts.⁴ This administrative review procedure is set forth in RPTL § 512.

With some exceptions, assessing units will issue their tentative tax assessment rolls on May 1 of each year. Real Property Tax Law § 510 requires assessors to notify any property owner whose property tax assessment has been increased, or if a change has been made regarding property tax exemptions applying to the property. Typically at this time, the assessor will provide notice to the property owner of the dates and times when the assessing unit's Board of Assessment Review (BAR) will convene to hear any grievances. Any property owner may file a grievance with the BAR, in a form provided by the ORPS on or before the appointed grievance date.⁵ The grievance form must be signed by the property owner or an authorized representative and certified as accurate.⁶ Although little information regarding the complaint is required on the form, it is often in the property owner's interest to provide additional documentation supporting the claim that the assessment is excessive. Appearance before the BAR at the grievance proceeding is often recommended, though not

4 Lee & LeForestier, *Review and Reduction of Real Property Assessments in New York* § 2.01, p. 63 (3d ed. 2000) (citing *Sterling Estates v. Bd. of Assessors of County of Nassau*, 66 N.Y.2d 122, 495 N.Y.S.2d 328 (1985)).

5 RPTL § 512.

6 Grievances of assessed values for properties located in the City of New York must be made on the documentation required by the City and must be verified by a person having knowledge of the facts stated therein. RPTL § 523.

required, unless the BAR notifies the property owner that a personal appearance is required. The BAR may also require that the grievant provide other types of documentation relating to the value of the property. This may include any recent appraisals, information on recent capital improvements, information relating to recent sales, leases, or marketing efforts for the property, or any number of other items. The key concept for the grievant to be aware of is that failure to appear when requested and a willful failure to provide requested documentation is not only grounds for dismissal of the grievance, but may be grounds for dismissal of a subsequent certiorari proceeding under RPTL Article 7.

The BAR may issue a response, to either lower or leave unchanged the assessed value, at the grievance proceeding, but often reserves decision and notifies the grievant afterward.⁷ The assessor will modify the assessment according to the decision of the BAR and issue the final tax roll.

If a property owner is still aggrieved by the assessed value, and the property owner has proceeded through the grievance proceeding set forth in RPTL Article 5, it may Petition the Supreme Court for a writ of certiorari to review the assessment pursuant to RPTL Article 7.⁸ Such a proceeding is commenced by filing a verified Petition and Notice of Petition, alleging the manner in which the assessment is excessive, unequal, unlawful, or misclassified, the extent to which the petitioner will be injured thereby, and the result of administrative review proceedings under RPTL Article 5.⁹ Filing of the Petition is subject to a strict statute of limitations, requiring the Petition and Notice of Petition to be served within 30 days of the later of the date of publication of completion and filing of the final tax roll, or such date fixed by law for completion of the final tax roll.¹⁰

The assessed value in an Article 7 proceeding bears a presumption of validity which must be overcome by proof provided by the petitioner.¹¹ Generally speaking, an Article 7 proceeding will proceed much in the manner of other litigation proceedings. However, there are several unique attributes to an Article 7 proceeding:

7 RPTL §§ 520, 701.

8 See below for a discussion of whether or not a tenant qualifies as an aggrieved person.

9 RPTL § 706(2).

10 RPTL § 702(2).

11 RPTL § 1134.

- *Filing of Income and Expense Statements.* For proceedings outside of the city of New York, prior to filing a Note of Issue, the petitioner must serve a certified statement of the income and expenses of the property for each year under review in the proceeding, or a certified statement that the property is not income producing.¹² Within the city of New York, the same requirement applies; however, the income and expense statement must be completed on the form provided by the Tax Certiorari Division of the Office of Corporation Counsel.¹³
- *Filing of a Note of Issue.* Once discovery is complete, a Note of Issue must be filed to place the matter on the trial calendar. However, in Article 7 proceedings, the Note of Issue must be served and filed within four years from the date of service of the Petition and Notice of Petition unless the parties stipulate to an extension or the court so orders on good cause shown.¹⁴ This rule is strictly applied, and failure to do so will generally constitute dismissal of the action. However, a Nassau County Court attempted to soften this rule by establishing a creative analysis of what could constitute a stipulation to revive an action that had been so dismissed.¹⁵
- *Exchange of Appraisal Reports.* A unique attribute to Article 7 proceedings is the exchange of appraisal reports by the petitioner and the respondent.¹⁶ The appraisal reports constitute the most critical evidence in most Article 7 proceedings, and their preparation is of utmost importance because the testimony of the appraiser as expert witness will generally be limited to the facts alleged in the report. It is also often a costly step in an Article 7 proceeding, and the parties will frequently pursue settlement vigorously prior to engaging appraisers. For proceedings outside of the city of New York, such discussions are frequently facilitated by a pretrial conference, which may be demanded by any party or mandated by the court.¹⁷ Upon the exchange of appraisals, Article 7 proceedings will often proceed to trial swiftly if settlement is not reached.

12 22 N.Y.C.R.R. § 202.59.

13 22 N.Y.C.R.R. § 202.60.

14 RPTL § 718(1).

15 *Transtechology Corp. v. Board of Assessors of the County of Nassau*, 21 Misc.3d 215, 864 N.Y.S.2d 826 (Sup. Ct., Nassau Co. 2008), *aff'd*, 71 A.D.3d 1034, 897 N.Y.S.2d 494 (2d Dep't 2010).

16 22 N.Y.C.R.R. § 202.59(g); 22 N.Y.C.R.R. § 202.60(g).

17 22 N.Y.C.R.R. § 202.59(e).

- *Relief.* In the event that the petitioner is successful, the court will order refunds to be paid on taxes over and above the fair market value of the property as determined by the court.¹⁸ The petitioner will be entitled to the payment of interest at the statutory rate on such refunds from the date of payment of taxes through the date of the order.¹⁹ Costs may be awarded to a successful petitioner where the reduction is equal to or greater than half of the reduction sought by the petitioner in the prior grievance proceeding, or at the discretion of the court.²⁰
- *Restriction on Future Increases.* Pursuant to RPTL § 727, after a final judgment of the assessed value is entered, the assessing municipality may not increase the assessment, and the petitioner may not challenge the assessment for the following three assessment rolls unless there is (i) a revaluation or update of all real property on the assessment roll or of similar class in a special assessing unit, (ii) there has been a physical improvement to the property, (iii) the zoning for the property has changed, (iv) the property has been destroyed or altered by a catastrophic event, (v) the government has taken action which has caused a discernible change in area values, (vi) the occupancy rate of the building has changed by 20 percent or more, (vii) the owner is no longer eligible for an exemption, or (viii) the use or classification of the property has changed.²¹

[17.7] 2. Lease Provisions Relating to the Right to Contest Real Property Taxes

In order for a tenant to have the right to commence either an administrative review proceeding with the Board of Assessment Review for the taxing jurisdiction pursuant to RPTL § 524 or a Tax Certiorari Petition pursuant to RPTL § 704, the lease must explicitly state that the tenant has the right to bring such a proceeding. Such provision should include an obligation of the landlord to provide the tenant with all notices relating to tentative and final assessments on the property. However, tenants should be aware of the timing for posting of the tentative tax roll, Board of Assessment Review hearing dates, and the outside date for bringing a certiorari action (within 30 days following posting of the final tax roll).

18 RPTL § 726.

19 RPTL § 726(2).

20 RPTL § 722(1).

21 RPTL § 727.

It should be noted that a tenant's ability to bring an action to contest real property taxes has been reviewed extensively by the courts. Where a nonfractional tenant (i.e., one leasing the entire property interest comprising the tax parcel in question) is bound by the lease to directly pay the entire tax assessment on behalf of the landlord, the tenant will have standing to commence a tax certiorari proceeding.²² This is the case even if the lease does not contain a provision expressly granting the tenant the right to commence an action contesting the assessment.²³

With respect to fractional tenants, the analysis is more involved to account for the potential conflicts in granting standing to multiple parties to contest a single assessment. In *Waldbaum Inc. v. Finance Admin. of City of New York*,²⁴ the Court of Appeals set the standard under which a fractional commercial tenant may bring a tax certiorari proceeding. In that case, the tenant, Waldbaum, Inc., was a fractional tenant in premises for which the landlord paid all real property taxes. Under an escalation clause, Waldbaum was obligated to pay additional rent equal to its pro rata share of the taxes in excess of a base tax amount. However, Waldbaum's tax payments to the landlord were to reduce any additional rent paid to the landlord under a percentage rent provision. Unless the tax payments exceeded percentage rent, the net tax liability to the tenant, Waldbaum, would be zero. The court held that, in order for a fractional tenant to have standing to bring a tax certiorari proceeding, a lease must either (i) give a fractional tenant the right to assert the landlord's "undivided" property interest in a tax certiorari proceeding, or (ii) require the tenant to directly pay the entire, undivided, tax bill.²⁵ The court further held that, even if one of these standards is met, the tax assessment must have a direct adverse effect on the tenant's "pecuniary interests."²⁶ Because Waldbaum was not obligated to pay the entire tax bill affecting the leased premises and had no contractual right to bring an action to contest the entire tax assessment, the court held that it lacked standing.

22 See *In re Burke*, 62 N.Y. 224 (1875).

23 See *EFCO Products v. Cullen*, 161 A.D.2d 44, 560 N.Y.S.2d 158 (2d Dep't 1990) (also holding that payments in lieu of taxes required to be made by a tenant where the property is owned by an industrial development agency, and thus technically exempt from property taxation, are equivalent to property tax payments for purposes of determining the right to contest an assessment).

24 74 N.Y.2d 128, 544 N.Y.S.2d 561(1989).

25 *Id.* at 132.

26 *Id.*

The court in *Waldbaum* further held that the provision requiring a reduction of percentage rent by the amount of taxes paid by the tenant negated Waldbaum's argument that its pecuniary interests were adversely affected by the tax escalation provision.²⁷ The court found that such adverse effect was "legally remote and only consequential," because of the possibility that there would be no net tax liability on behalf of the tenant if percentage rent were to exceed the pro rata tax obligation of Waldbaum.²⁸ As a result, in drafting a provision on behalf of a fractional tenant authorizing the tenant to contest the assessment or to pay the entirety of the tax bill, one should understand that if another provision in the lease entitles the tenant to a set-off of its tax liability against rent, that set-off may preclude the tenant from bringing a certiorari proceeding.

Although the tenant in *Waldbaum* was denied standing, the rule has been followed to grant standing to tenants where the lease included the right to commence a tax certiorari proceeding.²⁹

The courts have held that a provision granting the right to contest property tax assessments in the landlord's name is sufficient to satisfy the *Waldbaum* test, even if the lease provision does not expressly state that the tenant's right extends to the landlord's "undivided interest."³⁰ There, the court found that the language "in lessor's name" was sufficient to establish the right to assert the lessor's undivided interest.³¹

Practice Tip: A tenant needs to be wary of a right to bring an action in which it may not be able to meet discovery demands of the municipality or provide necessary information to its own appraiser. In the event the tenant has such right to contest the assessment, its duty will be to appraise the value of the entire tax account number, not just the rental parcel, and all information relevant to all uses and tenants of the property are both discoverable by the municipality and relevant. Therefore, a clause requiring the landlord to cooperate fully with discovery if a tenant is prosecuting an assessment is both appropriate and necessary.

27 *Id.* at 135.

28 *Id.*; see also *C&P Partners v. Dep't of Assessment & Taxation of City of Albany*, 192 Misc. 2d 139, 744 N.Y.S.2d 829 (Sup. Ct., Albany Co. 2002).

29 See *Ames Dep't Store, No. 418 v. Assessor of Town of Greece*, 261 A.D.2d 835, 689 N.Y.S.2d 791 (4th Dep't 1999); see also *Caldor, #30 v. Town of Ramapo*, 253 A.D.2d 876, 678 N.Y.S.2d 508 (2d Dep't 1998).

30 *K-Mart Corp. v. Bd. of Assessors of Co. of Tompkins*, 176 A.D.2d 1034, 575 N.Y.S.2d 185 (3d Dep't 1991).

31 *Id.*

The right to commence an administrative review proceeding pursuant to RPTL § 524(3) has been held to require the same standards as the right to commence a tax certiorari proceeding.³²

The provision relating to real property tax actions should be clear as to who will bear what portion of the litigation expense. This is especially important in multiple tenant scenarios. In such cases, the tenant should be aware of the rights of other tenants in the premises to ensure that the tenant's future tax liability will not be controlled by other tenants within the overall tax parcel.

Where the tenant is unable to negotiate the right to contest the assessment in the event that the landlord or another tenant elects to do so, the lease should include language to the effect that the tenant will be entitled to its share of any refunds. This right should survive termination or expiration of the lease in the event refunds on taxes paid during the lease term are not paid until after termination or expiration. In addition, it should be noted that the parties controlling an Article 7 proceeding may elect to settle the proceeding by prospective relief, in the form of reduced assessments for a period of time following settlement, rather than refunds. Such a settlement may be governed by the terms of RPTL § 727 as noted above. Therefore, where the lease does not provide the tenant the right to control an Article 7 action, but does require the tenant to bear a portion of the tax liability, the tenant should seek to have the lease obligate the landlord to not only pay the tenant its proportional share of any refunds (even if received after the term of the lease has expired), but to pay the tenant its proportional share of refunds that would have been paid but are not because the party controlling the action accepts as prospective relief an assessment reduction for tax years beyond the lease term.

In defining the tenant's proportional share of any refunds, care should be taken to make certain it equals the tenant's proportional share of its tax liability under the lease. That may be based solely on the tenant's pro rata share of the overall tax liability, based on the ratio of the square footage of the overall leasable area to the tenant's leased premises, but, in the case of an escalation provision, it also may take into account the extent to which tax increases relate to improvements to the tenant's premises.

A tenant should seek to negotiate representations and warranties from the landlord that it will timely pay all taxes due. In the event the landlord

32 7 Op. Couns. SBEA No. 123 (a shopping center tenant who was obligated pursuant to the lease to pay taxes had the right to bring an administrative review proceeding).

fails to pay, that failure can threaten the tenant's quiet enjoyment of the leased premises. The tenant may, therefore, seek the right to pay taxes directly if the landlord fails to do so and to have a corresponding right of setoff against rent. A landlord, on the other hand, if there is an excessive assessment on the property, may as a practical matter choose not to pay the taxes while it seeks to have the taxes lowered.

It must be remembered that there is no right in New York State to pay less than the full amount of tax due during the period of time in which an assessment is being challenged.³³ Therefore, the landlord must either pay the whole amount of taxes due or nothing at all, and if no payment is made, the property may be subject to tax foreclosure despite the pendency of an action contesting the real property taxes.³⁴ In the instance of an actual tax foreclosure for nonpayment of taxes, a landlord may have a reason to allow the tax foreclosure to proceed where, for example, the outstanding property tax liability exceeds the value of the property. A tenant should consider this issue in light of the fact that most leases contain provisions limiting the landlord's exposure for damages sustained by the tenant to the landlord's interest in the leased premises, and may not extend to other assets of landlord. If that interest is so diminished by a tax foreclosure, the tenant will be without recourse against the landlord. This is yet another reason why a tenant should negotiate a right to make payment on the landlord's behalf with a corresponding set off against rent, and if the rents remaining under the lease are exceeded by the amount of the tenant's payment on the landlord's behalf, a contractual right to seek damages from the landlord.

[17.8] II. LANDLORD'S ANALYSIS OF REAL PROPERTY TAX CONSIDERATIONS PRIOR TO ENTERING INTO LEASE

[17.9] A. Real Property Tax Escalation Clauses

When viewing tax escalation clauses from the landlord's perspective, one should be cognizant of the same general issues as when viewing on behalf of the tenant. Landlords will generally desire to have the base year for escalation purposes exclude the tenant's improvements and buildout expenses. The lower the base year assessed value, the greater the tenant's tax liability will be. In addition, the landlord may be better served by

33 RPTL § 704(3).

34 See *W.T. Grant Co. v. Srogi*, 52 N.Y.2d 496, 438 N.Y.S.2d 761 (1981).

defining the base year in terms of property tax dollar amounts rather than assessed values. In so doing, the landlord is able to defer liability to the tenant where property tax amounts increase, even where assessed values do not or are not the sole factor resulting in such increase. For instance, where property tax amounts increase as a result of an increase in tax rates, the tenant would be liable for such increases. From the landlord's perspective, the property tax escalation provision should relate to all charges based upon the assessment, not just real property taxes.

[17.10] B. When Landlord Contests Property Tax Assessments

Unless the landlord has contracted to give away the right to bring an assessment proceeding to a tenant, the landlord always retains a right to challenge tax assessments. In general, where a landlord is not leasing a single-tenant property on a "net lease" basis, the landlord will want to control litigation with respect to the affected tax parcel. If a landlord grants a tenant too much control, the tenant's actions may adversely affect other tenants and the marketability of other space within the premises. In such cases, the lease should be clear that consulting, appraisal, and legal fees incurred by the landlord will be borne by the tenant to the extent of the tenant's applicable share of the tax liability, and will be chargeable as additional rent.

A unique consideration for landlords in evaluating the right to contest assessments relates to the impact of reduced assessments on the profitability of subsequent leases of the subject premises. If an assessment is reduced too aggressively, the landlord may be faced with resistance by a future tenant because the base year is considered too low and, therefore, likely to create too large a tax burden. For that reason, the landlord should consider reserving control over real property tax litigation, especially in the later years of the lease term.

In addition, the landlord may seek to include a provision in the escalation clause such that any reductions below the base assessment will result in a corresponding reduction in the base assessment. A tenant has no incentive to have the assessment reduced to an amount lower than the amount which would produce the equivalent of the base tax since that amount is paid by the landlord. On the other hand, the landlord would have an incentive to have even the base assessment reduced. In such instances, the landlord would want the tenant to pay based upon the reduced base. This is all a matter of negotiation and relative bargaining power.

[17.11] C. Interaction Between Rents And Real Estate Taxes

Whatever the extent of the tenant's property tax obligations under the lease, the landlord should take care to clearly identify any property tax and other payments, as well as costs of pursuing reductions in assessments through litigation, made to the landlord as additional rent. If not, the landlord will not be able to enforce payment by the tenant as a matter of contract under the lease. Such an outcome would obviously defeat the purpose of any clause relating to the tenant's obligation to bear a portion of the real property tax expense.

In addition, when drafting an escalation clause on behalf of the landlord, one should take care that the lease does not otherwise contain a cap on additional rent, or a provision by which additional rent paid pursuant to an escalation clause is "compounded" into base rent.³⁵

[17.12] III. PROPERTY TAX EXEMPTIONS AND ABATEMENTS AND THEIR IMPACT ON LEASE NEGOTIATIONS

Real Property Tax Law Article 4 outlines a wide variety of property tax exemptions available to owners of real property. In the commercial leasing context, many exemptions may be available to landlords in their capacity as owners, developers, or investors of commercial real property. However, several exemptions may be available to tenants, or should be considered by tenants in commercial leasing transactions, as the benefits, in the form of property tax savings or even reduced rental payments, can accrue to tenants. This section will outline several of those exemptions.

[17.13] A. Municipal Industrial Development Agency Exemption

Where property is owned by a municipal Industrial Development Agency (IDA) or is otherwise under its jurisdiction, control, or supervision, and is used in a qualified manner as defined in RPTL § 412a and General Municipal Law § 874, the property may be eligible for a real property tax exemption in the amount of 100 percent of all real property taxes due (excluding special ad valorem levies and special assessments). A tenant in a commercial lease transaction should be aware of the exis-

35 See *CBS Inc. v. P.A. Bldg. Co.*, 200 A.D.2d 527, 606 N.Y.S.2d 674 (1st Dep't 1994); see also *Kenilworth Realty Trust v. Bankers Trust Co.*, 112 Misc. 2d 523, 447 N.Y.S.2d 210 (Sup. Ct., N.Y. Co. 1982).

tence of such an exemption where title or a leasehold interest to the leased premises is vested in an IDA, or where the vesting of title or a leasehold interest in an IDA would be possible, as in certain single-tenant build-to-suit leases or leases to qualified single tenants.

As a threshold matter, in order to obtain the exemption, there must be an applicable IDA with jurisdiction over the municipality in which the real property is located. There are many IDAs throughout New York State, and a current list can be obtained through the ORPS. Each IDA that offers an exemption program has an established uniform tax exemption policy which establishes guidelines under which the exemption may be granted. In establishing such policy, an IDA must take into account its benefit on job creation and retention and other impacts on both existing and future businesses in the municipality, among other factors. In addition, the policy must address the impact of the exemption program on the local tax base. For this reason, the granting of such an exemption is frequently conditioned upon the property owner entering into a payment in lieu of tax agreement (PILOT). PILOT agreements may be advantageous to landlords and tenants insofar as they frequently (although not always) lessen the tax burden and provide a stable basis on which to estimate future tax liability. In each instance where a PILOT is required, it must set forth the time, place, and manner of payment, the amount of each annual payment and the allocation among the affected taxing jurisdictions, and the date upon which the payment will be treated as delinquent if it is not paid. It should be noted that PILOT agreements are not considered tax payments and are, therefore, not designated on the tax rolls for the assessing unit. As a result, a party to a lease including provisions relating to the obligation of a landlord or tenant to pay real property taxes should consider whether such provision should specifically reference PILOT payments as well as real property tax payments.

Qualified property uses include those which promote, encourage, develop, or assist in acquiring, constructing, or improving industrial, manufacturing, warehousing, and commercial facilities.

[17.14] B. Business Investment Property and Commercial Property Exemptions

[17.15] 1. Business Investment Property Exemptions (Outside New York City)

Pursuant to RPTL § 485-b, commercial or industrial facilities located outside New York City that are constructed, or improved, at a cost exceed-

ing \$10,000 or such other minimum amount chosen by the applicable taxing jurisdiction, may be partially exempt from taxation and certain special ad valorem levies. This partial exemption is only effective after the construction or improvements have been completed. Eligible properties are those used primarily for buying, selling, storing, or developing goods or services, for the manufacture of goods, for raw materials, or for hotel or motel purposes. The exemption is available at a declining scale over a period of 10 years. There are limitations on § 485-b exemptions to the extent that other exemptions apply for the same property or improvements.

Taxing jurisdictions do have a certain amount of control over the application of the exemption. For instance, taxing jurisdictions may elect to restrict the exemption to properties located within a specific geographic area, usually for targeted economic development purposes. They may also restrict the types of businesses that are eligible for the exemption, and may elect to raise the minimum construction cost for eligibility, up to a maximum of \$50,000. Furthermore, they may elect to offer either the Basic Exemption or Accelerated Strategic Exemption, as set forth below. Taxing jurisdictions (except for the city school districts of Buffalo, Rochester, Syracuse, and Yonkers) may also elect to administer the exemption program through the establishment of an Industrial Commerce Incentive Board (ICIB), which formulates a plan to address the various options mentioned above.

The exemption relates to increases in assessed value due to improvements, similar to the Empire Zone exemption outlined below. Two exemption options are available, both over a 10-year term: a “Basic Exemption” and an “Accelerated Strategic Exemption.” The Basic Exemption is a 50 percent reduction of any increase in assessed value relating to improvements in the first year of the exemption (or such reduced percentage as the taxing jurisdiction may elect), declining by five percent in each subsequent year through year 10. The Accelerated Strategic Exemption provides for a 50 percent reduction in the first three years, declining from 40 percent to five percent through year 10. The Accelerated Strategic Exemption may only be enacted where an ICIB has been established and recommends restricting the exemption to certain types of business properties and to certain geographic areas, where necessary for targeted economic development.

The RPTL § 485-b exemption has broad application for commercial lease transactions in both build-to-suit scenarios and those with substantial buildout for renovations. As a result, where such an exemption is

available, the exemptions should be considered when drafting lease provisions relating to real property taxes. Because the owner of the property is the only party eligible to apply, tenants should consider a lease provision requiring the landlord to apply for the exemption to minimize tax liability on the tenant.

[17.16] 2. Commercial Properties in Designated Areas of Manhattan

Pursuant to RPTL § 499-b, certain real property constructed before January 1, 1975, that is located in designated areas of Manhattan and contains premises which are occupied or used for retail or office purposes pursuant to a lease dated after April 1, 1997, is eligible for a three-year tax abatement (not including special assessments). In order for a lease to qualify, however, it must be for a term of between three and five years. The tax abatement is for a period of three years.

Computation of the RPTL § 499-b abatement is based upon the tenant's share of the eligible square footage multiplied by the abatement base (the per square foot tax liability, with a maximum of \$2.50 per square foot in the first year of the abatement, two thirds of that amount in the second year, and one third for the third year).

In order to qualify, this abatement provides varying standards for when and to what extent expenditures on improvements must be made, depending on the tenant's status and the number of employees in the facility. For a new or expansion tenant, expenditures must be made within 60 days of the lease commencement date. For a renewal tenant, expenditures must be made within one year. The amount of improvement expenditures required varies with the number of persons employed: 125 or fewer employees and a lease term of five years or more require improvement expenditures of at least \$10 per square foot; 125 or fewer employees with lease terms of less than five but at least three years require improvement expenditures of at least \$5 per square foot; and buildings with more than 125 employees with a lease term of ten years or more requires improvements of at least \$35 per square foot to be eligible.

[17.17] 3. Commercial Properties In New York City Outside Designated Areas of Manhattan

Real Property Tax Law § 499-bb provides an exemption for real property located within the city of New York, but outside the designated areas of Manhattan, subject to the exemption contained in RPTL § 499-b

described above. This exemption may be for a period of five years or three years for Abatement Zone B or three to 10 years for Abatement Zone C, and does not include special assessments. Abatement Zone A applied to commencement only through March 31, 2001, and will not be discussed.

Abatement Zone B is defined as any district zoned commercially or industrially in any area of New York City, except south of the center line of 96th Street in Manhattan. In Zone B, if such property was constructed prior to January 1, 1999, and is occupied or used for office, commercial, or manufacturing purposes (excluding retail, hotel, or residential use) pursuant to a lease agreement certified by the New York City Department of Finance and dated on or after July 1, 2000, with an aggregate floor area of 25,000 square feet, it may be eligible for a five year tax abatement. In such instance, the abatement is computed as the tenant's proportionate share of the overall eligible square footage of the building, multiplied by the "abatement base." The abatement base is (1) \$2.50 of the tax liability on a per square foot basis, or (2) 50 percent of the tax liability per square foot for the first three years of the abatement and two-thirds of that amount in year four and one-third of that original amount in year five, whichever is less.

The three-year abatement in Zone B is the tenant's share of the eligible square footage of the building multiplied by the abatement base. The abatement base for the three-year exemption in Zone B is \$2.50 per square foot for year one, two thirds of that amount for year two, and one third of the original amount for year three.

Abatement Zone C includes properties occupied or used for industrial or manufacturing activity in an area zoned commercially or industrially by a tenant pursuant to a three-to-10 year lease executed on or after July 1, 2005. The same restriction for properties located south of the center line of 96th Street in Manhattan applies, except for the Special Garment Center District as defined by resolution of the city of New York. In Zone C, the abatement is from three to 10 years, depending on the term of the lease. It is computed as the tenant's share of the eligible building square footage multiplied by the abatement base, which is the tax liability per square foot up to a maximum of \$2.50 per square foot for each year of the lease.

All of the abatements under RPTL § 499-bb are administered by the New York City Department of Finance, and require a certificate of occupancy as proof of construction before the applicable time frame.

All of the aforementioned tax exemptions and abatements under RPTL §§ 485-b, 499-b, and 499-bb should be considered by landlords and tenants entering into qualified leases or, in the case of RPTL § 485-b, constructing or improving the property within the qualified time period. It is important for the parties to a lease to include language requiring mutual cooperation with obtaining such abatements and to ensure that the benefits run to the parties in conformity with other real property tax provisions as negotiated in the lease.

[17.18] C. Empire Zone Property Tax Benefits

The Empire Zone property tax exemption for improvements in a designated Empire Zone, set forth in RPTL § 485-e, provides for a 10-year declining scale tax exemption attributable to the value of new construction or improvements to commercial property after a certain base year. Effective June 29, 2010, New York State closed the program to new participants. However, businesses certified to participate in the program and receive the benefits including the RPTL § 485-e exemption prior to June 30, 2010 may continue to do so, and may obtain benefits in connection with a move or expansion into property located within the Empire Zone boundaries designated as of June 29, 2010. As a result, landlords negotiating leases for expansion or renovation for a tenant certified in the Empire Zone program, and tenants who are certified businesses within the program seeking to expand or move, should consider whether they may be eligible for the RPTL § 485-e exemption.

Such an exemption can significantly reduce property tax expenses relating to improvements, which are either borne by the landlord in a gross lease transaction (resulting in higher rents to account for the tax liability) or passed on to the tenant in net lease transactions or leases involving escalation clauses relating to the cost of improvements. Therefore, it should be considered carefully by tenants prior to entering into a lease, as the property tax exemption may require the cooperation of, and indeed accrue to, the landlord.

Although the exemption may be granted within one year of completion of improvements, it is not advisable for a tenant to enter into a lease in reliance upon such a later designation because the taxing jurisdictions may enact legislation opting out of the Empire Zone exemption where one previously existed. In *Boynton Suites, LLC v. Board of Assessment Review of the City of Plattsburgh*,³⁶ a contract vendee entered into an agreement

³⁶ 274 A.D.2d 926, 711 N.Y.S.2d 266 (3d Dep't 2000).

to purchase real property in reliance upon, among other things, the availability of an Empire Zone exemption. Prior to the time such exemption was granted, but after the purchase contract was entered into, the taxing jurisdictions enacted legislation repealing their prior Empire Zone exemption program. The contract vendee commenced an action against the taxing jurisdictions claiming that RPTL § 485-e did not allow for taxing jurisdictions to “opt out” of an Empire Zone exemption program once they had opted in. The Third Department held that it was within the powers of the municipality to do so, and denied the Petition. However, once an exemption is granted, it will remain in effect throughout the duration of the exemption period regardless of repeal of the effective local laws or termination of the affected Empire Zone (provided that subsequent improvements will not be eligible for the exemption in either case).

[17.19] D. Tax Benefits Under the Excelsior Program

In the void left by the phase out of the Empire Zone Program, New York has introduced its current flagship incentives program, the Excelsior Jobs Program. The Excelsior program is targeted toward investment and job creation in certain key industries including manufacturing, biotechnology, pharmaceutical, high-tech, clean-technology, green technology, financial services, and agriculture. Among the four tax credits that may be available to participants in the Excelsior Program that meet the criteria is a real property tax credit component. As with the Empire Zone real property tax credit, eligibility for Excelsior Program benefits should be considered by landlords and tenants wherever the tenant is engaged in one of the targeted industries noted above, and the leased premises will result in qualifying job creation.

A qualifying participant must either have a regionally significant project, or be located in an investment zone. The property tax benefit conferred upon any qualifying participant is a 10-year credit, commencing with 50 percent of the eligible real property taxes in year one, and declining by five percent per year thereafter through the end of the 10-year credit period.

What constitutes “eligible real property taxes” under the Excelsior program is the same as for the Empire Zone program, defined in Section 15(e) of the Tax Law. As with the Empire Zone program, taxes paid by tenants can only be eligible for the credit if paid pursuant to an explicit requirement of the lease, and if the taxes constitute a lien on the property during the year in which the tenant is certified under the Excelsior Program and the tenant has made direct payment of the taxes. As such, when

negotiating leases for tenants that intend to qualify for the Excelsior program, be sure to include in the lease an obligation for the tenant to pay the taxes directly.

The maximum aggregate amount of the tax credit under the Excelsior program is determined by the Commissioner of Taxation and Finance, taking into account the value of any improvements projected to be made to the real property comprising the regionally significant project or otherwise located in an investment zone. The detailed qualification requirements and application process for the Excelsior Program are beyond the scope of this article, but should be explored by the practitioner negotiating leases in the target industries early in the lease negotiation process, as the potential benefits are substantial, and directly impact how to draft the real property tax clauses of the lease.

CHAPTER EIGHTEEN

**COMMERCIAL CONDOMINIUM
LEASES**

Matthew J. Leeds, Esq.

[18.0] I. INTRODUCTION

In a growing number of cases, commercial developments (including both horizontal and high-rise properties) are being structured in the form of condominium ownership. There are many reasons for this, including critical matters of financing.¹ Although the condominium form of ownership generally involves fee ownership of real property, a unit owner can lease out its unit to a tenant. In such cases, the special legal nature of the condominium form of ownership significantly affects the landlord-tenant relationship.²

As the broadest example, in a normal landlord-tenant situation, the landlord who owns and operates the building can promise services and utilities to a tenant, but in the condominium form of ownership the immediate landlord (the owner of the condominium unit) may not control such matters, which are typically governed by the condominium's board of managers. Many other obvious and subtle issues arise in these circumstances. Accordingly, a careful tenant would want to identify the issues in a particular commercial condominium through appropriate due diligence.

The owner of the condominium unit, the landlord, must consider the concerns of prospective tenants and would engage in similar due diligence. Through negotiation, the tenant would like to obtain assurances that it will be able to get the benefits it bargains for in its lease, as well as realistic mechanisms to enforce its rights against its landlord, or even against the condominium board and all the unit owners.

A major tenant negotiating a lease before the condominium is established might have the best chance of actually having some control over these matters. Such a tenant has the best opportunity to have its desired protections built into the condominium documents. For a tenant, this is an ideal situation—but the relative bargaining power of tenants will vary. In addition, especially once the condominium is created, the ability to implement a tenant's wish list of protections might be diminished. However, any tenant—large or small—would, theoretically, need to take into account all the concerns that a highly desirable large commercial tenant would identify. Nevertheless, in any situation, an understanding of the larger ownership structure would be necessary for the tenant to make a

1 David Clurman, *The Business Condominium* (1973).

2 Matthew J. Leeds, *The ACREL Papers*, Fall 1999, *Special Considerations of a Major Tenant Taking Space in a Commercial Condominium* (1999).

business decision on whether to tolerate the risk if all its concerns were not addressed perfectly.

[18.1] II. IDENTIFYING ISSUES

This chapter provides a survey of a tenant's considerations in leasing space within a commercial condominium. The discussion seeks to identify the issues that would normally arise for a commercial tenant, suggesting some methods to perform appropriate due diligence to identify special issues that might exist in a particular condominium, and describing some methods to resolve competing interests to address these issues. Again, although the discussion mostly takes the view of a major tenant that can command significant changes, it also reflects the concerns of any commercial tenant in a condominium.

Because condominiums are a creature of statute, state law must be reviewed for special considerations peculiar to the jurisdiction. In New York, counsel must consider the New York Condominium Act, article 9-B of the Real Property Law.³ The New York formulation is to refer to the space that is actually owned by an individual owner as a "condominium unit," while the entire development is referred to as the "condominium." (In some other jurisdictions, these words have somewhat different meanings.)

This discussion also assumes that a property has been fully dedicated to commercial use, as opposed to a "mixed-use property," which would present many of the same issues with more highly concentrated particulars. The discussion also assumes a condominium where the units are owned in fee simple, as opposed to a condominium where the entire condominium property is subject to a leasehold. Finally, it should be noted that a condominium might be part of a larger development or community and thus may also be subject to other "umbrella" property owners' associations in addition to the condominium regime itself.

³ N.Y. Real Property Law § 339-d–339-k (RPL).

[18.2] III. THE CONDOMINIUM FORM OF OWNERSHIP

Like all other unit owners in the condominium form of ownership,⁴ the landlord in the situations referred to in this article typically owns one or more of the various condominium units in the condominium. Each condominium unit is a separate parcel of real estate,⁵ owned in fee simple, and constitutes its own separate tax lot.⁶ Each unit is much like a three-dimensional parcel of air space contained within the inside surfaces of the walls and ceiling (or other boundaries) that usually describe a particular space.

As a separate parcel of real estate, each condominium unit may be burdened by a separate mortgage that will affect no other condominium units, absent the consent of those other unit owners.⁷ Inextricably entwined with the ownership of a condominium unit would be the ownership of an undivided interest in what are referred to as the “common elements” of the condominium, generally the structural or shared areas of the condominium property. Typical common elements include the land on which the building sits, structural portions of the building, including the walls and the roof, and any common lobbies, hallways and spaces, including those which house building systems serving the condominium units.⁸ Each unit owner’s proportionate interest in the common elements is frequently referred to as the “common interest” allocable to that unit.⁹ The unit owners are thus in many respects like tenants-in-common with respect to the common elements.

The unit owners together in effect constitute an association responsible for running the property. This association is managed by a board of managers elected by the unit owners. Although the board is responsible for running the association, it can hire professional management to handle much of that function.

4 See, e.g., David Clurman & Edna Hebard, *Condominiums and Cooperatives* (1970); Patrick J. Rohan & Melvin A. Reskin, *Condominium Law and Practice: Forms* (1965); William Jay Lipman, *Condominium and Co-op Closings* (1987); Matthew J. Leeds & Walter Goldsmith, *New York Practice Guide: Cooperatives & Condominiums* (1986).

5 RPL § 339-e.

6 RPL § 339-y.

7 RPL § 339-l.

8 RPL § 339-e(3).

9 RPL § 339-e(5).

To pay the expenses of operating the property, the board normally assesses each unit owner a certain portion of these costs, in what are called “common charges.” Although common charges are normally allocated based on the unit owners’ relative common interests, in commercial condominiums it is not unusual for a particular unit owner that uses a greater portion of some common element, or uses building services or facilities to a degree disproportionate to the common interest, to be required to pay a greater share of expenses related to that item. Sometimes the condominium documentation calls for a specific allocation of expenses among the unit owners in a manner other than proportionately to common interests.¹⁰ In addition, some common elements may be allocated as “limited common elements” for the exclusive use of one or more units. Generally, the unit owner who has use of a limited common element has greater responsibility for the expenses and maintenance of those spaces than the unit owners who do not actually use them.

It is always significant to note that the expenses of operation of the condominium association do not normally include two major expenses of real property ownership: real estate taxes and debt service on a mortgage. This reflects the fact that each condominium unit is itself a parcel of real estate, and only the owner of the unit affected by the liens for mortgages and real estate taxes has any obligation to pay them.

As security for payment of a condominium unit owner’s common charges, the association (by the board of managers or otherwise) usually has a lien against each unit owner’s unit to secure the payment of such common charges.¹¹ In New York, this lien is generally subordinate to liens for real estate taxes and a first mortgage of record.¹² The Condominium Act does, however, permit the priorities between a mortgage and the lien for common charges to be adjusted in a fully non-residential condominium if so provided in the condominium documents.¹³

Those who are more familiar with residential condominium situations than with commercial condominium situations may be aware of a common device by which a condominium association can become involved in the sale or leasing of a unit. That is, many residential condominiums provide that, in order to permit some common control over the unit owners or

10 RPL § 339-m.

11 RPL §§ 339-z–339-aa.

12 RPL § 339-z.

13 *Id.*

residents without flouting any common law restriction against unreasonable restraints on alienation, many residential condominiums require that a unit owner seeking to sell or lease its property offer a right of first refusal to the condominium association. Not surprisingly, in commercial condominiums, business considerations dictate that a right of first refusal is not usually imposed on sales or leases by unit owners.

A property is subjected to the condominium form of ownership, (i.e., divided into separate condominium units, each as a separate parcel of real estate and the common elements and subjected to the governing provisions of the local condominium statute), by recording or filing statutorily required documents. These materials are normally in the nature of a “declaration of condominium” and appropriate floor plan drawings indicating the locations of the separate condominium units and the common elements. The declaration normally incorporates, or is accompanied by, the by-laws of the condominium, which typically govern management and operation of the condominium.¹⁴

In the area of consumer protection, such as the sale of real estate securities laws in New York,¹⁵ states often require that sales of condominium units take place pursuant to an information statement or offering plan or memorandum. In some of those jurisdictions, information is merely maintained or compiled by the association or the developer. In New York, the offering plan is the subject of a separate filing with a government agency, the New York State Department of Law Real Estate Financing Bureau.¹⁶ That agency reviews the materials to determine whether they are acceptable for filing. For some projects, when it is deemed upon application that the requirement of an offering plan does not fulfill a necessary statutory or public purpose, the Department of Law has authority to issue a “no-action” or “no-jurisdiction” letter. It essentially states that, based on the application, a full filing is not required. Any offering materials would not normally be required to be provided to tenants of units. If available, though, they might provide an interesting source of information for a tenant renting a unit.

The basics of the condominium structure suggest issues that can arise for anyone intending to lease a condominium unit. To identify which generic structures affect the particular condominium, however, and to

14 RPL § 339-u.

15 N.Y. General Business Law art. 23-A (GBL) (the Martin Act).

16 See, e.g., N.Y. Comp. Codes R. & Regs. tit. 13, §§ 20.1–20.7 (N.Y.C.R.R.).

identify any idiosyncratic issues that might exist for a particular condominium, a lawyer will normally engage in a certain amount of due diligence.

[18.3] IV. DUE DILIGENCE

Any tenant will perform certain physical and business investigations before deciding whether a particular property is appropriate. For example, a tenant and its experts (other than the lawyer) would probably conduct a physical inspection of the property, determine whether building systems purportedly available are adequate to support the tenant's needs, investigate the reputation of the property and the developer (if relevant), and ask other similar questions. The lawyer is normally asked to review any requested documentation that might shed light on issues raised by the tenant. Equally important is the lawyer's review of appropriate documentation to suggest issues that the tenant might have had no reason to expect.

Documentation is not necessarily "standard" and is frequently tailored to a particular project. As in any real estate transaction, the lawyer can anticipate general categories, but does not know how they will be phrased in a particular instance, nor whether any surprises will appear. Thus, legal review will frequently involve the following documents, to be reviewed provision-by-provision to determine how a particular condominium structure might affect a tenant client. Specifically, the lawyer might be asked to review:

- *Condominium Act.* In a profession of increasing specialization, even seasoned leasing lawyers might find it appropriate to engage colleagues who are more conversant in condominium law and practice to review a lease of commercial space in a condominium unit. If the property is located in another state, consultation with local counsel is recommended.
- *Certificate of Occupancy.* Although this would normally be part of the physical inspection conducted by the client and its other experts, there may be occasions when required-use issues or local statutes suggest the lawyer review the certificate of occupancy as it affects the contemplated space.
- *Declaration of Condominium and Condominium By-laws.* In most instances, an examination of these fundamental documents is the meat of the attorney's due diligence analysis. Together, these documents will lay out how the condominium unit

is described, the services that will be provided to the unit, and the obligations of the unit owner. Critically, these documents indicate who controls different aspects of condominium operations and whether the landlord will actually be able to deliver services and other promises made under the lease to the tenant. Even if the initial documents indicate that the landlord will have full rights to perform for the tenant, the documents will also indicate whether the condominium can change its rules and operations in the future in a manner that could subvert the arrangements contemplated by the lease.

- In combination with a review of the condominium statute, these documents will also indicate whether the landlord-owner of the condominium unit will be subject to a lien on behalf of the board of managers that, if foreclosed for nonpayment of common charges or other nonperformance, could lead to a termination of the lease.
- *Rules and Regulations of Condominium.* The extent to which these rules affect the tenant, and the extent to which they could be changed by somebody (i.e., the other unit owners) other than the landlord (who is just one of the unit owners), are important considerations for any tenant. They will often be handled in the course of reviewing the declaration and by-laws.
- *Offering Plan (If Any).* Any offering plan or similar document normally recites a considerable amount of information. If the particular condominium has been created without an offering plan because of an exemption or administrative permission, it would be of interest to see a document evidencing such consent. It is always meaningful to determine whether the condominium was properly created (and therefore, among other things, whether the landlord actually owns what is being leased to the tenant).
- *Condominium Floor Plans.* Although an examination of the floor plans is normally part of the physical inspection of the property, those floor plans are often the source of the description of the condominium units themselves and the common elements. Regardless of the presentation by business people on behalf of a landlord or the understanding of the tenant's experts, the condominium documentation itself should be checked (much like reviewing a survey) to make sure that it actually describes the demised premises as part of the condominium unit the landlord

owns. In addition, an examination of the floor plans will indicate whether building facilities exclusively allocated to the tenant are actually within the control of the landlord in its own unit, or are subject to control by the board of managers or the other unit owners, as a common element.

- *Title Insurance.* The issue of title insurance is very similar to the issue of whether a tenant in a conventional landlord-tenant relationship is interested in title insurance, to support its own interests or for reassurance that the landlord owns the leased space. In addition, because the space to be leased as a condominium unit is a separate parcel of real estate, issues regarding existing lienors and other aspects of the landlord's status and financial well-being can be important.
- *Books and Records of Condominium.* These would include: (1) financial statements of the condominium; (2) minutes of meetings of the board of managers; (3) minutes of meetings of unit owners; (4) accountant's statements such as certified financials; (5) alteration agreements for past renovations; and (6) miscellaneous correspondence and statements included in the foregoing, or maintained separately with the records. Examination of most of these materials usually takes place in the office of the managing agent for the condominium. This review can open a wide range of issues, where the recital of an incidental fact could provide desired insight into a deal. For example, an indication in financial statements of difficulties in collecting common charges from other major unit owners, or references to major work that needs to be performed, could suggest an inadequacy in the physical plant or a forthcoming assessment. Such due diligence also often allows an opportunity to speak with the individuals actually involved in management to ask them generally about operation of the property. Such casual interviews can sometimes elicit interesting current information or a better overview than would be available from the dry documents themselves. The review process described in this paragraph often yields much information that it is not necessary to describe separately to the client. On the other hand, it can reveal important facts.
- *Review of Unit Owner's Mortgage and Other Due Diligence.* Any tenant under a major lease will often consider certain issues related to the landlord's financing. These include the availability of nondisturbance agreements (presumably in conjunction with

subordination agreements) and other matters that are routine for the experienced leasing or financing lawyer.

- A lawyer's review of these due diligence materials typically raises practical and legal issues. It is usually profitable to identify these ahead of time, particularly when the landlord has not anticipated the tenant's concerns in the draft lease. The organization of negotiation between the parties might begin with a general meeting about these kinds of global concerns. Ideally, this might even precede any drafting exercise. In some development situations, a large tenant might even participate in planning the entire condominium, and so might have a say in the way the condominium documents are drafted. If not, many of the considerations will still be the same, and the parties will need to address them in other ways (subject to bargaining power and other practicalities).

[18.4] V. SAMPLE CONCERNS

Due diligence and a general understanding of the condominium situation are likely to bring out a mix of generic issues and issues particular to a deal.

As an overall matter, it can be useful, throughout a condominium lease review, to keep in mind the similarities to a conventional sublease, where the subtenant is not in privity with the person who has actual ownership and control of the property.¹⁷

Examples of typical concerns and some brief thoughts on how they can be addressed include the following:

- *Services, Use, Rules and Regulations.* In a condominium, the board of managers, acting as the representative of all unit owners, governs the operation of the property, tempered by the provisions of the condominium documents. The tenant must be sure that its landlord can provide everything that is promised in the lease. The tenant and the landlord, in turn, must determine whether the landlord in the first instance has the right to require the board to provide those services which the landlord has promised. These can be as direct as the provision of heating, ventilating and air conditioning; provision of parking; use of loading facilities; main-

¹⁷ Andrew Herz & Russell Wohl, *Subleases: The Same Things as Leases, Only Different*, 35 Real Prop. Prob. & Tr. J. 667 (2000). See Chapter 29, *infra*.

tenance of signage on the exterior of the building; and the like. One aspect of this examination involves determining whether areas that must be accessible to the tenant are actually technically part of the landlord's condominium unit, or whether they consist of common areas (such as entranceways and parking, or a storefront or areas where signage will be maintained and possibly changed from time to time). It is often not enough for a tenant if the landlord has an obligation to provide services, but the landlord cannot itself require that they be provided. Rules of operation of the building, such as limits on hours for air conditioning, or hours during which a loading dock may be used, can significantly detract from the rights that a tenant would normally require in the lease. Another area of critical examination is the permitted use of the property. In particular, a tenant whose lease is by its terms subject to the declaration of condominium and by-laws might be told by a landlord that the tenant should have realized that the condominium might not provide services for the unit owner-landlord, so the tenant is out of luck.

- *Obligations of Tenants as Unit Owners.* A frequently encountered drafting anomaly in many condominium documents suggests that, for purposes of the condominium documents, unit owners shall be deemed to mean not only unit owners, but also their tenants, and sometimes their licensees and guests. Presumably, such drafting was meant to suggest that all these other people would be subject to the same restrictions as unit owners, and to require unit owners to police the behavior of their tenants and guests. Unfortunately, carrying such logic through a document might mean that a tenant could be argued to have all the obligations of a unit owner. This makes sense for day-to-day behavior at the property, but not necessarily as it relates to the unit owner's obligations to pay common charges or a lien to secure such payment.
- *Lien for Non-Payment of Common Charges.* Typical condominium statutes and typical condominium documents secure the payment of common charges by establishing a lien against a unit owner's unit in favor of the board of managers. A tenant would be concerned that such a lien would be a superior right to the lease and that foreclosure could wipe out the lease.
- *Insurance, Casualty and Condemnation.* Because of the nature of a condominium, in which the improvements are owned essentially in common by all unit owners, building-wide casualty

insurance is obtained by the board of managers on behalf of the unit owners. Although the general rule under the Condominium Act is that the condominium will be obligated to restore the property, this rule does not apply in catastrophic circumstances. For example, under the New York Condominium Act, where a loss affects 75% or more of the property, 75% of the unit owners must agree to restore, or the property will be subject to a partition and, presumably, termination of the condominium.¹⁸ Such provisions might contradict a lease. In addition, the parties should work to assure that a tenant's separate insurance would not conflict with, or be negated by, a condominium policy. The parties should determine from insurance experts the need for mutual waivers of subrogation, defenses based on acts of the insured, and the like.

- *Rent and Common Charges.* Common charges do not necessarily represent the operating expenses that are strictly relevant to the tenant. A tenant should examine the appropriate lease provisions to determine whether it is appropriate to tolerate a direct pass-through of common charges. In particular, if the lease seeks to require a tenant to assume a portion of increased expenses for the entire property, it should be determined whether there is a way to account for such expenses properly and whether common charges actually serve as a measure of such passed-through operating expenses.
- *Real Estate Taxes.* Any provision allowing escalation of rent to reflect increases in real estate taxes should be reviewed to confirm that it reflects the appropriate measure of real estate taxes on the leased unit(s). Because each unit will have its own real estate tax bill, rather than bear a fixed percentage of the total tax bill for the entire project, the normal real estate tax escalation provision should be adjusted accordingly. In addition, condominium documents can provide that any grievance of taxes would be coordinated by the board, but a tenant might want to resist such a unified effort, depending upon the circumstances and the jurisdiction.

It is noted that to the extent that real estate taxes are passed through to a tenant, that the landlord and tenant explore how the taxes are likely to be assessed. An example of an issue would arise

18 RPL §§ 339-bb-339-cc.

where the taxing authorities take a position that the taxes on a condominium unit should in the first instance be assessed on the basis of applying the percentage of common interest allocated to the unit to a number that would have been the full assessment for the building, as if it were not owned in the condominium form of ownership as separate parcels of real estate. Even then, it is not uncommon that over time the authorities would recognize the income generated from the space as a factor to be applied in determining the correct assessment, so the methodology of calculating taxes might change over time.

- *Ability to Finance Lease.* Concerns of potential leasehold mortgagees should be considered, including concerns about whether the mortgagee would be entitled to copies of notices in the event of a unit owner's default under its obligations to the condominium, and would have rights to cure.
- *Alterations and Work.* The ability to perform alterations in the space will be governed by limitations in the documents, rules, and regulations of the condominium, including matters pertaining to work that will affect common areas or building systems, insurance issues, and even questions of when work can be performed.
- *Consents.* It is not unusual for a lease to require that a tenant may perform a certain act (such as alterations in its space) only with the consent of the landlord, with a frequently modified position being that such consent cannot be unreasonably withheld. Similar provisions often appear in condominium documents, where such activities can be performed by unit owners with consent of the board, provided that they are within certain reasonable bounds. Regardless of whether the "reasonableness" standard modifies the issue of consent, any tenant must recognize the potential problem of asking for consent from a landlord who would otherwise give it, but who is then prohibited from giving such consent by the condominium documents or by the board. Additional problems arise if the landlord cannot unreasonably withhold consent but there is no similar standard of cooperation imposed on the board. Furthermore, even if both the landlord and the board are required to behave reasonably at their respective levels of involvement, there may be instances where the board seeks to withhold its consent for a consideration that is reasonable in the subjective position of the board, but might not be reasonable as seen by the landlord or the tenant. In some cases, an owner of a building

might be willing to give consent, but the board might have some special concerns because of the condominium form of ownership, such as the objective concerns of other tenants or issues relating to common property. A condominium board might pay more attention to these concerns than a typical building owner.

- *Further Subdivision of Unit.* The landlord-unit owner might have a right under the condominium documents to have the leases broken into one or more condominium units. Because this is just a matter of documentation, it does not necessarily require physical work. The landlord would, however, then own multiple pieces of real property, all subject to the lease. Presumably, each unit could end up being owned by a different owner, thus creating concerns arising from multiple ownership for the tenant suddenly occupying the property of more than one owner.
- *Termination of Condominium Ownership.* Either by operation of law or by a vote of unit owners, a condominium can be terminated.¹⁹ In that situation, the landlord that previously owned a discrete parcel of real property that was rented to a tenant is no longer the technical direct owner of the premises. The tenant's position is somewhat unsure, but it would appear that all unit owners would become tenants-in-common for the entire property.
- *Amendments to Condominium Documents.* Condominium documents are normally subject to amendment by a vote of unit owners (sometimes also requiring the vote of mortgagees of unit owners). Naturally, if a tenant evaluated its position in a condominium based upon the condominium documents, its position could be changed by an act of the unit owners amending the provisions previously relied upon for comfort (a dramatic example being that of a change in permitted use enacted by a vote of unit owners).

[18.5] VI. SAMPLE DRAFTING MECHANISMS

The imagination of lawyers can suggest myriad ways to deal with these concerns. Regardless of how clever a strategy might be, its use might be limited by the bargaining positions of parties, their energy and other practicalities affecting a given situation. Still, it is appropriate to suggest some sample approaches to concerns raised above.

¹⁹ RPL § 339-t.

The most general principle to be invoked is that a tenant would like to know that it can require that the rights it bargained for in the lease can be implemented. (That is, a tenant would prefer not to allow a landlord to make a hollow promise, which can be redressed only by an action for damages against the landlord.) In some instances, this would suggest an attempt to make sure that the landlord-unit owner has a right against the condominium to obtain the necessary services and rights. The landlord would then agree in the lease to provide the services and give rights to the tenant (thus permitting the tenant recourse against the landlord for failure to provide such services). In other instances, a tenant might seek assurance that the board and other unit owners would respect the rights of the tenant, and might even seek more direct privity with them in the condominium documents or in separate agreements. Not surprisingly, experience has shown that in a major development where the presence of the tenant is a critical component of the success of the project, a tenant might be able to arrange for condominium documents to respect its interest and give the tenant some direct rights of types more typically held by a unit owner. Such a tenant's "wish list" can inform any tenant's negotiation. In such situations, techniques include:

- *Deal With Specifics.* If a tenant can identify matters that it needs to confirm are provided by the entire building, the condominium documents can go into intensive detail on issues such as provision of heat, the number of parking spaces applicable to the unit, the hours of operation, and so on. This might create a problem of flexibility in the future, though. In addition, it is important to make sure that the critical provisions cannot be amended later without the tenant's consent. It might be troublesome if some specific matter had not been considered by the imagination of the business people and attorneys at the time of drafting the document, only to have it later become an important consideration.
- *"Subordination" of Condominium Documents to Lease.* One short-hand approach to a tenant's concerns would be to suggest that the operation of the condominium and all condominium documents would be subject to the rights of the tenant and the operation of the property as required by the lease. Some practitioners express the view that any lease existing before the condominium document is recorded would be in this superior position. (This argument, in part, includes a supposition that all unit owners succeed to the interests and obligations of the original owner of the property, who was the landlord.) However, an explicit "catch-all"

statement to this effect in the condominium documents, specifically identifying a particular lease, might express an important governing doctrine for the protection of a tenant. Further, a tenant might seek a provision in the condominium documents recognizing not only the existence of the lease, but explicitly stating that the board and all unit owners recognize that the condominium would operate in such a way as to provide everything required under the lease to the tenant, and not to diminish such rights or to increase any obligations of the tenant.

- *Consents.* To address the concern that a landlord might not give consent under a lease because the condominium's consent under the condominium documents was withheld, a tenant might seek to have the board limit its rights of consent in certain matters, such as (1) the board's consent being deemed given if the landlord gives its consent (whether or not it could be reasonably withheld); or (2) the landlord agreeing that it would not be a reason for withholding consent that the condominium did not give consent (thus giving a tenant rights against the landlord, although the tenant might still not be able to perform the act that was proposed); or (3) having the board agree that in such a situation it would be required to give consent if a landlord who owned the entire property would be required to give consent, independent of the condominium form of ownership.
- *Amendments.* If specific rights of a tenant are protected in condominium documents, those protections can be meaningful only if the documents cannot be amended by the unit owners so as to diminish those rights. Accordingly, the provisions in the documents that permit amendments might be changed in a way that would prohibit any amendment that would affect the lease without the consent of either the tenant and/or the owner of the unit that contains the demised premises.
- *Protection Against Board's Lien for Common Charges.* The documents themselves, or a separate agreement with the board, could provide recognition and nondisturbance of the tenant if the unit is foreclosed upon by the board. In addition, the tenant, both on behalf of itself and any mortgagee, might request mortgagee-type protections, such as copies of any notice of the unit owner's (i.e., the landlord's) default and an opportunity to cure such default. Some commercial condominium documents recognize the concern of tenants with respect to the lien for common charges,

by providing for the automatic recognition, nondisturbance and attornment of leases covering spaces in excess of a certain minimum size.

- *Insurance.* Tenants might seek provisions in condominium documents, or separate agreements by which the parties would agree, that any insurance of the tenant, the unit owner and of the board or other unit owners would include appropriate provisions so that their insurance policies would not conflict, and/or (2) that the parties would enter into such side agreements as would be necessary so as to keep the scheme of insurance in place (such as an agreement, if necessary, not to sue each other in such a way as to negate a waiver of a claim that a covered act was an act of the insured). These might include waivers of subrogation, defenses for acts of the insured and the like.
- *Restoration.* A tenant would seek to have condominium documents recognize that the portion of the condominium property consisting of the demised premises must be restored in accordance with the landlord's obligations under the lease regarding casualty. Where the law (on 75% destruction)²⁰ or condominium documentation might require an affirmative resolution of unit owners to restore, a tenant might seek a power of attorney and proxy from all unit owners in the event of such a vote (whether these run in favor of the tenant or in favor of the tenant's landlord). The condominium documentation itself might provide for these powers of attorney and proxies (presumably to attempt to bind all present and future owners).
- *Multiple Owners.* If the demised premises are located in more than one unit, or if there is a prospect of an existing unit being further subdivided into more than one unit, a tenant might seek to require that the tenant will never be required to deal with more than one landlord. Multiple landlords would create difficult administrative problems, as well as the possibility of receiving different treatment from different landlords. One sample mechanism would be for the landlord to agree that the owner of a particular part of the space would be deemed the agent for all of the owners, and that the tenant would only be required to give notice and deal with that one agent, who would be authorized to speak in a binding way on behalf of all of the landlord-unit owners.

20 RPL §§ 339-bb-339-cc.

- *Termination.* A tenant might seek a provision that, in the event of termination, not only would the lease be deemed to remain in place, but also the original landlord would be deemed to be the de facto owner of the portion of the premises subject to the lease, and would be the agent for all of the other owners with respect to whom the tenant would deal. The tenant would also want all owners to be held responsible jointly and severally for the performance of the landlord's obligations under the lease.
- *Enforcement Rights.* A tenant might seek not only to have the condominium documents provide that its landlord be the unit owner having a right to require the condominium to provide everything which has been negotiated in the lease, but also to have the condominium agree that the tenant, as a person named in the condominium documents, would have a right to claim such benefits. In addition, a tenant might seek to have both the lease and the condominium documents recognize a right of the tenant to pursue enforcement of such rights directly against the board and other unit owners. To the extent that the condominium documents and/or operation of the condominium are subject to the lease, a tenant would like the board and the unit owners to recognize their obligations to perform the landlord's obligations to the tenant, although this might be taken as an extreme statement in certain circumstances. In fact, in order to mollify other unit owners, it might be appropriate in many situations for a tenant to agree that enforcement of its rights against other unit owners would be limited to equitable remedies to make sure that appropriate services were obtained, at the same time suggesting a limitation on damages that could be sought against the unit owners (but leaving the opportunity to pursue damages from the landlord-unit owner or an obstreperous board).

[18.6] VII. CONCLUSION

This survey of the concerns of tenants taking space in condominium units can only be read in light of the specifics of a particular project. In addition, although a major tenant in a development deal might have significant opportunity to negotiate its wish list of protections in condominium documents, many situations will not allow a tenant to protect itself in this manner.

All the same, a discussion of these issues raises concerns that all tenants should consider. For a developer to succeed, the concerns of prospec-

tive tenants might be anticipated and addressed in formative condominium documents. To go full circle, it should be recognized that these “deals” start at the beginning of negotiations for such a lease, with a statement of general principles and approaches derived from due diligence.

CHAPTER NINETEEN

LEASES WITH FOREIGN SOVEREIGNS AND INTERNATIONAL ORGANIZATIONS

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* Mr. Odell wishes to acknowledge gratefully the contribution of Xiu Ming (Lily) Gao for her invaluable assistance in preparing this article.

[19.0] I. OVERVIEW

As a world capital, New York City hosts the headquarters of many international organizations including the United Nations Organization and its subsidiary organs. Virtually every entity of global, economic or political significance maintains a presence there including the International Monetary Fund and the World Bank. A complex set of issues arises under U.S. statutory and treaty law when these entities are parties to real estate transactions, presenting both opportunities and problems for the attorney.

This chapter discusses some of the practical considerations that should be uppermost in the practitioner's mind from the outset of analysis and negotiations, and provides tips on how to prosper from the opportunities, while avoiding the pitfalls.

The following is intended to distinguish among the various forms of foreign sovereigns and international organizations with respect to the applicable laws in the United States (including U.S. bilateral and multilateral treaties and federal law) which grant to them certain privileges and immunities and impose on them certain obligations. It is also intended to provide an overview of legal issues and useful considerations when dealing with foreign state and international organization parties in commercial leasing matters.

There are various factors discussed below that a landlord must consider which are not part of a customary commercial transaction when foreign sovereigns or international organizations are involved in leasing or other real estate transactions.

[19.1] A. With Whom Are You Dealing?

At the outset of a transaction involving a foreign state or international organization, it is important to look beyond appearances¹ and identify the legal character of the person at issue since its legal character will determine the extent of its privileges and immunities in the United States. Generally, if a foreign sovereign has no "diplomatic" status, as hereinafter discussed, then its rights to jurisdictional or enforcement immunities are

¹ For example, for many years, the U.S. State Department accredited certain New York City-based foreign government trade offices to their respective Washington embassies, resulting in diplomatic privileges and immunities for those New York City offices. However, those offices typically had no suggestion of their diplomatic accreditation in their names or activities.

governed by the Foreign Sovereign Immunities Act (FSIA).² However, foreign sovereigns acting through diplomatic entities (e.g., United Nations missions, Washington embassies or consular posts) are protected by multilateral treaties to which the United States is party. International organizations (e.g., the United Nations Organization or the International Monetary Fund), on the other hand, are generally protected by the International Organizations Immunities Act,³ as well as other bilateral agreements and statutory law.

The following chart illustrates the applicable broad categories of foreign sovereigns under the FSIA:⁴

Foreign State or Political Subdivision Category	Agency or Instrumentality Category (Foreign Government Owned or Controlled)
U.N. missions in New York	Foreign bank branches and agencies in New York and country-wide
Embassies in Washington	Trading companies
Consulates-general in New York and consular offices countrywide	Transportation companies (e.g., airlines or shipping lines)
Other foreign government offices (e.g., cultural, press, tourism or trade promotion offices)	Other entities that meet the statutory definition

Numerous international organizations, some easily recognizable and some not so recognizable, are protected by a body of international law, including the IOIA. The following chart provides some limited indication

2 Foreign Sovereign Immunities Act of 1976, Pub. L. No. 94-583, 90 Stat. 2891 (codified at 28 U.S.C. §§ 1330, 1332, 1391(f), 1441(d), and 1602–1611, as amended).

3 International Organizations Immunities Act, Pub. L. No. 79-291, 59 Stat. 669 (1945) (codified at 22 U.S.C. §§ 288–288l, as amended) (IOIA).

4 See 28 U.S.C. § 1603 for distinctions among categories of foreign states.

of the multitude of international organizations that a landlord and its counsel may encounter:

Recognizable	Not So Recognizable
United Nations Organization (and its subsidiary organs)	ITER International Fusion Energy Organization
International Monetary Fund	Taipei Economic and Cultural Representative Office*
Organization of African Unity	Customs Cooperation Council
Organization of American States	International Civilian Office in Kosovo
International Committee of the Red Cross	Universal Postal Union
European Bank for Reconstruction and Development	Global Fund to Fight AIDS, Tuberculosis and Malaria

* See Taiwan Relations Act, Pub. L. No. 96-8, 93 Stat. 14 (1979) (codified at 22 U.S.C. §§ 3301–3316, as amended).

[19.2] B. Role of U.S. State Department

Under article 22, section 2, of the Vienna Convention on Diplomatic Relations⁵ as hereinafter discussed,

[t]he receiving State [i.e., the United States for the purposes of this chapter] is under a special duty to take all appropriate steps to protect the premises of the mission against any intrusion or damage and to prevent any disturbance of the peace of [a diplomatic] mission or impairment of its dignity.

As a consequence, the U.S. State Department is vested with an affirmative obligation to protect—and take all steps it deems necessary or appropriate to do so, including intercession on behalf of a mission against a landlord—when the premises of a United Nations mission or Washington

5 Vienna Convention on Diplomatic Relations, Apr. 18, 1961, 23 U.S.T. 3227, T.I.A.S. No. 7502 (“Vienna Diplomatic Convention”).

embassy is involved in any dispute, commercial or otherwise.⁶ Furthermore, section 112 of Title 18 of the United States Code provides that

[w]hoever willfully (1) intimidates, coerces, threatens or harasses a foreign official or an official guest or obstructs a foreign official in the performance of his duties; (2) attempts to intimidate, coerce, threaten or harass a foreign official or an official guest or obstruct a foreign official in the performance of his duties . . . shall be fined under this title or imprisoned not more than 6 months or both.⁷

That section requires recognition of the treaty obligations of the U.S. State Department and caution in dealing with diplomatic or consular premises. Such caution, for example, should be exercised with regard to the reliance by a landlord on the self-help provisions of a commercial lease (i.e., those provisions which permit a landlord to withhold heating, ventilating or other services when a tenant is in default of its rent obligations). The withholding of such services could be deemed to violate the foregoing provision.

[19.3] C. Absolute Immunity

Because of the breadth of the protections under the various international treaties that affect diplomatic offices and the great worldwide deference allowed to those offices, particularly in the developing world, some foreign sovereigns act with impunity from time to time—that is, for example, by stonewalling rent or other lease obligations when budget shortfalls arise. In those circumstances, absolute immunity exists in that no recourse is available to a landlord other than the non-judicial intervention of the State Department. Under article 22 of the Vienna Diplomatic Convention and section 1610 of the FSIA, no judgment enforcement measures may be taken in connection with premises leased (or owned) for diplomatic purposes, absent a waiver of immunity.

6 *See 767 Third Ave. Assoc. v. Permanent Mission of Zaire to U.N.*, 988 F.2d 295 (2d Cir. 1993). Here, the landlord of the Zaire United Nations mission sought to evict the mission from its office premises for non-payment of rent. Although there was little argument that rent was due and unpaid, in accordance with article 22 of the Vienna Diplomatic Convention, the U.S. Department of State interceded in the litigation through the filing of an *amicus curiae* brief seeking to forestall eviction proceedings and thereby protect the dignity of the mission.

7 *See Act for the Protection of Foreign Officials and Official Guests of the United States*, Pub. L. No. 92-539, 86 Stat. 1070 (1972) (codified at 18 U.S.C. § 112, as amended).

[19.4] D. Transactional Pace/Political Events

The pace of business in the foreign governmental sector, particularly for the developing world, can be significantly slower than in the commercial sector. In addition, foreign political events and U.S. geopolitical concerns can affect transactions in the United States.⁸

[19.5] E. Some Illustrations

Before addressing the relevant body of law, the following examples, drawn principally from professional experiences, illustrate some of the basic practical legal issues that need to be considered when a foreign government or international organization is involved in a leasing transaction. As these experiences reflect, the primary issues consist of the ability to effect jurisdiction, to serve process and to enforce a court order or judgment. Generally, the best way to achieve jurisdiction over a foreign government or international organization is to provide in the lease—if negotiable—for an express waiver of jurisdictional immunity under the FSIA and other applicable law and submission to the jurisdiction of the appropriate courts. Likewise, service of process is best achieved at the contract stage by providing for an express method of service of process, thereby avoiding a potentially expensive and lengthy procedure. Finally, the consideration perhaps of greatest concern is enforcement of a judgment, which raises the same commercial considerations as with any non-governmental party. Here, too, the lease should provide for an express waiver of immunity from judgment enforcement measures.

Illustration 1—During the course of the construction of leased premises, a construction worker was seriously injured and brought suit against a United Nations mission. Due to an omission, the mission did not have adequate personal injury liability coverage. The facts raised certain fundamental issues for the plaintiff.

As to jurisdiction, although no waiver of jurisdictional immunity (express or implied) existed, the plaintiff used two sovereign immunity exceptions available under the FSIA to assert jurisdiction—the commer-

⁸ In a recent transaction involving a New York City consular post, the foreign ministry of a country in political turmoil took approximately five months to obtain budgetary approval for the purchase of a Manhattan office building and an additional five weeks to analyze a “plain vanilla” all-cash purchase and sale agreement. While attorneys in the foreign ministry were analyzing the agreement, the seller opted to sell the building to a different purchaser.

cial activity exception and the tort exception.⁹ Service of process was possible under the FSIA.¹⁰

With regard to judgment enforcement, although the claim was eventually settled by the insurance carrier of the general contractor, the plaintiff could *not* have enforced a judgment against any mission property pursuant to the Vienna Diplomatic Convention or any other property owned by the subject foreign state pursuant to the FSIA.¹¹

Illustration 2—A United Nations mission was in substantial rent arrears with regard to its Manhattan office premises under a lease that contained no provisions taking account of its diplomatic legal status.

A question arose after discussion with U.S. government officials as to whether the landlord could limit its losses by cutting building services, which contractually would have been permissible, without violating federal law in light of the provisions of 18 U.S.C. section 112 and other laws. Furthermore, the subject mission believed (albeit incorrectly) that it was exempt from the tax escalation portion of its “added rent” in light of the Vienna Diplomatic Convention¹² which provides, in relevant part, “The sending State . . . shall be exempt from all national, regional or municipal dues or taxes in respect of the premises of the mission, whether owned or leased.”¹³

With regard to jurisdictional immunity, notwithstanding the absence of a waiver thereof, the lease was subject to judicial review pursuant to the “commercial activity” exception of the FSIA.¹⁴ The lease did not, however, provide any “special arrangement” for service of process,¹⁵ which left the landlord with the lengthy and costly method of service provided under the FSIA.¹⁶ Furthermore, as in Illustration 1, there was *no* possibil-

9 28 U.S.C. §§ 1605(a)(2) and (a)(5).

10 28 U.S.C. § 1608(a).

11 28 U.S.C. § 1610(a)(1); Vienna Diplomatic Convention, *supra* note 5, art. 22.

12 Vienna Diplomatic Convention, *supra* note 5, art. 23, § 2.

13 *Id.* at Art. 23, § 1.

14 28 U.S.C. § 1605(a)(2).

15 28 U.S.C. § 1608(a)(1). *See e.g., Arbitration Between Space Systems/Loral, Inc. v. Yuzhnoye Design Office*, 164 F. Supp. 2d 397 (S.D.N.Y. 2001).

16 28 U.S.C. § 1608(a)(3), (4).

ity of judgment enforcement both with regard to a warrant of eviction or any monetary award.¹⁷

Illustration 3—The Embassy of the Democratic Republic of the Congo executed an agreement to sublease office space in Washington, D.C. The sublease contained a detailed notice provision applicable to all notices, demands and requests that was expressly deemed to be a “special arrangement for service” on a foreign state within the meaning of 28 U.S.C. § 1608(a)(1), as well as an express blanket waiver of immunity under the FSIA. When the embassy refused to take possession of the premises or to make sublease payments, it was successfully served with process by the sublessor and held liable for damages, including unpaid rent, interest, expenses incurred by the sublessor in reletting the premises and attorney fees.¹⁸

Illustration 4—This matter involved a cooperative apartment purchased for the residence of the ambassador of a United Nations mission and the exemption from taxation under provisions of the Vienna Diplomatic Convention. The subject purchase agreement provided for the “mansion tax”¹⁹ to be paid by the mission at closing, which, in fact, occurred. However, one year later, the mission applied for and received a full refund from New York State tax authorities with regard to the “mansion tax.” As a result of the mistaken refund,²⁰ the seller was obligated to reimburse the state for the mansion tax and paid same. The seller considered an action for breach of contract against the mission, which would have been a legally sustainable claim, but decided against such suit because of the costs involved. As in the prior illustrations, the seller would have had to deal with service of process and judgment enforcement issues because the contract of sale for the subject cooperative contained no special provisions concerning the diplomatic status of the purchaser.

Illustration 5—In retaliation for the 1983 ouster of two U.S. diplomats from Nicaragua, the U.S. State Department removed 21 Nicaraguan consular officers from the United States and closed consular posts in New York, Houston, Los Angeles, Miami and San Francisco. This left the

17 28 U.S.C. § 1610(a)(1), (a)(4)(B); Vienna Diplomatic Convention, *supra* note 5, art. 22.

18 *International Rd. Fed'n v. Embassy of the Democratic Republic of the Congo*, 131 F. Supp. 2d 248 (D.D.C. 2001).

19 N.Y. Tax Law § 1402-a.

20 See Vienna Diplomatic Convention, *supra* note 5, art. 23, § 2 (providing for payment of taxes by mission if such obligation is agreed upon by mission under contract).

Manhattan landlord of the Nicaraguan United Nations mission and consulate-general with claims under the commercial lease and issues involving jurisdiction and service of process with regard to rent and judgment enforcement.

Illustration 6—A United Nations mission entered into a long-term lease of a Greenwich, Connecticut estate for the residence of its United Nations ambassador. The foreign government made appropriate budgetary allocations for rent prior to lease execution. Shortly before taking occupancy, however, the foreign government was forced to call an unanticipated presidential election and re-allocated the Greenwich rent budget to cover the costs of Western presidential election observers and associated expenses. That left the United Nations mission without the means to meet rent obligations, and the landlord with few remedies because of the issues raised in the preceding examples.

Illustration 7—A former Soviet-bloc United Nations mission leased six apartments for its United Nations diplomats at one end of a Manhattan residential floor and purchased the apartments after the building was converted to cooperative use. For security purposes, the mission abruptly erected a wall in the hallway of the floor that blocked the fire exit for the other residents of the floor. The cooperative sought to commence a lawsuit against the mission to compel the removal of the wall. This situation presented the cooperative with the inviolability provisions affecting diplomatic residences under the Vienna Diplomatic Convention and FSIA,²¹ as well as questions of service of process and judgment enforcement.

[19.6] II. APPLICABLE LAWS

In all the preceding examples, generally, the relevant laws to be considered are as follows:

- Foreign Missions Act (FMA)
- Foreign Sovereign Immunities Act (FSIA)
- Vienna Diplomatic Convention
- Vienna Convention on Consular Relations
- International Organizations Immunities Act (IOIA)

²¹ *Id.* at art. 30; 28 U.S.C. § 1610(a)(4)(B).

In dealing with a lease or other agreement involving a foreign state party, in addition to considerations under the Foreign Missions Act,²² the extent of such party's immunity from jurisdiction and enforcement must be assessed. Historically, the concept of immunity may be traced to the usages and customs of the earliest people. As a means of negotiation and discussion, it often became necessary for early tribes to appoint envoys whose functions were of social significance to both the sending and receiving communities. Those tribes soon realized that reciprocal advantages and mutual interests would be gained by granting those envoys special privileges and protections. The use of ambassadors by the Greek city-states, for example, was a common practice, and their inviolability was recognized as necessary to carrying on negotiations. By the 18th and 19th centuries, the doctrine of broad diplomatic immunity for envoys was generally recognized in international law and practiced by most civilized states.²³

Today in the United States (and in most countries), a distinction may be made between *diplomatic* immunity which, on the one hand, provides immunity from U.S. jurisdiction to "diplomatic agents" or "consular officers" (i.e., individuals) and provides certain protections to real or personal property leased or owned by a foreign government for diplomatic purposes, and *sovereign* immunity, on the other hand, which provides a range of immunities from U.S. judicial and administrative jurisdiction to foreign states and their agencies and instrumentalities. In addition, with regard to international organizations (and their officials), their immunities in the United States are governed by sovereign immunity or diplomatic immunity depending on the particular entity involved.

In order to identify legal issues with respect to any particular leasing transaction involving a foreign government or international organization party, the juridical character of the party must be determined in order to make an analysis of the applicable law.

[19.7] A. The Foreign Missions Act

By 1981, Congress came to the conclusion that American diplomatic missions abroad were not treated on the same basis as were foreign missions operating in the United States. The Senate Committee on Foreign Relations in referring to inequities faced by American diplomats abroad

22 Foreign Missions Act, 22 U.S.C. §§ 4301-4316 (FMA).

23 William Barnes, *Diplomatic Immunity From Local Jurisdiction*, Dep't of State Bulletin, Vol. 43, No. 1101 (Aug. 1, 1960).

described the former Soviet Union and certain East European countries as barring the United States from purchasing offices and residential properties for its diplomatic installations, and Algeria as expropriating U.S. property and placing restrictions in the leasing of local office space and residential housing for U.S. missions.²⁴ Accordingly, on August 24, 1982, Congress passed the FMA to provide control in the United States over all foreign missions.²⁵ The aim of the FMA is to ensure equal treatment for U.S. diplomatic installations worldwide on a reciprocal basis with that granted to foreign missions in the United States; the FMA makes U.S. foreign policy a factor of every foreign government office lease in the United States.

Under the FMA, the secretary of state must consider several factors in determining whether a foreign mission or international organization must obtain “benefits” through the State Department based on reciprocity (or otherwise) and on terms approved by the secretary of state.²⁶ The extremely broad authority of the secretary of state under the FMA includes the right to approve, disapprove or impose special conditions on “benefits” available to foreign missions including, among other things,

24 S. Rep. No. 97-283, 97th Cong. 1st Sess. 2 (1981).

25 See *supra*, note 22.

26 22 U.S.C. § 4304(b). The criteria are (1) whether relations between the United States and a foreign state will be facilitated; (2) whether U.S. interests will be protected; (3) whether adjustments need to be assessed in view of costs and procedures of obtaining benefits for U.S. missions abroad; (4) whether a dispute affecting U.S. interests and involving a foreign state might be resolved; or (5) whether implementing “an exchange of property between the Government of the United States and the government of a foreign country, such property to be used by each government in the respective receiving state for, or in connection with, diplomatic or consular establishments . . .”

real property acquisitions.²⁷ Consequently, on the basis of diplomatic reciprocity, the Secretary of State may invoke the FMA in connection with any commercial lease or other real estate transaction.

The FMA establishes a section within the State Department—the Office of Foreign Missions (OFM)—whose primary responsibility is to review “benefits” available to foreign missions.²⁸ Procedurally, under the FMA, all foreign government offices in the United States, including United Nations missions, Washington embassies, consular posts and a variety of other foreign government offices (including trade or cultural affairs offices), are required to notify the OFM before any proposed lease, acquisition, sale or other disposition of any real property. The term acquisition includes any “acquisition or alteration of, or addition to, any real property or any change in the purpose for which real property is used by a foreign mission.”²⁹ The State Department has sixty days to review the notification and, significantly, where a real property acquisition occurs without appropriate approval, the Secretary of State has the authority to void the transaction.³⁰

27 22 U.S.C. § 4302(a)(1). Under this provision, “benefit” is defined as:

any acquisition, or authorization for an acquisition, in the United States by or for a foreign mission, including the acquisition of—

- (A) real property by purchase, lease, exchange, construction, or otherwise,
- (B) public services, including services relating to customs, importation, and utilities, and the processing of applications or requests relating to public services,
- (C) supplies, maintenance, and transportation,
- (D) locally engaged staff on a temporary or regular basis,
- (E) travel and related services,
- (F) protective services, and
- (G) financial and currency exchange services,

and includes such other benefits as the Secretary may designate.

28 22 U.S.C. § 4303.

29 22 U.S.C. § 4305(a)(2).

30 22 U.S.C. § 4305. In the early 1980s, Hsinhua, the news reporting agency of the People’s Republic of China (PRC), entered into an agreement to purchase a building in Washington for use as its offices at a time when the U.S. was not entitled to take title to real property in the PRC. The State Department, using its authority under the FMA, prevented Hsinhua from acquiring the property. The State Department ultimately resolved the matter after negotiations by taking title in the name of the United States Government and granting a long term lease to the PRC.

[19.8] B. Foreign Sovereign Immunities Act

The FSIA provides all foreign states with immunity from the jurisdiction of U.S. courts, subject to various exceptions set forth in sections 1605 and 1605A of the FSIA. Prior to the enactment of the FSIA, the State Department in litigation involving a foreign state would suggest its views to a particular judicial forum as to whether or not immunity would be appropriate based on principles of international comity. In 1952, the State Department issued the so-called “Tate letter”³¹ to the Justice Department, pursuant to which the United States adopted as a policy the then-current international practice of granting immunity to foreign governments only with respect to their sovereign or public acts. However, the State Department’s primary responsibility for U.S. foreign policy left litigants in the position of not knowing whether the geopolitical interests of the United States would affect the views of the State Department on sovereign immunity issues in a given litigation.

Accordingly, in 1976, Congress passed the FSIA, which formally adopted the so-called restrictive theory of sovereign immunity by limiting the immunities of foreign states to their public or governmental acts (*jure imperii*) and therefore eliminating their immunities with respect to their commercial or private acts (*jure gestionis*).³² In addition, the FSIA vests the judiciary with immunity determinations, and provides for service of process and judgment enforcement in litigation involving foreign sovereigns.

Under section 1603 of the FSIA, a “foreign state” is defined to include a “political subdivision” or an “agency or instrumentality” of a foreign state. The term “political subdivision” of a foreign state, for example, would include a Washington embassy, United Nations mission or consulate-general of a foreign sovereign. Under section 1603, the term “agency or instrumentality of a foreign state”

means any entity—(1) which is a separate legal person, corporate or otherwise, and (2) which is an organ of a foreign state or political subdivision thereof, or a majority of whose shares or other ownership interest is owned by a foreign state or political subdivision thereof, and (3)

31 Letter from Jack B. Tate, Acting Legal Advisor of U.S. Dep’t of State, to Philip B. Perlman, Acting U.S. Attorney General, 26 Dep’t St. Bull. 984 (1952).

32 See, e.g., *Samantar v. Yousuf*, 560 U.S. 305 (2010) (holding that FSIA does not apply to suits against individual foreign officials in their personal capacity).

which is neither a citizen of a state of the United States . . .
nor created under the laws of any third country.

Thus, the foregoing definition includes all entities which are owned or controlled by foreign governments, including, *inter alia*, banks, trading companies, shipping companies and airlines. Once a foreign state claims immunity under the FSIA, the plaintiff bears the initial burden of producing evidence that one of the FSIA exceptions applies.³³ The burden of proof then shifts to the foreign state defendant to prove by a preponderance of the evidence that the exception does not apply.³⁴

[19.9] 1. Immunity Exceptions Under the FSIA

Sections 1605 and 1605A of the FSIA establish the general exceptions to sovereign immunity. Section 1605 provides that a “foreign state” is not immune from the jurisdiction of U.S. courts in any case:

(1) in which the foreign state has waived its immunity either explicitly or by implication, notwithstanding any withdrawal of the waiver which the foreign state may purport to effect except in accordance with the terms of the waiver;³⁵

33 *Peterson v. Islamic Republic of Iran*, 627 F.3d 1117, 1125 (9th Cir. 2010) (citing *Phaneuf v. Republic of Indonesia*, 106 F.3d 302 (9th Cir. 1997)).

34 *See, e.g., Pradhan v. Al-Sabah*, 299 F. Supp. 2d 493, 497 (D. Md. 2004).

35 *See, e.g., Aquamar S.A. v. Del Monte Fresh Produce N.A.*, 179 F.3d 1279 (11th Cir. 1999) (holding that statement by Ecuador’s ambassador that government of Ecuador and government agency waived agency’s immunity was valid waiver of immunity under FSIA); *Trans Chem. Ltd. v. China Nat’l Mach. Imp. and Exp. Corp.*, 161 F.3d 314 (5th Cir. 1998) (holding that corporation owned by Chinese state waived immunity by contracting to arbitrate in United States claims arising out of construction contract); *Berdakin v. Consulado de La Republica de El Salvador*, 912 F. Supp. 458 (C.D. Cal. 1995) (holding that consulate implicitly waived immunity by entering into a lease explicitly governed by state law); *Eckert Int’l Inc. v. Gov’t of Sovereign Democratic Republic of Fiji*, 32 F.3d 77 (4th Cir. 1994) (holding that government of Fiji impliedly waived immunity by entering into a contract with a Virginia corporation containing Virginia choice of law provision); *Raji v. Bank Sepah-Iran*, 139 Misc. 2d 1026, 529 N.Y.S.2d 420 (Sup. Ct., N.Y. Co. 1988) (holding that Iranian commercial bank waived immunity when it failed to raise immunity defense in responsive pleading and instead asserted claims against plaintiff for adjudication by court). Implied waivers are generally found only where a foreign state has (1) agreed to arbitration in another country, (2) agreed that the law of a particular country will govern a contract, or (3) when a foreign state has filed a responsive pleading in an action without raising the defense of sovereign immunity; *Saudi Basic Indus. Corp. v. ExxonMobil Corp.*, 194 F. Supp. 2d 378, 402 (D.N.J. 2002), citing to *Aquamar S.A. supra*.

(2) in which the action is based upon a commercial activity³⁶ carried on in the United States by the foreign state; or upon an act performed in the United States in connection with a commercial activity of the foreign state elsewhere; or upon an act outside the territory of the United States in connection with a commercial activity of the foreign state elsewhere and that act causes a direct effect in the United States;³⁷

(3) in which rights in property taken in violation of international law are in issue and that property or any property exchanged for such property is present in the United States in connection with a commercial activity carried on in the United States by the foreign state; or that property or any property exchanged for such property is owned or operated by an agency or instrumentality of the foreign state and that agency or instrumentality is engaged in a commercial activity in the United States;

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- 36 Section 1603(d) of the FSIA provides that commercial activity means “either a regular course of commercial conduct or a particular commercial transaction or act;” 28 U.S.C. § 1603(d). For additional discussion of what constitutes a “commercial activity,” see *In re Potash Antitrust Litigation*, 686 F. Supp. 2d 816, 823 (N.D. Ill. 2010) (holding that a decision made by a company owned and established by the Government of Belarus to reduce exportation of a product constituted a sovereign function and not a commercial activity); *Microsoft Corp. v. Commonwealth Scientific and Indus. Research Org.*, 2005 WL 2233861 (N.D. Cal. Sept. 13, 2005) (negotiations relating to a patent license held to constitute a commercial activity); *Cho v. Republic of Korea*, 66 F. App’x 85 (9th Cir. 2003) (Republic of Korea’s fraudulent act of forging corporate documents of privately held company as part of alleged scheme to nationalize companies held to constitute commercial activity). *But see Dale v. Colagiovanni*, 443 F.3d 425, 428 (5th Cir. 2006) (formation of charitable trust by a monsignor constituted apparent, not actual authority and thus was insufficient to trigger the commercial activity exception of the FSIA).
- 37 See, e.g., *City of New York v. Republic of Philippines*, 2004 WL 2710026 (S.D.N.Y. Nov. 23, 2004) (holding that Republic of Philippines’ operation of a bank, restaurant and airline office did not entitle it to claim sovereign immunity under FSIA with respect to such activities); *Byrd v. Corporacion Forestal y Industrial de Olancho S.A.*, 182 F.3d 380 (5th Cir. 1999) (affirming district court’s assertion of subject matter jurisdiction over Honduran corporation which leased sawmill located in Honduras to U.S. lease assignee pursuant to commercial activity exception to FSIA), *abrogated on other grounds*, *Samanter v. Youseuf*, 560 U.S. 305 (2010); *Stupay v. Embassy of the Sultanate of Oman*, 187 F.3d 631 (4th Cir. 1999) (affirming district court’s fee award after finding that embassy’s lease of a house in Virginia fell within commercial activity exception); *Berdakin v. Consulado de La Republica de El Salvador*, 912 F. Supp. 458 (C.D. Cal. 1995) (holding that consulate’s breach of lease due to property’s unsuitability for consular purposes fell within commercial activity exception); *Saunders Real Estate Corp. v. Consulate General of Greece*, 1995 WL 598964 (D. Mass. Aug. 11, 1995) (holding that consulate’s lease of property in Massachusetts fell within commercial activity exception); *Joseph v. Office of the Consulate General of Nigeria*, 830 F.2d 1018 (9th Cir. 1987) (holding that Nigerian consulate’s execution of lease agreement to provide residence for employees fell within commercial activity exception).

(4) in which rights in property in the United States acquired by succession or gift or rights in immovable property [i.e., real estate] situated in the United States are in issue; or

(5) not otherwise encompassed in paragraph (2) above, in which money damages are sought against a foreign state for personal injury or death, or damage to or loss of property, occurring in the United States and caused by the tortious act or omission of that foreign state or of any official or employee of that foreign state while acting within the scope of his office or employment; except this paragraph shall not apply to—

(A) any claim based upon the exercise or performance or the failure to exercise or perform a discretionary function regardless of whether the discretion be abused, or

(B) any claim arising out of malicious prosecution, abuse of process, libel, slander, misrepresentation, deceit, or interference with contract rights; or

(6) in which the action is brought, either to enforce an agreement made by the foreign state with or for the benefit of a private party to submit to arbitration all or any differences which have arisen or which may arise between the parties with respect to a defined legal relationship, whether contractual or not, concerning a subject matter capable of settlement by arbitration under the laws of the United States, or to confirm an award made pursuant to such an agreement to arbitrate, if (A) the arbitration takes place or is intended to take place in the United States, (B) the agreement or award is or may be governed by a treaty or other international agreement in force for the United States calling for the recognition and enforcement of arbitral awards, (C) the underlying claim, save for the agreement to arbitrate, could have been brought in a United States court under this section or section 1607, or (D) paragraph (1) of this subsection is otherwise applicable.

Furthermore, section 1605A³⁸ provides that, subject to certain limitations,³⁹ a “foreign state” is not immune from the jurisdiction of U.S. courts in any case:

not otherwise covered by this chapter [Chapter 97 – Jurisdictional Immunities of Foreign States] in which money damages are sought against a foreign state for personal injury or death that was caused by an act of torture, extrajudicial killing, aircraft sabotage, hostage taking, or the provision of material support or resources for such an act if such act or provision of material support is engaged in by an official, employee, or agent of such foreign state while acting within the scope of his or her office, employment, or agency.⁴⁰

There are certain other exceptions to jurisdictional immunity that are not relevant to this chapter.

With regard to service of process, section 1608 draws a distinction between foreign states (and their political subdivisions), on the one hand, and agencies or instrumentalities, on the other hand.⁴¹ Under section 1608(a), service of process may be made on a foreign state (or political subdivision) (1) by way of a special arrangement for service of process (e.g., a lease provision providing a method for service of process); or (2) if there is no special arrangement for service of process, then under an

38 For additional discussion on § 1605A, also known as the “state terrorism exception,” see *In re Islamic Republic of Iran Terrorism Litig.*, 659 F. Supp. 2d 31 (D.D.C. 2009).

39 See 28 U.S.C. § 1605A(a)(1).

40 Definitions of “torture,” “extrajudicial killing,” “hostage taking” and “aircraft sabotage” are found at 28 U.S.C. § 1605A(h). It should be noted that, in connection with § 1605A (the so-called “state-sponsored terrorism” exception), property of foreign governments is subject to execution or attachment pursuant to the Terrorism Risk Insurance Act of 2002, Pub. L. No. 107-297, 116 Stat. 2322.

41 See e.g., *Barot v. Embassy of Republic of Zambia*, 11 F. Supp. 3d 24 (D.D.C. 2014) (holding that FSIA’s service of process requirements under § 1608(a) requires strict compliance), but see *Barot v. Embassy of Republic of Zambia*, 785 F.3d 26 (D.C. Cir. 2015); see also *Magness v. Russian Fed’n*, 247 F.3d 609, 616 (5th Cir. 2001), (noting that “substantial compliance with § 1608(b) is sufficient so long as the defendants have actual notice of the suit”); *Semtek Int’l Inc. v. Info. Satellite Sys.*, 2012 WL 831475 (D. Mass. Mar. 9, 2012) (“While service on a ‘foreign state’ under FSIA § 1608(a) must be accomplished in accordance with standard of ‘strict compliance,’ service on an agency or instrumentality of a foreign state under § 1608(b) requires only ‘substantial compliance.’”); but see *Peterson v. Islamic Republic of Iran*, 627 F.3d 1117 (9th Cir. 2010) (stating that the “Ninth Circuit has adopted a substantial compliance test” for service of process against a foreign state).

applicable international convention.⁴² If service of process cannot be effected by any of the foregoing means, then a copy of a summons and complaint and a notice of suit, together with translations of applicable papers, may be delivered to the clerk of the relevant court for delivery to the head of the ministry of foreign affairs of the foreign state concerned.⁴³ If service of process cannot be effected through the clerk of the court within 30 days, then service may be made through the Secretary of State using diplomatic means.

With regard to foreign state-owned entities (that is, agencies or instrumentalities of foreign sovereigns), service of process may be effected in the same manner as with foreign states and their political subdivisions, in addition to certain other means.⁴⁴

[19.10] 2. Enforcement Measures Under the FSIA

Under section 1610(a) of the FSIA, the property of a foreign state is immune from attachment or execution except as otherwise provided in sections 1610 and 1611. Section 1610 provides that the property of a foreign state (including a political subdivision or agency or instrumentality thereof) used for “commercial activities” in the United States⁴⁵ shall not be immune from attachment in aid of execution or from execution upon a judgment if (1) the foreign government has expressly or implicitly waived its immunity from attachment or execution; (2) the property against which attachment or execution is sought “is or was used for the commercial

42 Hague Convention on Service Abroad of Judicial and Extrajudicial Documents in Civil and Commercial Matters, Feb. 10, 1969, 20 U.S.T. 361, T.I.A.S. No. 6638; Inter-American Convention on Letters Rogatory and Additional Protocol, Jan. 30, 1975, S. Treaty Doc. No. 98-27 (1986).

43 In this connection, it should be noted that the clerk of the District Court for the Southern District of New York has special rules regarding service of process on foreign sovereigns (see Appendix C); see *Ben-Rafael v. Islamic Republic of Iran*, 540 F. Supp. 2d 39 (D.D.C. 2008) (holding that under § 1608(a)(3), service of process via mail must be sent to the head of the ministry of foreign affairs of the foreign state concerned and that attempted personal service on an embassy of a foreign state, foreign ambassador, or UN mission does not comply with the statutory requirements).

44 28 U.S.C. § 1608(b).

45 See *Walters v. People’s Republic of China*, 672 F. Supp. 2d 573 (S.D.N.Y. 2009) (in order for FSIA to apply, the property and assets of a sovereign defendant must be located within the United States); see also *Republic of Argentina v. NML Capital Ltd.*, 134 S. Ct. 2250 (2014) (holding that no provision of the FSIA immunizes a foreign-sovereign judgment debtor from post-judgment discovery of information concerning its extraterritorial assets).

activity upon which the claim was based”;⁴⁶ (3) “the execution relates to a judgment establishing rights in property . . . taken in violation of international law”; (4) the execution relates to rights in property acquired by succession or gift or in immovable property (i.e., real property) located in the United States (other than real property used for certain diplomatic purposes);⁴⁷ (5) the property consists of a contractual obligation to indemnify a foreign state under a policy of automobile or other liability insurance covering the claim which merged with the judgment; (6) “the judgment is based upon an order confirming an arbitral award”; or (7) “the judgment relates to a claim for which the foreign state is not immune under section 1605A . . .”

It should be noted that an express or implied waiver of immunity under FSIA section 1605 for jurisdictional purposes will not be helpful with respect to enforcing a judgment against a foreign state for which a separate waiver under section 1610 is required or other conditions must be met.⁴⁸

Furthermore, under section 1610(b) of the FSIA with respect to *any* property (i.e., regardless of whether it is used for commercial activity) of an agency or instrumentality of a foreign state engaged in commercial activities in the United States, such property is not immune from attachment in aid of execution or execution upon a judgment (1) where the entity has explicitly or implicitly waived its immunity from attachment or execution, notwithstanding any withdrawal of such waiver; or (2) where a “judgment relates to a claim for which the agency or instrumentality is not immune by virtue of section 1605(a)(2), (3), or (5), 1605(b), or 1605A of this chapter, regardless of whether the property is or was involved in the act upon which the claim is based.” Consequently, in contrast to a foreign state or political subdivision thereof, when an agency or instrumentality

46 See, e.g., *Enron Equip. Procurement Co. v. M/V Titan 2*, 82 F. Supp. 2d 602 (W.D. La. 1999) (denying motion to dissolve attachment of vessel where explicit waiver from attachment was granted, foreign sovereign admitted agreements were the result of commercial activity and purpose of attachment was to secure payment); *Birch Shipping Corp. v. Embassy of United Republic of Tanzania*, 507 F. Supp. 311 (D.D.C. 1980) (holding that Republic of Tanzania’s checking account was not immune from attachment since Tanzania waived immunity by executing agreement providing for arbitration and judicial enforcement of any award entered pursuant to agreement and checking account was used for commercial activity).

47 See *Permanent Mission of India to the United Nations v. City of New York*, 551 U.S. 193 (2007) (holding that the “immovable property” exception in § 1605(a)(4) includes an action to establish the validity of a tax lien).

48 See, e.g., *Ministry of Defense and Support v. Elahi*, 556 U.S. 366 (2009) (in order to prevail on a defense of sovereign immunity to prevent attachment of arbitral award, attachment at issue had to be a “blocked asset” under the Terrorism Risk Insurance Act).

of a foreign state is subject to jurisdiction of U.S. courts on the basis of its commercial activities, any property of that agency or instrumentality will be available for judgment enforcement, notwithstanding the absence of a separate express or implied judgment enforcement waiver.

As a result of the foregoing, any commercial lease involving a foreign sovereign, in addition to providing for a special arrangement for service of process, should include an express waiver of sovereign immunity as to both jurisdiction and enforcement. Annexed hereto as Appendix A is a model form of commercial lease clause which, if executed by a foreign government or other official with appropriate authority, should provide for service of process, jurisdiction and attachment or judgment enforcement measures with regard to foreign government tenants, including diplomatic tenants.

[19.11] C. The Vienna Conventions

When a foreign state acts through a diplomatic entity (e.g., its Washington embassy, United Nations mission or a consular post), in addition to sovereign immunity, the foreign state will enjoy immunities under the Vienna Diplomatic Convention or the Vienna Consular Convention, depending upon the official United States accreditation of the office involved. Those conventions generally provide foreign governments certain broad immunities with regard to diplomatic premises owned or leased for office premises or for residences of diplomats.

[19.12] 1. Diplomatic Immunity

The Vienna Diplomatic Convention establishes diplomatic law worldwide and applies to all “diplomatic offices”⁴⁹ in the United States accredited as such by the State Department. It is the product of the United Nations International Law Commission, established in 1947 to promote the development of public international law and is currently the law in 190 countries.⁵⁰ Although the Vienna Diplomatic Convention was

49 Although the term “diplomatic office” is often used to refer generally to an embassy or consulate, there is a distinction in function (and therefore in legal rights) between a “mission” accredited under the Vienna Diplomatic Convention, and a “consular post” accredited under the Vienna Consular Convention. Generally, a mission is charged with bilateral political relations between its sending state and the receiving state (or in the case of United Nations missions, multilateral political relations), and a consular post is generally charged with bilateral trade, investment or cultural relations between its sending state and the receiving state, as well as protecting the interests of the sending state’s citizens in the receiving state.

50 Entered into force with respect to the United States on December 13, 1972.

intended to set the standard for bilateral diplomatic relations worldwide, it also applies to New York City's multilateral United Nations diplomatic community pursuant to U.S. statutory and treaty law.⁵¹

The Vienna Diplomatic Convention protects diplomatic premises as well as individual diplomatic officers.⁵² The protection of “mission premises”⁵³ under the Vienna Diplomatic Convention is very broad. Article 22 bluntly states that the premises of the mission are inviolable and that agents of the receiving state may not enter the premises without the consent of the head of the mission. Further, the receiving state has an affirmative obligation to protect the “peace” and “dignity” of the mission. Moreover, under article 22, the transport of the mission and mission property are granted broad immunities. In short, there is no enforcement jurisdiction whatsoever over diplomatic premises or property absent an effective waiver, including any jurisdiction to enforce a warrant of eviction with regard to commercial offices. Similarly, section 1610(a)(4)(B) of the FSIA, which, as a general proposition, provides for jurisdiction over foreign state-owned real property situated in the United States, is careful to carve out an exception for real property used for maintaining a diplomatic or consular mission or the residence of the head of such mission.⁵⁴

51 Diplomatic Relations Act of 1978, Pub. L. No. 95-393, 92 Stat. 808 (1978); Convention on the Privileges and Immunities of the United Nations, Feb. 13, 1946, 21 U.S.T. 1418, T.I.A.S. No. 6900 (“General Convention”); Agreement Between the United Nations and the United States of America Regarding The Headquarters of the United Nations, June 26, 1947, 61 Stat. 3416, T.I.A.S. No. 1676, as amended (“Headquarters Agreement”).

52 See, e.g., *Tachiona v. U.S.*, 386 F.3d 205, 221–22 (2d Cir. 2004). In case involving attempted service of process on Zimbabwe President Robert Mugabe and other Zimbabwe officials visiting New York, Vienna Diplomatic Convention’s protection of diplomats’ “inviolability” of the person protected them against class plaintiffs’ service of process.

53 Vienna Diplomatic Convention, *supra* note 5, art.1 defines the “premises of the mission” to include the building and land used for purposes of the mission (irrespective of ownership) and the residence of the head of mission.

54 See *Mendik Realty Co. v. Permanent Mission of Libya to the U.N.*, 81 Civ. 5410, 1981 U.S. Dist. LEXIS 15862 (S.D.N.Y. Nov. 16, 1981). In this case, an action was brought against the Libyan U.N. Mission for failing to vacate its premises at the end of its lease pending the completion of its Manhattan office building. However, the merits of the action were not reached because Libya obtained a dismissal of the action for insufficiency of service of process and negotiated a lease extension with its landlord. Although commercial leasing was intended to be an exception to sovereign immunity under the FSIA, 28 U.S.C. § 1610(a)(4)(B) specifically excludes attachment or execution against property “used for purposes of maintaining a diplomatic . . . mission.” Further, article 22 of the Vienna Diplomatic Convention would similarly preclude any enforcement procedures.

With regard to diplomatic officers (or “agents”) accredited as such by the State Department, the Vienna Diplomatic Convention makes them immune from U.S. civil or criminal jurisdiction under article 31, except in the following circumstances:

- (1) A real property action relating to private immovable property unless held on behalf of the sending state for purposes of the mission;
- (2) An action relating to succession in which a diplomatic agent is involved as a private person; or
- (3) Any action relating to professional or commercial activities exercised by the diplomat outside official functions.

Notwithstanding these jurisdictional exceptions, article 30 provides that the private residence of a diplomat enjoys the same inviolability and protection as the premises of a mission, and article 31 states that no measures of judgment execution may be taken with respect to the above exceptions which would infringe upon the inviolability of a diplomatic agent or his or her residence. As a consequence, absent a waiver, the success of any enforcement action against an individual diplomat is extremely remote.⁵⁵

[19.13] 2. Consular Immunity

The Vienna Consular Convention, which, like the Vienna Diplomatic Convention, is the product of the International Law Commission, sets the worldwide standard for consular law. With regard to the premises of consular posts, article 31 of the Vienna Consular Convention states that the “Consular premises shall be inviolable” and “the authorities of the receiv-

55 Generally, the presumption of immunity under the Vienna Diplomatic Convention for “diplomatic agents” is very strong. *See, e.g., Ahmed v. Hoque*, 2002 WL 1964806 (S.D.N.Y. Aug. 23, 2002), where the Economics Minister for the Permanent Mission of Bangladesh to the U.N. was sued for, *inter alia*, 13th Amendment claims of slavery by former domestic employee and suit was dismissed where plaintiff offered no authority to support a claim that a constitutional right prevails over diplomatic immunity. In addition to diplomatic agents, there are other categories of mission employees, including “members of the administrative and technical staff” and “members of the service staff.” In order to determine the extent of any individual’s privileges and immunities, an analysis of the individual’s accreditation must be made to determine the extent of applicable privileges and immunities under the Vienna Diplomatic Convention.

ing State shall not enter that part of the consular premises which is used exclusively for the purpose of the work of the consular post except with the consent of the head of the consular post.” Accordingly, judgment enforcement measures may not be taken against consular premises under the Vienna Consular Convention, including the enforcement of warrants of eviction. In addition, the enforcement restrictions concerning diplomatic premises under section 1610(a)(4)(B) of the FSIA are also applicable to consular premises. With regard to consular officers, their immunities are substantially more limited than those of diplomatic agents in that they enjoy so-called “functional immunity,” that is, immunity with respect to matters pertaining to official duties.⁵⁶

[19.14] 3. Diplomatic/Consular Waivers

Both the Vienna Diplomatic Convention and the Vienna Consular Convention provide for the “sending state” (i.e., not the individual) to waive the immunities of “diplomatic agents” and “consular officers.”⁵⁷ Both conventions provide that the waiver of jurisdictional immunity must be express and require a separate express waiver for judgment execution.

With regard to asserting jurisdiction over a mission or consular post, as political subdivisions of a foreign state, the FSIA must be considered.⁵⁸ With regard to enforcement measures against mission or consular premises or other property, there are no specific waiver provisions under either the Vienna Diplomatic Convention or the Vienna Consular Convention. Although it is probably contractually permissible to obtain such a waiver, most foreign sovereigns are extremely reluctant to waive any diplomatic privileges or immunities. Such a request on the part of a prospective lessor would likely create an impediment to a lease transaction. However, this reluctance to grant waivers is not necessarily the case with regard to non-diplomatic foreign government offices or entities.

[19.15] D. Related Laws

There are currently 85 “international organizations” in the United States that are protected by multilateral agreements or U.S. statutory law, among which, perhaps, the United Nations is best known. In negotiating any lease with an international organization, it is essential to identify the

56 Vienna Convention on Consular Relations Optional Protocols, Apr. 24, 1963 (“Vienna Consular Convention”), art. 43.

57 *Id.* at art. 45; Vienna Diplomatic Convention, *supra* note 5, art. 32.

58 28 U.S.C. §§ 1602–1611.

applicable body of law affecting the international organization in order to analyze relevant legal issues.

With regard to the United Nations, the U.N. Charter,⁵⁹ drafted in San Francisco in 1945, establishes the United Nations as an international organization and provides the basis for its privileges and immunities. The U.N. Charter establishes the juridical character of the United Nations,⁶⁰ and provides that the U.N. shall be granted such immunities as are necessary to fulfill its purposes. In 1946, the United Nations General Assembly adopted the General Convention,⁶¹ which implements section 105 of the U.N. Charter. Under the General Convention, all assets and property of the United Nations shall enjoy immunity from every form of legal process except As is the case with diplomatic premises, the premises of the United Nations are inviolable, and all property of the United Nations is immune from search, requisition or any form of execution. As to officials of the United Nations, by and large, they enjoy functional immunity under the General Convention, except that senior officials (e.g., the Secretary-General, assistants secretary general and under secretaries general) generally enjoy the same immunities as diplomatic agents.⁶²

Further, the Headquarters Agreement,⁶³ among other things, establishes the contractual rights of the United Nations, the governing law and authority in the United Nations headquarters district and the diplomatic status of representatives of United Nations members. As to immunity from process, no federal, state or local law officials are permitted to perform any duties within the United Nations headquarters district without the approval of the Secretary General.

59 Charter of the United Nations, June 26, 1945, 59 Stat. 1031, T.S. No. 993, as amended, entered into force with respect to the United States on Aug. 8, 1945 ("U.N. Charter").

60 *Id.* at art. 104.

61 General Convention, *supra* note 50.

62 *Id.* § 19. *But see Westchester County v. Ranollo*, 187 Misc. 777, 67 N.Y.S.2d 31 (New Rochelle City Ct. 1946), in which the court held that the defendant driver of a car carrying former U.N. Secretary General Trygvie Lie was not immune from prosecution for driving an automobile in excess of the speed limit, although he was an employee of the United Nations. The court reasoned that "[t]o recognize the existence of a general and unrestricted immunity from suit or prosecution on the part of the personnel of the United Nations, so long as the individual be performing in his official capacity, even though the individual's function has no relation to the importance or the success of the organization's deliberations, is carrying the principle of immunity completely out of bounds."

63 *See* Headquarters Agreement, *supra* note 50.

In addition to the foregoing, the IOIA provides special status to the United Nations as well as other international organizations. Under section 1 of the IOIA, an international organization is defined as “any... international organization in which the United States participates pursuant to treaty or under the authority of any act of Congress....” The benefits of IOIA are granted through presidential executive order.⁶⁴

Section 2 of the IOIA provides international organizations, their property and assets with the same immunity from suit and judicial process as is enjoyed by foreign governments, absent an express waiver. Similarly, representatives of, or to, international organizations are entitled to functional immunity under section 7 of the IOIA with regard to their official acts, absent an express waiver.

In sum, when dealing with any international organization in the United States, the same issues as those relating to foreign sovereigns need be considered, including the basis for asserting personal jurisdiction and means of service of process and judgment enforcement.

[19.16] III. CONCLUSION

In order to analyze the issues involving a foreign sovereign or international organization in commercial leasing transactions, its legal status in the United States must be examined—that is, a determination must be made as to whether the subject entity is a foreign state (or a political subdivision or an agency or instrumentality thereof) or an international organization. That determination will help clarify whether sovereign and/or diplomatic immunity are at issue. On that basis, the relevant laws referenced in this article should provide the legal framework to recognize and assess leasing issues.

⁶⁴ By Presidential Executive Orders, there are approximately 85 “international organizations” under the IOIA, including those listed in Appendix B at the end of this chapter.

APPENDIX A**Form of Commercial Lease Waiver
for Foreign Sovereign Tenants**

The Tenant agrees that this Lease (including any modification, amendment or supplement to this Lease, as well as any related consent, license, window display or other agreement that may be hereafter entered into) constitutes a commercial act by the Tenant within the meaning of the FSIA (as hereinafter defined) and the Tenant is generally subject to setoff, suit, attachment judgment and execution in respect of this Lease and the transactions contemplated thereby, and neither has, nor is entitled to, and hereby expressly and irrevocably waives to the full extent permitted by applicable law (including, without limitation, the United States Foreign Sovereign Immunities Act of 1976, as amended (FSIA), the Vienna Convention on Diplomatic Relations, 23 U.S.T. 3227, and the Vienna Convention on Consular Relations, 23 U.S.T. 77), any present or future claim to any immunity, whether characterized as sovereign immunity, diplomatic immunity or otherwise from any legal proceedings, whether in the United States of America or elsewhere, to enforce or collect upon this Lease (including, without limitation, immunity from service of process, immunity from jurisdiction of any court or tribunal, and immunity of any of its property from attachment prior to entry of judgment and from attachment in aid of execution, and from execution upon a judgment) in respect of itself or its property in any action or proceeding in respect of its obligations under this Lease. The Tenant hereby agrees that any legal action or proceeding with respect to this Lease may be brought in the courts of the State of New York in the City of New York, or in the United States District Court for the Southern District of New York, as the Landlord may elect. By execution and delivery of this Lease, the Tenant hereby accepts with regard to any such action or proceeding, for itself and in respect of its property, generally and unconditionally, (i) the jurisdiction of the aforesaid courts; and (ii) that service of process may be effected upon Tenant by any lawful means permissible within the State of New York and said service is hereby deemed a "special arrangement" for service within the meaning of section 1608 of the FSIA. Nothing herein shall affect the right of the Landlord to commence legal proceedings or otherwise proceed against the Tenant in the Tenant's country or in any other jurisdiction in which assets of the Tenant are located or to serve process in any other manner permitted by applicable law. The Tenant further agrees that final judgment against it in any such action or proceeding shall be conclusive

and, to the extent permitted by applicable law, may be enforced in any other jurisdiction within or outside the United States of America by suit on the judgment, a certified or exemplified copy of which shall be conclusive evidence of the fact and of the amount of its indebtedness.

APPENDIX B
Organizations Under the IOIA

African Development Bank

African Development Fund

African Union

Asian Development Bank

Border Environment Cooperation Commission

Caribbean Organization

Commission for Environmental Cooperation

Commission for Labor Cooperation

Commission for the Study of Alternatives to the Panama Canal

Council of Europe in Respect of States Against Corruption

Customs Cooperation Council

European Bank for Reconstruction and Development

European Central Bank

European Space Agency

Food and Agriculture Organization

Global Fund to Fight AIDS, Tuberculosis and Malaria

Great Lakes Fishery Commission

Hong Kong Economic and Trade Offices

Inter-American Defense Board

Inter-American Development Bank

Inter-American Institute of Agricultural Sciences

Inter-American Investment Corporation

Inter-American Statistical Institute

Inter-American Tropical Tuna Commission

Intergovernmental Maritime Consultative Organization

International Atomic Energy Agency

International Bank for Reconstruction and Development

International Boundary and Water Commission

International Centre for Settlement of Investment Disputes

International Civil Aviation Organization

International Civilian Office in Kosovo

International Coffee Organization

International Committee of the Red Cross

International Cotton Advisory Committee

International Cotton Institute

International Criminal Police Organization (INTERPOL)

International Development Association

International Development Law Institute

International Fertilizer Development Center

International Finance Corporation

International Food Policy Research Institute

International Fund for Agricultural Development

International Hydrographic Bureau

International Joint Commission, United States and Canada

International Labor Organization

International Maritime Satellite Organization

International Monetary Fund

International Pacific Halibut Commission

International Secretariat for Volunteer Service

International Telecommunication Union

International Telecommunications Satellite Organization

International Union for Conservation of Nature and Natural Resources

International Wheat Advisory Committee

Interparliamentary Union

Israel-United States Binational Industrial Research and Development Foundation

ITER International Fusion Energy Organization

Korean Peninsula Energy Development Organization

Multilateral Investment Guarantee Agency

Multinational Force and Observers

North American Development Bank

North Pacific Anadromous Fish Commission

North Pacific Marine Science Organization

Office of the High Representative in Bosnia and Herzegovina

Organization for European Economic Cooperation (now known as the Organization for Economic Cooperation and Development)

Organization for the Prohibition of Chemical Weapons

Organization of African Unity

Organization of American States (including Pan American Union)

Organization for Eastern Caribbean States

Pacific Salmon Commission

Pan American Health Organization

Preparatory Commission of the International Atomic Energy Agency

Provisional Intergovernmental Committee for the Movement of Migrants from Europe (now known as the Intergovernmental Committee for European Migration)

South Pacific Commission

United International Bureau for the Protection of Intellectual Property (BIRPI)

United Nations

United Nations Educational, Scientific, and Cultural Organization

United Nations Industrial Development Organization

United States–Mexico Border Health Commission

Universal Postal Union

World Health Organization

World Intellectual Property Organization

World Meteorological Organization

World Tourism Organization

World Trade Organization

APPENDIX C

**Special Rules for Service of Process on Foreign Sovereigns
in U. S. District Court for the Southern District
of New York**

**UNITED STATES DISTRICT COURT
SOUTHERN DISTRICT OF NEW YORK**

CLERK'S OFFICE
FOREIGN MAILING INSTRUCTIONS



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**UNITED STATES DISTRICT COURT
SOUTHERN DISTRICT OF NEW YORK**

**INSTRUCTIONS FOR SERVICE OF PROCESS
ON A FOREIGN DEFENDANT**

The Clerk of Court's Office will accomplish service overseas of the summons and complaint, either directly or through the U.S. Department of State under the following statutes:

1. An **individual in a foreign state**, under Rule 4(f)(2)(C)(ii) of the Federal Rules of Civil Procedures (FRCP); or
2. A **foreign state or a political subdivision of a foreign state** under the Foreign Services Immunities Act, 28 U.S.C. §1608(a)(3); or
3. A **foreign state or a political subdivision of a foreign state through diplomatic channels** via the U.S. Department of State under the Foreign Services Immunities Act, 28 U.S.C. §1608(a)(4); or
4. An **agency or instrumentality of a foreign state**, under the Foreign Services Immunities Act, 28 U.S.C. §1608(b)(3)(B).

OTHER DOCUMENTS SERVED

- **Orders**

An order may be entered by the court at any time during a case. The judge may request that the order be served upon the defendant(s) and should state specifically which rule to follow. An order should be served following the same methods by FRCP 4(f)(2)(C)(ii), 28 U.S.C. §1608(a)(3), 28 U.S.C. §1608(a)(4), or 28 U.S.C. §1608(b)(3)(B), depending on which rule the judge specifies.

- **Defaults**

A default may be entered by the court against a foreign defendant assuming the summons and complaint was returned unexecuted, AND the deadline for the answer has passed. A foreign state, political subdivision, or an agency or instrumentality of a foreign state has **60 days** to answer the complaint. An individual has **20 days** to answer the complaint. A default should be served according to rule judge specifies to follow: FRCP 4(f)(2)(C)(ii), 28 U.S.C. §1608(a)(3), 28 U.S.C. §1608(b)(3)(B), or 28 U.S.C. §1608(a)(4).

- **Judgments/Default Judgments**

A default may be entered by the court against a foreign defendant. The judge may request that the order be served upon the defendant(s) and should state specifically which rule to follow. A judgment or default judgment should be served following using: FRCP 4(f)(2)(C)(ii), 28 U.S.C. §1608(a)(3), 28 U.S.C. §1608(a)(4), or 28 U.S.C. §1608(b)(3)(B) depending on which rule the judge specifies.

METHODS OF SERVICE

The Clerk of Court strongly recommends the use of Federal Express (FedEx) or DHL Worldwide Express (DHL) rather than the United States Postal Service (USPS). The USPS requirements for such service are complicated and failing to comply to their standards, will result in the return of a package delaying its ultimate delivery. Using FedEx or DHL also avoids the necessity of providing the Clerk's Office with cash for postage.

Rules Set by the U.S. Postal Service

1. Do not use postage meter stamps.
2. Leave more than the exact amount for the postal fee.
3. Do not seal envelopes.
4. Make sure there is glue on the pink return receipt. (Postal Form 2865)
Mailing labels are not accepted on foreign mailing envelopes. **Addresses must be typed or handwritten on the envelope.**
5. The following envelopes are ineligible for Registered Mail:
 - a. Mail presented in a padded envelope; envelope or mailer manufactured of spun bonded.
 - b. olefin, such as Tyvek; plastic envelope or mailer; or envelope or mailer
 - c. made of glossy-coated paper.
6. Packages weighing more than four pounds must be split up according to post office regulations.

Please check with your local Post Office for the appropriate customs forms as well as updated forms.

Courier Service

Overnight mail (FedEx & DHL) is acceptable, as long as you are able to obtain a signed returned receipt. You may track the delivery of your package on the courier's website, and print the tracking summary indicating that the package was delivered to its ultimate destination. Provide a copy of that tracking summary and cover letter to the Clerk of Court as your return of service. If you have any questions, or would like a copy of our INSTRUCTIONS FOR SERVICE OF PROCESS ON A FOREIGN DEFENDANT, please see the administrative assistant to the Clerk of Court, Room 120 or visit the Court's website at www.nysd.uscourts.gov.

Foreign Sovereign Immunities Act of 1976

The Foreign Service Immunities Act of 1976 (FSIA) limits the role of the Executive Branch in suits against foreign governments and governmental entities by precluding the Department of State from making decisions on state immunity. A party to a lawsuit, including a foreign state or its agency or instrumentality, is required to present defenses such as sovereign immunity directly to the court in which the case is pending.

FSIA (28 U.S.C. §1608(a)(1)-(4)) provides for service of process on foreign state defendants in a four-step, hierarchical manner: (Source: www.travel.state.gov)

1. Pursuant to a special agreement between the plaintiff and the foreign state.
2. As prescribed in an applicable international agreement.
3. Via mail from the Clerk of Court to the head of the foreign state's Ministry of Foreign Affairs (28 U.S.C. §1608(a)(3)).
4. Via the diplomatic channel 28 U.S.C. §1608 (a)(4)

SPECIAL NOTES:

Under 28 U.S.C. § 1608(c)(1) and (c)(2) – Date of Service:

1. In the case of service under 28 U.S.C. § 1608(a)(4), service is deemed to have been made as of the date of the transmittal indicated in the certified copy of the diplomatic note.
2. In any other case under 28 U.S.C. § 1608 service is deemed to have been made as of the date of receipt applicable to the method of service employed.

Under 28 U.S.C. § 1608(e)- Default Judgment

No Judgment by default shall be entered by a court of the United States or of a State against foreign state, a political subdivision thereof, or an agency or instrumentality of a foreign state, unless the claimant establishes his claim or right to relief by evidence satisfactory to the Court. A copy of any such default judgment shall be sent to a foreign state or political subdivision in the manner prescribed for service under 28 U.S.C. §1608.

Role of the United States Department of State

The United States Department of State, Overseas Citizens Services, Office of Policy Review & Interagency Liaison is responsible for service and implementing regulations under the FSIA via the diplomatic channel in accordance with 28 U.S.C. §1608(a)(4). (Source: www.travel.state.gov)

The defendant served by the United States Department of State MUST BE a FOREIGN STATE OR POLITICAL SUBDIVISION as defined by 1603 of FSIA, not an agency or instrumentality of a foreign state to be served under section 1608(b) of the Act. The United States Department of State **DOES NOT** serve **NATURAL PERSONS** under FSIA. (Source: www.travel.state.gov) The Act specifies that when service of process upon a foreign state cannot otherwise be effected

under FSIA, the Clerk of Court may dispatch a request to the Secretary of State, attn: Director of Special Consular Services, for service upon a foreign state defendant.¹

The Act allows for service under FSIA 1608(a) (4) only after 30 days have passed since service was attempted under section 1608 (a) (3) (by any form of mail requiring a signed receipt). The U.S. Postal service and private courier services can deliver documents to virtually any location. Plaintiffs should attempt service under FSIA 1608 (a) (3) unless a foreign state has specifically objected to service by mail.²

The U.S. Department of State does not normally serve on a foreign state any documents not specifically mentioned in the Act; however, it reserves executive authority to communicate with foreign governments. Note: a default judgment does **not** include a document(s) directing further hearings on a judgment.³

Please review the United States Department of State's "Checklist for Plaintiff's Service of Process Upon a Foreign State." (**Attachment A**). If you have any additional questions regarding 28 USC § 1608(4) mailings, please contact U.S. State Department's Office of Policy Review and Inter-Agency Liaison at ASKPRI@state.gov or (202) 736-9110.

¹ U.S. Department of State. "Checklist for Plaintiffs Service of Process upon A Foreign State" http://travel.state.gov/law/judicial/judicial_685.html# Accessed May 19, 2011.

² U.S. Department of State. "Checklist for Plaintiffs Service of Process upon A Foreign State" http://travel.state.gov/law/judicial/judicial_685.html# Accessed May 19, 2011.

³ U.S. Department of State. "Checklist for Plaintiffs Service of Process upon A Foreign State" http://travel.state.gov/law/judicial/judicial_685.html# Accessed May 19, 2011.

THE HAGUE CONVENTION

Service Abroad of Judicial and Extrajudicial Documents in Civil and Commercial Matters

The Hague Convention on Service Abroad of Judicial and Extrajudicial Documents in Civil and Commercial Matters applies in cases wherein the occasion is to transmit a judicial or extrajudicial document for service abroad.

Form (USM-94)

You may obtain a copy of the Request for Service Form from the U.S. Marshal's Service website: http://www.justice.gov/marshals/process/foreign_process.htm or you may use the interactive PDF fillable form provided by the Permanent Bureau of the Hague Conference on Private International Law. http://www.hcch.net/index_en.php?act=text.display&tid=47

Complete the Form

Private litigants wishing to serve a person in one of the Convention countries should complete copies in duplicate of the three forms prescribed by the Convention: The "Request", the "Certificate" and the "Summary." Once the form is completed, the litigants must transmit them, together with the documents to be served. (See FRCP Rule 4 under Notes and Annotations to the Convention).

For further assistance in completing form, please refer to the Bureau of Consular Affairs, U.S. Department of State, http://www.travel.state.gov/law/judicial/judicial_702.html or the Convention of 15 November 1965 on the Service Abroad of Judicial and Extrajudicial Documents in Civil or Commercial Matters, <http://www.hcch.net/>

Federal Authority for Attorneys to Complete and Send Form

Attorneys representing the party seeking service should execute the portion of Form marked "Identity and Address of the Applicant" and the "Name and Address of the Requesting Authority" portion of the Summary of the Document to be Served, unless the foreign country does not consider private attorneys to be officers of the Court. (<http://www.travel.state.gov>)

If the Clerk of Court is directed by a court Order to effect service, the Form should reflect the law firm's information as the "Identity and Address of the Applicant" and the Clerk of Court under the "Name and Address of the Requesting Authority." The Clerk of Court will effect service under FRCP 4(f)(2)(C)(ii), 28 U.S.C. §1608(a)(3); 28 U.S.C. §1608(a)(4) or 28 U.S.C. §1608(b)(3)(B), depending on which rule the judge specifies. Please refer to Sections II and III for service instructions.

NOTE: For countries that require the form to be executed by an officer of the court, the Clerk of Court may sign and stamp the "Request." Unless directed by a court Order, the forms will be returned to the requestor to effect service abroad. All forms (Request, Certificate & Summary, certified court Order, if applicable) must be brought to the Clerk of Court's Office, Room 120.

Parties to the Hague Convention

As of February 1, 2011, there are 62 countries (Members & Non-Members) which are party to this Convention:

Albania, Antigua and Barbuda, Argentina, Australia, Bahamas, Barbados, Belarus, Belize, Belgium, Bosnia & Herzegovina, Botswana, Bulgaria, Canada, China, Croatia, Cyprus, Czech Republic, Denmark, Egypt, Estonia, Finland FYR of Macedonia, France, Germany, Greece, Hungary, Iceland, India, Ireland, Israel, Italy, Japan, Republic of Korea, Kuwait, Latvia, Lithuania, Luxembourg, Malawi, Mexico, Monaco, Netherlands, Norway, Pakistan, Poland, Portugal, Romania, Russian Federation, San Marino, Serbia, Seychelles, Slovakia, Slovenia, Spain, Sri Lanka, St. Vincent & The Grenadines, Sweden, Switzerland, Turkey, Ukraine, United Kingdom, United States, Venezuela. (Source: <http://www.hcch.net>)

Foreign States Objecting to Service by Mail

If a foreign state (party to the Hague Convention) objects to service by mail, service under Section 1608(a)(3) SHOULD NOT BE ATTEMPTED. The plaintiff should proceed under Section 1608(a)(4), directing their cover letter to the Department of State (Office of Overseas Citizens Services), citing the foreign state's objection to service by mail. (Source: www.travel.state.gov)

As of February 11, 2011, the following countries have objected to service by mail via postal channels under the Hague Convention (Source: www.hcch.net)

- | | |
|---------------------------------|---------------------------|
| 1. Argentina | 15. Macedonia-Republic of |
| 2. Bulgaria | 16. Mexico |
| 3. China (People's Republic of) | 17. Monaco |
| 4. Croatia | 18. Norway |
| 5. Czech Republic | 19. Poland |
| 6. Egypt | 20. Russian Federation |
| 7. Germany | 21. San Marino |
| 8. Greece | 22. Serbia |
| 9. Hungary | 23. Slovakia |
| 10. India | 24. Sri Lanka |
| 11. Japan | 25. Switzerland |
| 12. Korea- Republic of | 26. Turkey |
| 13. Kuwait | 27. Ukraine |
| 14. Lithuania | 28. Venezuela |

For definitive up to date information about countries objecting to service by mail, Article 10 (a), see the Status Table of the Service Convention and review the reservations and declarations for each country. (<http://www.hcch.net>)

NOTE: If a foreign state which is a party to the Hague Service Convention formally objected to service by mail when it acceded to the Convention, service under Section 1608(a)(3) should not be attempted, and the plaintiff should proceed to service under Section 1608(a)(4), citing in the cover letter to the Department of State, Office of Overseas Citizens Services the foreign state's objection to service by mail as noted in its accession to the Hague Service Convention.

For updated information, please check the following internet links:

- U.S. Department of State's Judicial Assistance: Service of Process Abroad: http://travel.state.gov/law/judicial/judicial_702.html
- Hague Convention on Service Abroad of Judicial and Extrajudicial Documents in Civil and Commercial Matters: www.hcch.net

THE INTER-AMERICAN CONVENTION AND ADDITIONAL PROTOCOL: The United States also has a treaty relationship on service with ARGENTINA, BRAZIL, CHILE, COLOMBIA, ECUADOR, GUATEMALA, MEXICO, PANAMA, PARAGUAY, PERU, UNITED STATES, URUGUAY and VENEZUELA. Please see the Department of State's circular on the operations of this Convention at:

http://travel.state.gov/law/judicial/judicial_5219.html

**PROCEDURES FOR SERVICE PURSUANT TO
RULE 4 (f) (2) (C) (ii)**

To serve a defendant pursuant to Rule 4 (f) (2) (C) (ii) of the Federal Rules of Civil Procedure, the Clerk of Court requires you to furnish the following for each case:

- (1) LETTER of REQUEST: A letter, addressed to the Clerk of Court, Ruby J. Krajick, requesting the service of documents pursuant to Rule 4 (f) (2) (C) (ii) of the Federal Rules of Civil Procedure. Include in the letter the name(s) and address(es) of the party being served and itemize list of the documents being served.
- (2) DOCUMENTS: One (1) copy of the summons and one (1) copy of the complaint (as well as copies of any additional documents filed at the time the case was opened) for EACH defendant; one (1) duplicate copy of all the documents for the Court's file being served on each party.
- (3) Select a method of service for the documents and provide the following:

A. VIA U.S. POSTAL SERVICE

1. ENVELOPE(S): One envelope, sufficient to hold an entire set of papers, addressed to each party with the **law firm's return address**.
2. RETURN RECEIPTS:
 - a. A pink return receipt card (Postal Service Form #2865) made out to the party being served with the return address of the Clerk of Court. On the upper left hand corner of this card you must include both the case number and judge's initials. (**Attachment B**)
 - b. A white return receipt (Postal Service Form #3806) made out to the party being served with the return address of the law firm. (**Attachment B**)
3. MONEY: A sum of cash sufficient for postage and registration and return receipt fees. If the amount of cash tendered is insufficient, you will be contacted and the documents will be held in the Clerk's Office (Room 120) until additional funds are received. Cash for each party to be served must be kept separately.

All mailings are brought to the Post Office on Monday, Wednesday and Friday mornings after 9:00 am. **All documents submitted for mailing must be delivered the previous day no later than 4:00 pm.** You may pick up the change two business days later after 11:00 am. See page 2 of this document, regarding postal service transactions. As per postal rules, customs form (P.S. Form 2976) must be included when using a letter sized envelope or if the package weighs 1 to 4 pounds. (See page 2 & 3 of this document)

B. SERVICE VIA FED-EX OR DHL

1. ENVELOPE(S): One envelope, per party being served, sufficient to hold an entire set of papers.
2. INTERNATIONAL AIR WAYBILL: Addressed to the party being served with the law firm's account number and return address. **(Attachment C)**
 - Note: CUBA: For special clearance and specific instructions regarding deliveries, please contact DHL directly at (800) 225-5345.
3. Use the appropriate shipping company's website to print a tracking summary indicating that the package was delivered to its ultimate destination. Provide a copy of that tracking summary and a cover letter to the Clerk of Court as your return of service.

**PROCEDURES FOR SERVICE PURSUANT TO
28 U.S.C. § 1608(a)(3)
(Direct Mail)**

To serve an agency or instrumentality of a foreign state pursuant to the Foreign Sovereign Immunities Act, 28 USC §1608 (a) (3), the Clerk of Court requires you to furnish the following for each case:

- (1) **LETTER OF REQUEST:** A letter, addressed to the Clerk of Court, Ruby J. Krajick, requesting service of the documents pursuant to the Foreign Sovereign Immunities Act, 28 USC §1608 (a) (3). Include in the letter the name(s), title(s) and address(es) of the person(s) to be served, and specify the documents being served.
- (2) **DOCUMENTS:** One (1) copy of the summons, complaint, notice of suit (any additional documents filed at the time case was opened), and affidavit of translator along with translations of each document in the country's official language **for each party/defendant** to be served; and one (1) copy of each of these documents for the Court's file. The notice of suit must be prepared pursuant to 22 CFR §93.2. A copy of these documents must also be tendered to the Clerk's Office along with the other papers mentioned above.

NOTE: AFFIDAVIT OF TRANSLATOR: An affidavit from the translator stating his/her qualifications and that the translation is accurate [Rule 201(b), Civil Practice Law and Rules of N.Y.] for each party being served and one (1) for the Court's file.

- (3) Select a method of service for the documents and provide the following:

A. VIA U.S. POSTAL SERVICE

1. **ENVELOPE(S):** One envelope, sufficient to hold an entire set of papers, addressed to each party being served with the **law firm's return address**.
2. **RETURN RECEIPTS:**
 - a. A pink return receipt card (Postal Service Form #2865) made out to the party being served with the return address of the Clerk of Court. On the upper left hand corner of this card you must include both the case number and judge's initials. (**Attachment B**)
 - b. A white return receipt (Postal Service Form #3806) made out to the party being served with the return address of the law firm. (**Attachment B**)
3. **MONEY:** A sum of cash sufficient for postage and registration and return receipt fees. If the amount of cash tendered is insufficient, you will be contacted and the documents will be held in the Clerk's Office (Room 120) until additional funds are received. Cash for each party to be served must be kept separately.

All mailings are brought to the Post Office on Monday, Wednesday and Friday mornings after 9:00 am. **All documents submitted for mailing must be delivered the previous day no later than 4:00 pm.** You may pick up the change two business days later after 11:00 am. See page 2 of this document, regarding postal service transactions. As per postal rules, customs form (P.S. Form 2976) must be included when using a letter sized envelope or if the package weighs 1 to 4 pounds. (See page 2 & 3 of this document)

B. SERVICE VIA FED-EX OR DHL

1. ENVELOPE(S): One envelope, per defendant, sufficient to hold an entire set of papers.
2. INTERNATIONAL AIR WAYBILL: Addressed to the party being served, the **law firm's return address** and **law firm's account number.** (**Attachment C**)
 - Note: CUBA: For special clearance and specific instructions regarding deliveries, please contact DHL directly at (800) 225-5345.
3. Use the appropriate shipping company's website to print a tracking summary indicating that the package was delivered to its ultimate destination. Provide a copy of that tracking summary and a cover letter to the Clerk as your Return of Service.

**PROCEDURES FOR SERVICE PURSUANT TO
28 U.S.C. § 1608(a)(4)
(DIPLOMATIC CHANNELS VIA STATE DEPARTMENT)**

To serve an agency or instrumentality of a foreign state pursuant to the Foreign Sovereign Immunities Act, 28 USC §1608 (a) (4), the Clerk of Court requires you to furnish the following for each case:

- (1) **LETTER OF REQUEST:** A letter, addressed to the Clerk of Court, Ruby J. Krajick, requesting service of the documents pursuant to the Foreign Sovereign Immunities Act, 28 USC §1608 (a) (4). You must indicate what measures have been employed to effect service under (a) (1)-(3), e.g., that (a) (3) was attempted by the Clerk's Office on a specified date which was more than 30 days prior to this request and the return receipt has not been received by the Clerk's Office. Include in your letter the name(s), title(s), address(es) of the person(s) to be served and specify the documents being served.
- (2) **DOCUMENTS:** For each party to be served, provide two (2) complete sets of the documents in English and the country's official language, and one (1) copy of each of these documents for the Court's file. You **MUST** also include (per party) two (2) copies Notice of Suit English and in the country's official language) plus one (1) copy for the Court's file.

Note: Notice of Suit must be prepared pursuant to 22 CFR §93.2.

- (3) **AFFIDAVIT:** An affidavit from the translator stating his/her qualifications and that the translation is accurate [Rule 2101(b), Civil Practice Law and Rules of N.Y.] for each party to be served and one for the Court's file.
- (4) **CHECK:** Cashier's check or money order for **\$2,275.00** made payable to U.S. Embassy or Consulate involved. For requests for service upon Iran and its political subdivisions the check or money order should be made out to "U.S. Embassy Bern."
- (5) Select a method of service for the documents and provide the following:

A. VIA U.S. POSTAL SERVICE

1. **ENVELOPE(S):** One envelope, sufficient to hold an entire set of papers, addressed to: Secretary of State, Attn: Director of Consular Services, Office of Policy Review and Inter-Agency Liaison (CA/OCS/PRI), U.S. Department of State, SA-29, 4th Floor, 2201 C Street NW, Washington, DC 20520; with the **Clerk of Court's return address.**
2. **RECEIPT CARDS:** Completed Certified Mail Receipt (PS Form 3800) and a completed Domestic Return Receipt Card (PS Form 3811). The forms are addressed to:

Secretary of State, Attn: Director of Consular Services, Office of Policy Review and Inter-Agency Liaison (CA/OCS/PRI), U.S. Department of State, SA-29, 4th Floor, 2201 C Street NW, Washington, DC 20520. The PS Form 3811 should have the **return address of the Clerk of the Court**. On the upper left-hand corner of this card include the case number and the judge's initials. **(Attachment D & E)**

3. **MONEY:** A sum of cash sufficient for postage and registration and return receipt fees. If the amount of cash tendered is insufficient, you will be contacted and the documents will be held in the Clerk's Office (Room 120) until additional funds are received. Cash for each party to be served must be kept separately.

All mailings are brought to the Post Office on Monday, Wednesday and Friday mornings after 9:00 am. **All documents submitted for mailing must be delivered the previous day no later than 4:00 pm.** You may pick up the change two business days later after 11:00 am. See page 2 of this document, regarding postal service transactions. As per postal rules, customs form (P.S. Form 2976) must be included when using a letter sized envelope or if the package weighs 1 to 4 pounds. (See page 2 & 3 of this document)

B. VIA FED-EX OR DHL

1. **ENVELOPE(S):** One envelope, per defendant, sufficient to hold an entire set of papers.
2. **US AIRBILL:** Addressed to: Secretary of State, Attn: Director of Consular Services, Office of Policy Review and Inter-Agency Liaison (CA/OCS/PRI), U.S. Department of State, SA-29, 4th Floor, 2201 C Street NW, Washington, DC 20520. **Return address of the Clerk's Office with the law firm's account number.**

Please review the State Department's "Checklist for Plaintiff's Service of Process Upon a Foreign State." (**Attachment A**). If you have any additional questions regarding 28 USC §1608(4) mailings, please contact the U.S. State Department's Office of Policy Review and Inter-Agency Liaison at ASKPRI@state.gov or (202) 736-9110.

PROCEDURES FOR SERVICE PURSUANT**28 U.S.C. § 1608(b)(3)(B)**

To serve an agency or instrumentality of a foreign state pursuant to the Foreign Sovereign Immunities Act, 28 USC §1608 (b) (3) (B), the Clerk of Court requires you to furnish the following for each case:

- (1) LETTER OF REQUEST: A letter, addressed to the Clerk of Court, Ruby J. Krajick, requesting service of the documents pursuant to the Foreign Sovereign Immunities Act, 28 USC §1608 (b) (3) (B). Include in this letter the name(s), title(s), and address(es) of the person(s) to be served, and specify the documents being served.
- (2) One complete set of documents in English, one complete set of documents in the country's official language for each defendant to be served, and one copy of each of these documents for the court's file.
- (3) An affidavit from the translator stating his/her qualifications and that the translation is accurate [Rule 2101(b), Civil Practice Law and Rule of N.Y.] for each defendant to be served and one for the court's file.
- (4) Select a method of service for the documents and provide the following:

A. VIA U.S. POSTAL SERVICE

1. ENVELOPE(S): One envelope, sufficient to hold an entire set of papers, addressed to each party being served with the **law firm's return address**.
2. RETURN RECEIPTS:
 - a. A pink return receipt card (Postal Service Form #2865) made out to the party being served with the return address of the Clerk of Court. On the upper left hand corner of this card you must include both the case number and judge's initials. (**Attachment B**)
 - b. A white return receipt (Postal Service Form #3806) made out to the party being served with the return address of the law firm. (**Attachment B**)
3. MONEY: A sum of cash sufficient for postage and registration and return receipt fees. If the amount of cash tendered is insufficient, you will be contacted and the documents will be held in the Clerk's Office (Room 120) until additional funds are received. Cash for each party to be served must be kept separately.

All mailings are brought to the Post Office on Monday, Wednesday and Friday mornings after 9:00 am. **All documents submitted for mailing must be delivered the previous day no later than 4:00 pm.** You may pick up the change two business days later after 11:00 am. See

page 2 of this document, regarding postal service transactions. As per postal rules, customs form (P.S. Form 2976) must be included when using a letter sized envelope or if the package weighs 1 to 4 pounds. (See page 2 & 3 of this document)

B. SERVICE VIA FED-EX OR DHL

1. ENVELOPE(S): One envelope, per party being served, sufficient to hold an entire set of papers.
2. INTERNATIONAL AIR WAYBILL: Addressed to the party being served, the **law firm's return address** and **law firm's account number**. (**Attachment C**)

Note: CUBA: For special clearance and specific instructions regarding deliveries, please contact DHL directly at (800) 225-5345.

3. Use the appropriate shipping company's website to print a tracking summary indicating that the package was delivered to its ultimate destination. Provide a copy of that tracking summary and a cover letter to the Clerk as your Return of Service.

List of Attachments

- A. Checklist for Plaintiff's Service of Process Upon a Foreign State
- B. U.S. Postal Service Form 3806 and Form 2865 Samples (Registered Mail)
- C. FedEx International Air WayBill Sample/ DHL Express Worldwide Sample
- D. U.S. Postal Service Form 3800 Sample (Certified Mail)
- E. U.S. Postal Services Form 3811 Sample(Domestic Return Receipt Card)

ATTACHMENT A

Checklist for Plaintiffs Service of Process upon a Foreign State

05/04/2011

The U.S. Department of State is charged, under the Foreign Sovereign Immunities Act (FSIA), with handling service of process upon a foreign state or political subdivision through diplomatic channels. The Act specifies that when service of process upon a foreign state cannot otherwise be effected under FSIA, the clerk of court may dispatch a request to the **Secretary of State, attn: Director of Special Consular Services**, for service upon a foreign state defendant. The Department of State's service functions under the FSIA are currently administered by the **Office of Policy Review and Inter-Agency Liaison, CA/OCS/PRI**.

To avoid confusion and common mistakes, please take note of the following items before submitting a request for service under FSIA 1608(a)(4).

1. The defendant must be a foreign state or political subdivision, as defined in section 1603 of the Act, not an agency or instrumentality of a foreign state (to be served under section 1608(b) of the Act). The U.S. Department of State does not serve *natural persons* under the FSIA.
2. The Act allows for service under FSIA 1608(a)(4) only after **30 days have passed** since service was attempted under section 1608(a)(3) (by any form of mail requiring a signed receipt). The U.S. Postal service and private courier services can deliver documents to virtually any location. Plaintiffs should attempt service under FSIA 1608(a)(3) unless a foreign state has specifically objected to service by mail. To determine whether a particular country objects to service by mail, please see our country-specific judicial assistance information pages at http://travel.state.gov/law/info/judicial/judicial_2510.html.
3. The documents must be **translated** into the official language of the foreign state to be served.
4. The summons sheet and the notice of suit should state a **60 day** (not 20 day) response time for the defendant.
5. The notice of suit (or default) should conform to the requirements of **22 CFR 93.2** (the statute specifically refers to notice of suit "in a form prescribed by the Secretary of State by regulation"). The notice of suit must contain a copy of the FSIA.
6. The Act requires plaintiff to have first attempted service under sections FSIA 1608(a)(1), (2) and (3) before proceeding to section 1608(a)(4). Thus, the U.S. Department of State requires a **statement in writing** from the plaintiff or the clerk certifying that these attempts were made or were otherwise not applicable.

Attachment A

7. There should be two copies of either (a) the summons, complaint and notice of suit or (b) a default judgment and notice of default (depending on the request).
8. In cases involving allegations of terrorism, plaintiffs should refer to section 1605(a)(7)(B) regarding arbitration requirements (however, we defer to the court as to the adequacy of any action taken by the plaintiffs in fulfillment of this requirement).
9. The Act requires the clerk of court dispatch the documents; however, a plaintiff may **provide written confirmation** that the court allowed plaintiff to act for the Clerk (after docketing).
10. All requests for FSIA 1608(a)(4) service of process should be addressed to: Director, Office of Policy Review and Inter-Agency Liaison (CA/OCS/PRI), U.S. Department of State, SA-29, 4th Floor, 2201 C Street NW, Washington, DC 20520.
11. As of March July 3, 2010, the U.S. Department of State charges, in accordance with 22 CFR 22.1, a **\$2,275 fee** (cashiers check/ money order should be made out to the U.S. Embassy or Consulate involved. For requests for service upon Iran and its political subdivisions the check or money order should be made out to "U.S. Embassy Bern).
12. Clerks who may have further questions regarding these issues may wish to refer to memos from the Administrative Office of U.S. Courts, dated, Nov. 7, 2000, May 20, 1982 and Nov. 6, 1980.

Attachment A

ATTACHMENT B

Registered No. _____ Date Stamp _____

Reg. Fee	
Handling Charge	Return Receipt
Postage	Restricted Delivery
Received by	

Customer Must Declare Domestic insurance up to \$25,000 is included based upon the declared value. International Indemnity is limited. (See Reverse).

Full Value \$ _____

OFFICIAL USE

FROM: LAW FIRM'S ADDRESS

TO: DEFENDANT'S NAME & ADDRESS

PS Form 3806, Receipt for Registered Mail Copy 1 - Customer
 May 2007 (7530-02-000-9051) (See Information on Reverse)
 For domestic delivery information, visit our website at www.usps.com



Return Receipt for International Mail
 (Registered™, Insured and Express Mail®)

CASE#: **JUDGES** INITIALS
 des Postes des
 Etats-Unis
 d'Amérique

Postmark of the office returning the receipt
 Timbre du bureau renvoyant l'avis

Par Avion

Return by the quickest route (air or surface mail), a découvert and postage free. The sender completes and indicates the address for the return of this receipt. (A remplir par l'expéditeur, qui indiquera son adresse pour le renvoi du présent avis.)

Name or Firm (Nom ou raison sociale) **RUBY J. KRAICK**

Address: **UNITED STATES DISTRICT COURT, SDNY**
 Street and Number (Rue et no.)
500 PEARL STREET
 City, State, and ZIP Code (Localité et code postal)
NEW YORK, NY 10007
 UNITED STATES OF AMERICA Etats-Unis d'Amérique

PS Form 2865, March 2007 **Avis de réception** CN07 (Old C5)

Item Description (Nature de l'envoi)	Registered Article (Caval recommandé)	Letter (Lettre)	Printed Matter (Imprimé)	Express Mail International
<input type="checkbox"/> Insured Parcel (Colis avec valeur déclarée)	Insured Value (Valeur déclarée)	Article Number		
Office of Mailing (Bureau de dépôt)		Date of Posting (Date de dépôt)		
CHINA TOWN STATION				
Addressee Name or Firm (Nom ou raison sociale du destinataire)				
DEFENDANT'S NAME & ADDRESS				
Street and No. (Rue et No.)				
Place and Country (Localité et pays)				

This receipt must be signed by: (1) the addressee; or, (2) a person authorized to sign under the regulations of the country of destination; or, (3) if those regulations so provide, by the employee of the office of destination. This signed form will be returned to the sender by the first mail.
 (Cet avis doit être signé par le destinataire ou par une personne y autorisée en vertu des règlements du pays de destination, ou, si ces règlements le permettent, par l'agent du bureau de destination, et renvoyé par le premier courrier directement à l'expéditeur.)

The article mentioned above was duly delivered. (L'envoi mentionné ci-dessus a été dûment livré.)

Signature of Addressee (Signature du destinataire) _____ Date _____
 Official Destination Employee Signature (Signature de l'agent du bureau de destination) _____

PS Form 2865, March 2007 (Reverse) PSN 7530-02-000-8775

Attachment B



LC557990898US

United States Postal Service
Customs Declaration **CN22**
 May be processed in a... (See instructions on Reverse)
 Do not duplicate without USPS approval.

Gift **Commercial sample**
 Document **Other**

Quantity and related description of contents (1)	Weight (2) (lb. or kg.)	Value (3) (US\$)

For commercial items only:
 Marking (4) (tariff number, if any and country of origin) (code (5))

Do not sign this form unless you have inspected the item, certify that the articles are as described and that they are not restricted, controlled, or otherwise prohibited by legislation or by postal or customs regulations.

Date and sender's signature

Customs Declaration CN 22 — Sender's Declaration
 I, the undersigned, whose name and address are given on the item, certify that the particulars given in this declaration are correct and that this item does not contain any dangerous article or articles prohibited by legislation or by postal or customs regulations. This copy will be retained at the post office for 30 days.

Sender's Name & Address
Law Firm's Name & Address

Addressee's Name & Address
Defendants name & Address

Date and sender's signature

PS Form 2976, January 2004

Detached from PS Form 2976, January 2004

Post Office Copy

Attachment B

As per the postal rules, a customs form (postal form 2976) must be included when using a letter sized envelope or if the documents to be served are between one and four pounds.

ATTACHMENT C

FedEx International Air Waybill
Express For FedEx services worldwide.

/0010/0050/0037242562/5

Sender's Copy

PACKAGE LABEL
863629265050

COMMERCIAL INVOICE LABEL
863629265050

DELIVERY RECORD LABEL
863629265050

DELIVERY REENTRY LABEL
863629265050

1 From Please print and press hard
Date MM/DD/YYYY Sender's FedEx Account Number **LAW FIRM'S ACCOUNT # 15084115240**

Sender's Name **LAW FIRM'S RETURN ADDRESS**
Company _____
Address **ATTORNEY'S**
Address _____
City _____ State Province _____
Country _____ ZIP Postal Code _____

2 To
Recipient's Name _____ Phone _____
Company **DEFENDANT'S ADDRESS**
Address _____ Dept./Floor _____
Address _____
City _____ State Province _____
Country _____ ZIP Postal Code _____

Recipient's Tax ID Number for Customs Purposes
e.g. GST/TIN/VA/TW/EN/IBAN, if so kindly require.

3 Shipment Information For FedEx. Tick here if goods are not in free circulation and provide C.I.

Total Packages Shipper's Contact Details
Total Weight lbs. kg. DIM in. cm

Commodity Description DETAIL REQUIRED	Harmonized Code	Country of Manufacture	Value for Customs REQUIRED
Exempt/1-year's limited warranty, 99 percent duties LEGAL DOCUMENTS			
COMPLETE IN ENGLISH.			

Has EAS/ED been filed in AEST for U.S. Export Only. Check One
 No EAS/ED required, value \$2500 or less per Ship. 3 Number. Total Declared Value for Customs
 No EAS/ED required, value exemption number: 1 other than N/A, write (exemption description)
 Yes - Enter AEST proof of filing date:

4 Express Package Service
 FedEx Int. Priority FedEx Int. First Available to select locations. Higher rates apply.
 _____ FedEx Int. Economy FedEx Envelope and FedEx Pak not available.

Package up to 150 lbs./68 kg
For packages over 150 lbs./68 kg, use the FedEx Expedited Service Int. Air Waybill.

Not all services and options are available to all destinations. Dangerous goods cannot be shipped using this Air Waybill.

5 Packaging
 FedEx Envelope FedEx Pak FedEx Box FedEx Tube
 Other FedEx 10kg Box* FedEx 25kg Box*
*These options in new boxes with special pricing are provided by FedEx for FedEx Int. Priority only.

6 Special Handling
 HOLD at FedEx Location SATURDAY Delivery Available to select locations for FedEx Int. Priority only.

7a Payment Bill transportation charges to:
 Sender Acct. No. in Section 1 will be billed. Recipient Third Party Credit Card Cash Check/Cheque
 FedEx Acct. No. _____
 Credit Card No. _____
 Credit Card Exp. Date _____

7b Payment Bill duties and taxes to:
 Sender Acct. No. in Section 1 will be billed. Recipient Third Party
 FedEx Acct. No. _____

All shipments may be subject to Customs charges, which FedEx does not estimate prior to clearance.

8 Your Internal Billing Reference FedEx characters will appear on invoice.
 OPTIONAL _____

9 Required Signature
 Use of this Air Waybill constitutes your agreement to the Conditions of Contract on the back of this Air Waybill, and you represent that this shipment does not require a U.S. State Department License or contain dangerous goods. Certain international treaties, including the Warsaw Convention, may apply to the shipment and limit our liability for damage, loss, or delay, as described in the Conditions of Contract. WARNINGS: These compression, technology, or software were imported from the United States in accordance with Export Administration Regulations. Diversion contrary to U.S. law prohibited.
 Sender's Signature: _____
 This is not authorization to deliver the shipment without a recipient approval.

For Completion Instructions, see back of fifth page.

FedEx Tracking Number **8636 2926 5050** Form ID No. **0402**

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BACK

CASE NUMBER AND JUDGE'S INITIALS

Attachment E

CHAPTER TWENTY

GOVERNMENT LEASING

Robert C. MacKichan, Jr., Esq.

[20.0] I. BACKGROUND—EXTENT OF U.S. GOVERNMENT LEASING

The U.S. Government (the “Government”) is the largest procurer of space for federal tenant agencies in the world. The Government owns or leases more than 3 billion square feet of space in more than 890,000 buildings and structures in the United States, its territories and abroad. There are 12 categories of space owned or leased by the Government, including office warehouse, housing and storage space. Office is the largest such category, representing about 22% of the total.

The three largest holders of owned and leased office space are the General Services Administration (GSA), with about 346 million square feet, the Department of Defense, with about 236 million square feet, and the U.S. Postal Service, with approximately 190 million square feet.

In addition to these three agencies, over 30 other executive branch agencies have some degree of independent authority to purchase, own or lease office space or buildings. However, few of these agencies have authority to enter into long-term leases.

[20.1] II. FEDERAL LEASEHOLD ACQUISITION POLICY

It is uniformly recognized that the acquisition of a leasehold interest and a contract for the construction and/or purchase of real property by the Government is a Government contract. Therefore, a lessor of space to the Government is a Government contractor in all senses, just like the thousands of other Government contractors. As with the Government’s acquisition of goods and services, Government leases contain a myriad of requirements to further national policies reflected in a broad range of statutes and regulations. These are statutes, regulations and policies that are designed to further a public interest or policy and are often commonly referred to as “socio-economic” issues. These issues, and others, clearly distinguish a Government lease from the usual commercial lease, and parties interested in doing business with the Government need to appreciate the distinctions to favorably price an offer to the Government.

Technically, most agree that the acquisition of a leasehold interest is not subject to the Federal Acquisition Regulations (FAR) as it does not appear to fall within the definition of “acquisition” at FAR Section 2.101. However, the Competition in Contracting Act (the “Act”) has been amended to include interests in real estate, requiring agencies to imple-

ment competitive procedures. GSA has opted to fulfill this requirement through the issuance of the General Services Acquisition Regulations (GSAR) and other GSA guidance; the GSAR and such GSA guidance are consolidated in the General Services Administration Acquisition Manual (GSAM). The GSAM confirms that the FAR does not apply to the acquisition of leasehold interests (and certain GSAR and GSAM sections also do not apply unless specifically referenced in the GSAM Part 570, which is the part applicable to leasehold interests), but certain FAR sections specifically referenced in GSAM Part 570 have been adopted based on a statutory requirement applicable to leasehold acquisitions or as a matter of policy. Most notably though, as a matter of policy, many of the standard FAR provisions found in other Government contracts have not been applied to the acquisition of leasehold interests. As the procurer of the largest office space portfolio, GSA's policies and procedures have been adopted by many of the agencies with specific authority to acquire leasehold interests.

When considering leasing space to the Government, it is imperative that any offeror identify the authorities of the acquiring agency or department to verify that the agency has (1) long-term authority and (2) appropriate funding to acquire the space. GSA has such authority pursuant to the Federal Property and Administrative Services Act (FPASA) of 1949, which authorized the creation of the Federal Buildings Fund (FBF) as an intra-governmental revolving fund. FPASA granted to GSA plenary authority to enter into leases for real estate for an initial term of up to 20 years and sufficient funding through the FBF to do so. Although several other agencies have similar contract authority to enter into multi-year leases, they usually lack a funding mechanism for the multi-year term of the lease. For this reason, many agencies, other than GSA, with independent leasing authority will acquire space, but make it "subject to annual appropriations." In those instances, the Government has the right to terminate the lease if sufficient funds are not appropriated by Congress in any fiscal year. The uncertainty of the income stream in leases containing "subject to annual appropriations" language will often present issues for underwriting in the lending process. On the other hand, a GSA lease is usually "bondable" due to the multi-year funding authority and the absence of a termination for convenience clause.

The plenary authority of GSA to acquire leasehold interests may be delegated to another Federal agency. Currently, GSA has issued a general delegation of authority allowing agencies to handle the procurement of leases for less than 20,000 rentable square feet conditioned on the agency

demonstrating its procurement personnel have a requisite level of experience and training and upon a showing that suitable Government owned space cannot be provided to meet the agency's requirements. Consequently, very few agencies continue to utilize the limited blanket delegated leasing authority and in those instances of previously delegated specific authority, GSA has terminated or revoked those delegations. Agencies often prefer to use GSA because tenant agencies in GSA controlled leased space can vacate the premises with only 120 days' notice and are relieved of the rent obligation to GSA. On the other hand, if other Federal agencies use the delegated GSA authority, or its own authority, such agency's ability to vacate the leased premises prior to expiration of the lease is controlled by the terms of the lease.

[20.2] III. STATUTORY AND REGULATORY AUTHORITY FOR THE GOVERNMENT'S ACQUISITION OF LEASEHOLD INTERESTS IN REAL PROPERTY

For the purposes of this discussion, the GSA process is used as the most illustrative of the Government lease process. Other federal agencies have independent leasing authority—Department of Veterans Affairs, Department of Defense, Army Corps of Engineers, to name a few—but, in most instances, they follow the same procedures and use similar regulations as GSA. As a general matter, GSA utilizes two acquisition methods to acquire leasehold interests in real estate: (1) a simplified procedure for small leases¹ or (2) a competitive negotiated process.² The simplified process is used for lease acquisition when the average annual rent for the term of the lease, including option periods and excluding the costs of operating services, is less than \$150,000. For leases over that limit, GSA, as a matter of policy, has applied the competitive requirements of FAR part 6, Competition Requirements.³

Although as a product of GSA's 2011 Lease Reform Initiative, GSA restructured its lease procurement documents into five categories of leases; in 2015 GSA abandoned all but the on-airport lease and issued the Global template. The Global template is intended to be tailored by the contracting officer depending on the facts of the subject lease procurement.

1 Code of Federal Regulations tit. 48 subpt. 570.2 (C.F.R.).

2 48 C.F.R. § 570.105-1.

3 See 48 C.F.R. § 570.104.

The simplified process essentially consists of conducting a market survey and soliciting at least three offers to promote competition to the maximum extent possible.⁴ Because this is indeed a simplified process, a study of the provisions will likely be adequate to understand the procedural process. It appears that GSA intends to use the simplified lease model and its related forms in connection with this simplified process.

The competitive negotiated lease procurements follow the customary requirements of full and open competition and, as with general contract matters, allow for the use of the seven exceptions to full and open competition.⁵ The competitive negotiated lease procurements will involve the streamlined and standard lease models and their related forms.

As an alternate to specific requirement-based competitive lease procurements, or the simplified process, in 1991, GSA initiated its Advanced Acquisition Program in the National Capital Region as a means of streamlining the process and avoiding delay and additional cost for fulfilling smaller space requirements. The program complies with the statutory requirement for competition although awards are not made until a need is identified. With the advent of technology, this program is now handled online and referred to as the Automated Advanced Acquisition Program (AAAP) and has been expanded nationwide. AAAP has evolved into a multiple award platform that handles space requirements ranging from 2,000 square feet up to the prospectus threshold (approximately 60,000 to 70,000 square feet).

The AAAP approach allows for the submission of offers online for specified amounts of space (without identifying specific tenant agency requirements) and can be updated by an offeror on a monthly basis. Offers must meet the threshold technical requirements, and offers meeting the technical threshold are ranked utilizing a specified net present value calculation. Thereafter, GSA will satisfy its smaller space requirements by selecting offerors most favorably ranked in the desired delineated area. It should be noted that GSA only uses AAAP when the award criteria is “technically acceptable/lowest price.” If an agency prefers to use the “best value” approach, preferring to possibly pay more to get more, a separate solicitation for offers must be utilized.⁶

4 48 C.F.R. § 570.203-1-4.

5 48 C.F.R. § 570.302-309.

6 For more information regarding AAAP, see www.gsa.gov/portal/content/104895.

[20.3] IV. CATEGORIES OF LEASE PROCUREMENTS

Regardless of the method used to acquire leasehold interests, GSA generally categorizes lease procurements into three categories: (1) a replacement lease, (2) a succeeding lease (or superseding lease, if applicable), and (3) a new requirement.

[20.4] A. Replacement Leases

A replacement lease is usually an expiring lease, without any remaining renewal options to exercise, where GSA is desirous of fulfilling its continuing space requirement through full and open competition, as more particularly described below. In many instances, the incumbent lessor will be a competitor for the replacement lease.

[20.5] B. Succeeding Leases

A succeeding lease is a newly negotiated lease at the same location when GSA has made the threshold determination, pursuant to a cost benefit analysis as prescribed by the GSAR, that it is in the best interest of the Government to award a lease without full and open competition. On occasion, a superseding lease is used instead of a succeeding lease. A superseding lease refers to the circumstance when a succeeding lease is negotiated several years before the expiration of the current term. For example, in a real estate market with exceptionally competitive rates, GSA may decide to negotiate a new ten-year term several years before the expiration of the current fixed term. A superseding lease commences upon the bilateral termination of the existing lease.

The GSAR, as contained within the GSAM, provides a methodology to complete this cost-benefit analysis.⁷ Essentially, the Government considers the costs of relocation and the potential market rates with customary improvements in relation to the costs of entering into a new lease at its current location to determine what is in the best interests of the Government. As could be anticipated, in most instances, a succeeding lease is justified when considering the costs of relocation and required infrastructure. Until recently, this approach was commonly utilized when the Government was satisfied with the management and condition of the existing leased premises. However, within the last few years, GSA appears to have informally decided to more routinely use a competitive process for the continua-

⁷ 48 C.F.R. § 570.402-6.

tion of existing space requirements. Consequently, incumbent lessors, even with a fully satisfied customer agency, may be compelled to compete for a new firm term lease. It remains to be seen how the current Government mantra of fiscal restraint will affect this policy, though we anticipate that more agencies' space needs will be met with succeeding or superseding leases, at least in the short term.

The desirability of a succeeding lease is clearly evident for both incumbent lessors and the Government, making it critical for owners and managers of facilities with Government tenants to maintain a positive relationship with the tenant agency and GSA. As a provider of choice, it is imperative for GSA to maintain a good working relationship with its tenant agencies to avoid the potential they will go elsewhere to fulfill its lease requirements. If a lessor can help GSA in this mission, such lessor will put itself in a much stronger position to be awarded a succeeding or superseding lease.

[20.6] C. New Leases (Including Replacement Leases)

The last category is for new requirements, which are typically satisfied through full and open competition, similar to replacement leases.

[20.7] V. COMPETITIVE NEGOTIATED PROCUREMENT PROCESS FOR ACQUIRING LEASEHOLD INTERESTS

In such instances when the Government decides to pursue a replacement or new lease, the acquisition process usually involves five major phases:

[20.8] A. Defining the Requirements of an Agency

In most instances when a lease is due to expire in a year or two, or a tenant agency has a new requirement, the tenant agency will formally notify GSA of its new requirements or needs for continuation of its existing requirements. GSA will work with the tenant agency to draft an Occupancy Agreement outlining the specific requirements of the tenant agency. The most critical aspect of this process from the perspective of an incumbent lessor or a prospective offeror is the establishment of a delineated area, the geographic area that the tenant agency will accept as a suitable location for its requirement. The Occupancy Agreement later becomes the working document for securing the required leased premises.

[20.9] B. Preparing and Implementing an Acquisition Plan

As a predicate to initiating the acquisition process, GSA will establish and define the procurement process for securing the desired space. In other words, GSA will determine what method it will utilize to acquire the required space including consideration of the exceptions to full and open competition. As a preliminary means of testing the market, GSA will often opt to utilize a Request for Expressions of Interest as a first step prior to initiating the competitive process.

When utilizing a Request for Expressions of Interest, GSA will commonly issue the request publicly using www.fbo.gov. The announcement will generally specify the critical aspects of the requirement, the amount of rentable and office square footage, the delineated area, and the required delivery date. Unless the Government is using a simplified process, all prospective offerors that believe that they can meet the specified requirements may submit an Expression of Interest. If the Government receives a large number of Expressions of Interest, the GSA Contracting Officer may decide to restrict competition to a smaller subset of the original offerors.

Whether the Contracting Officer decides to restrict competition to a few offerors or opens it to the real estate community at large, the next step is the issuance of a formal Request for Lease Proposal (RLP), specifying the full requirements of the Government. The RLP will contain a detailed summary of the Government's requirements, including, among other things, the required size of the leased premises, the lease term, the delineated area, the delivery date, the technical building system requirements, any special requirements such as security and the standard lease clauses. Also included in the RLP will be the lease model documents that the Government intends to use for lease of the space, including the "Lease Contract" form, which is the primary lease document. In contrast to customary practices in the past, the RLP (formerly referred to as a Solicitation for Offers) will not become part of the final lease agreement.

Following receipt and review of the RLP, each prospective offeror must submit an initial proposal conforming to the requirements set forth in the RLP. Special consideration should be given to the lease model documents included with the RLP as they will become the final form of the lease. If the prospective offeror wants to propose revisions to the terms of the proposed lease model forms, we recommend that the offeror include any such proposed revisions as a rider with the offeror's initial proposal. However, suggestions for significant changes should carefully be considered before submitting them to the Government because the Government has the

option of concluding that the proposal is non-responsive if the offeror proposes substantial changes. If the Government concludes that the offer is non-responsive, the offeror will be excluded from further competition. It is important to note, however, that the Government rarely will conclude that an offer is non-responsive due to the offeror's inclusion of a rider without first giving the offeror a chance to modify or withdraw the offer.

[20.10] C. Evaluation of Offers, Discussions and Award

Upon receipt of initial proposals, the Government begins a process of evaluation leading to an eventual award of the lease. The award criteria contained in the RLP control this aspect of the process. The selection of an apparent successful offeror may be on the basis of (1) a technically acceptable/lowest price or (2) what is commonly referred to as best value. In the former, the Government first determines which offerors meet the minimum technical requirements (building specifications) and then award to the lowest bidder. Exceeding the technical requirements does not assist in this selection approach. In the latter, the Government conducts a cost and technical trade-off analysis and can select a higher priced proposal if the Government determines that there are greater benefits in the technical offering.

During the evaluation process, the Government customarily conducts "discussions" with each offeror, although the language of some RLPs reserves the right for GSA to award a lease without discussions. If GSA elects to conduct discussions with one offeror, it must conduct discussions with all offerors in the "competitive range." The competitive range is established by the Contracting Officer and essentially includes all offerors who could supplement or amend their offer to be the apparent successful offeror or is established based on the Government's administrative convenience. Discussions are sometimes referred to as negotiations, but they are very different than the common understanding of negotiations. When GSA conducts discussions, the Contracting Officer's (or the Government broker's) comments about an offeror's proposal must be restricted to the strengths and weaknesses of an offer, without reference to other proposals.

Following the completion of discussions, the Government will request Final Proposal Revisions from each of the offerors in the competitive range. An offeror can make any changes to its initial proposal and is not restricted to the Contracting Officer's (or the Government broker's) comments. This is an offeror's last opportunity to amend its proposal.

Following receipt of the Final Proposal Revisions, the Government will evaluate the proposals and select an offeror for satisfying the Govern-

ment's space requirements. Typically, after notifying the successful offeror, GSA will tender the final lease documents to the successful offeror and ask the successful offeror to submit executed copies of the same. Thereafter, after securing the final internal approvals, GSA will execute the lease. Unsuccessful offerors will then be notified of the selection.

[20.11] D. Completion of Tenant Improvements

Of all the phases of Government lease procurement, this component of the process is most similar to a typical private sector lease. Depending on the terms of the final lease, the completion of the tenant improvements may be as a "turnkey" project pursuant to a Government-provided agency specific requirements package, or the Lessor will be required to complete the improvements pursuant to a design and build process working with the tenant agency and GSA. In those instances, the Government will limit the offeror's overhead for performing tenant improvements, including architectural/engineering fees and other profit and/or fees to a percentage of the tenant improvement allowance. These limits are customarily negotiated before final execution of the lease.

[20.12] VI. STANDARD U.S. GOVERNMENT LEASE TERMS—UNIQUE PROVISIONS AND COMPARISON WITH PRIVATE SECTOR LEASES

Generally, a GSA or other Government lease addresses similar issues commonly found in private sector leases, such as subletting and assignment, tenant's acceptance of space, maintenance of the building and the leased premises, fire and casualty damage, subordination, nondisturbance, and attornment, and late payment fees. Several GSAR clauses specify what clauses must or should be in the lease.⁸ Many of the clauses are mandated by the GSAR or other non-GSA regulations to be included in a lease, but, in many instances, the regulations allow the Contracting Officer to delete or amend a clause.⁹ Offerors may propose such deletions or amendments by including applicable language in their rider. Many of the required provisions are not specific to leases for real property, but relate to such issues as size/status of subcontractors, improper business practices, environmental compliance, socio-economic objectives, and lease administration matters.

8 48 C.F.R. § 570.703.

9 48 C.F.R. § 570.704.

The most significant clause not usually found in GSA leases that is found in other Government contracts is the Termination for Convenience clause. The FAR requires the inclusion of this provision in all contracts for the acquisition of supplies and services, yet expressly excludes “land or interest in land.”¹⁰ Consequently, in GSA leases the Termination for Convenience clause is not included, making the lease a more desirable product for the purpose of lending. However, some GSA leases contain express termination rights as negotiated by the parties.

For the purpose of pricing a proposal to lease space to the Government, it is important to understand the aspects of a Government lease that deviate significantly from conventional private sector leases. It is also important to note that, as discussed above, an offeror may propose to amend some of the below clauses in the offeror’s rider. The most notable clauses unique to Government leases appear below; it should be noted that many of these clauses appear in GSA Form 3517B, the “General Clauses,” which is incorporated into the lease. As a product of GSA’s Lease Reform Initiative, GSA revised the older version of the GSA Form 3517B and all new leases will contain a newer version, GSA Form 3517B (03/13).

[20.13] A. Base Rent (Form 1364, “Proposal to Lease Space”)

The base rate offered for the initial term of a Government lease, or for any renewal terms, has not traditionally been subject to any escalation, as is the common practice in private sector leases. However, newer GSA leases contain space in the Form 1364 allowing for the offeror to provide rental escalations. From this, it seems clear that GSA will now accept rental escalations as part of an offer. Also, the Government typically pays monthly rent in arrears.

[20.14] B. Operating Costs (Form 1217, “Lessor’s Annual Cost Statement”)

Unlike most private sector leases, the operating expense pass-through in a Government lease are not based on actual operating expense increases. Rather, in the initial proposal, the offeror must list the amount of certain operating expenses expected to be incurred in the first year of the lease, including such items as janitorial, electrical, water, HVAC, elevator, security, and building engineer expenses. The Government will review the estimated expenses, and these estimated amounts may be the subject of discussions between the Government and the offeror. The oper-

¹⁰ 48 C.F.R. § 2.101.

ating costs agreed to in Standard Form 1217 will become the base rate on which operating cost increases will be determined after the first lease year. Changes in the Consumer Product Index for wage earners and clerical workers published by the Bureau of Labor Statistics is the method used for escalation of the operating expenses during the term of the lease, and is the only method for escalations thereof barring a supplemental lease agreement between the Government and the lessor that specifies a new rate or methodology for adjusting for operating expenses. As a product of the GSA Lease Reform Initiative, GSA no longer intends to use this method for operating cost escalations with the simplified lease model and expects offerors to bake these costs into their rental rate.

[20.15] 1. Subletting and Assignment Clause

The Government may sublet any part of the leased premises but shall not be relieved from any of the lease obligations by subletting. The Government may at any time assign the lease and will be relieved from all obligations to the lessor, except for unpaid rent and other liabilities accruing before the assignment. The assignment is subject to the lessor's consent, but may not be unreasonably withheld.

[20.16] 2. Subordination, Nondisturbance and Attornment Clause

The lease, or any renewal, modification or extension thereof, is subject and subordinate to any and all recorded mortgages, deeds of trust, and other liens existing at the time of execution of the lease or thereafter imposed. No subordination shall operate to affect adversely any right of the Government under the lease so long as the Government is not in default thereunder.

If the building or any portion thereof is transferred by foreclosure of the lien of any mortgage, deed of trust, other security instrument, or giving of a deed in lieu of foreclosure, the Government will be deemed to have attorned to the purchaser, transferee, or their successors and assigns, and such parties shall be deemed to have accepted all obligations of the lessor under the lease.

[20.17] 3. Tax Adjustment Clause

Although the lessor in Government leases is expected to include insurance and real estate taxes in the base rent, the Government will reimburse the lessor for increases in real estate taxes above the real estate tax base

established pursuant to the lease. The real estate tax base may be established: (1) by agreement of the parties or (2) pursuant to a “full assessment,” taking into consideration the Government’s contemplated use of the leased premises. The Government is responsible to pay additional rent for its share of any actual increases in real estate taxes to the lessor. The Tax Adjustment Clause has been the subject of substantial litigation with regard to defining a “full assessment,” making the use of a mutually agreed upon real estate tax base the preferred approach. Furthermore, as mentioned above with respect to operating costs, as a product of the GSA Lease Reform Initiative, GSA no longer intends to use this method for real estate tax adjustments with the simplified lease model and expects offerors to bake these costs into their rental rate.

[20.18] C. Tenant Improvements

As mentioned above, whether as a turnkey approach or a design build approach, the Government requires the lessor to install any tenant improvements in accordance with the Government’s specifications and for the standard lease model utilizing a specified tenant improvement allowance. Pursuant to either approach, the lessor will be required to amortize the specified allowance over the initial term of the lease, although in the standard lease model the Government reserves the right to make cash payment(s) for any or all of the work performed by the lessor.

[20.19] D. Tenant Improvement Process

Tenant improvements required under the standard lease model must be made prior to the Government’s occupancy of the leased premises and may be accomplished using one of two specified methods. The first method requires the lessor to submit cost or pricing data in its initial proposal. The alternative method is the Government’s acceptance of a price for the subject work based upon a process of competitively selecting a contractor or subcontractors. The lessor must submit, as part of its initial proposal, the amounts for construction fees such as overhead, profit, architectural fees, permits, and regulatory fees. These fees are negotiated before the award of the lease to a lessor, and, subsequently, through a three competitor process, a general contractor, or its subcontractors, is/are selected using the agreed upon fees.

[20.20] 1. Maintenance of Building and Premises & Right of Entry Clause

This General Clause places responsibility on the lessor to keep and maintain the leased premises and the building and all equipment, fixtures, and appurtenances furnished by the lessor in good repair and suitable condition for the Government's particular contemplated use. In exchange for maintaining the leased premises, this clause grants the lessor reasonable access rights to the leased premises. Under this provision, the customary operational services such as cleaning, maintenance, repair, landscaping, and security (in most instances) are the lessor's responsibility. The lessor, however, may not unreasonably disrupt the Government's use and enjoyment of the leased premises in the course of such maintenance, but may, at reasonable times, enter the leased premises to perform its maintenance duties with the approval of the authorized Government official.

The full service requirement of a Government lease is distinctively different than a triple net private sector lease. In a Government lease, in addition to rent, the Government pays for all taxes, insurance, and maintenance costs attributable to its use of the leased premises. Also, in a Government lease, in addition to its responsibility to maintain the common areas and base building systems of the building, the lessor is responsible for the maintenance of the leased premises.

[20.21] 2. Fire and Casualty Damage Clause

If the building in which the premises is located is totally destroyed or damaged by fire or other casualty, the lease shall immediately terminate. However, if the building is only partially destroyed or damaged, so as to render the premises untenable or not usable for its intended use, the lessor has the option to repair (in a period not to exceed 270 days) or restore the premises or terminate the lease. If the Lessor elects to restore, and submits within 60 days of the destruction of the premises, a reasonable schedule for repair of the premises, the Government may not terminate the lease. During the time that the leased premises are unoccupied, rent will be abated.

[20.22] 3. Default By Lessor Clause (Right of Rent Setoff)

As a product of the 2010 GSA Lease Reform Initiative, the Failure in Performance and the Default in Delivery clauses have been consolidated into this new clause. The new clause distinguishes between conditions that shall constitute default by the lessor either before or after acceptance

of the premises and sets forth what grounds are necessary to provide the basis for the Government to terminate the lease. Before acceptance, subject to Government notice of default with a reasonable opportunity to cure, a failure by the lessor to diligently perform all obligations required for acceptance of the premises will constitute a default. After acceptance, and also subject to Government notice of default with a reasonable opportunity to cure, a failure of the lessor to perform any service, to provide any item, or satisfy any requirement of the lease shall constitute a default of the lessor and Government has the option of performing the service, providing the item or obtaining satisfaction of the requirement using its own employees or contractors. In the event the Government elects to exercise this option, the Government may deduct from any payment under the lease an amount that reflects the reduced value of the contract requirement not performed.

Lastly, the clause defines the defaults that will provide the grounds for the Government to terminate the lease. Essentially, the grounds include (1) persistent failure of the lessor to cure the deficiency or (2) lessor's failure to take actions necessary to prevent the reoccurrence of the default conditions *and* such conditions substantially impair the safe and healthful occupancy of the premises or render the premises unusable for its intended purpose.

The clause also specifies the circumstances that constitute an excuse to non-performance under this section.

[20.23] 4. Alterations Clause

This General Clause allows the Government to make alterations and building system connections in the leased premises, and gives the Government the option to remove or leave alterations in the leased premises at the end of the term of the lease, at its discretion. Unlike the customary provisions in private sector leases, this clause allows the Government to make alterations to the structure of the leased building and tie into the building systems without first obtaining the lessor's consent.

[20.24] 5. Delivery and Condition Clause

This General Clause provides that the lessor must deliver the leased premises ready for occupancy as a complete unit, unless the Government elects to occupy the leased premises in increments.

[20.25] 6. Acceptance of Space and Certificate of Occupancy Clause

The Government reserves the right to determine when the leased premises are substantially complete and the space shall only be considered substantially complete if the space may be used for its intended purpose and completion of the remaining work will not unreasonably interfere with the Government's enjoyment of the space.

This is different from usual provisions in private sector leases because it allows the Government to determine when the improvements are substantially complete, thereby triggering the payment of rent. In most instances in the private sector, the commencement of rent is specified by the terms of the lease, or, if based on substantial completion of the improvements, a third party (architect or construction manager) will determine when the leased premises are substantially complete.

[20.26] 7. Changes Clause

The Changes Clause has also been amended as product of the GSA Lease Reform Initiative. Essentially, this clause allows the Government to unilaterally direct changes in three defined categories without the risk of breaching the lease. The contracting officer may at any time, by written order, direct changes to the (1) tenant improvements with the space, (2) building security requirements or (3) services required under the lease. The procedure for determining the compensation due to the lessor for changes is found in the Proposal for Adjustment Clause. If the parties are unable to agree on the compensation for the requested change, the Disputes Clause specifies a procedure for resolution of disputed claims. Claims for other entitlements under a Government lease are also handled pursuant to the Disputes Clause.

[20.27] 8. Substitution of Tenant Agency Clause

This General Clause permits the Government to substitute any Government agency or agencies for the tenant agency or agencies named in the lease.

[20.28] 9. Examination of Records by GSA Clause

For three years beyond the expiration of the lease, the Government may inspect and review the lessor's records pertaining to the leased premises and the lease.

[20.29] 10. Audit and Records—Negotiations Clause

This General Clause is a similar provision to the Examination of Records by GSA Clause discussed above. For cost-reimbursement, incentive, time-and-materials, labor-hour, or price redeterminable type contracts, this clause grants the Contracting Officer, or its authorized representative, the authority to examine and audit all records and other evidence related to costs incurred, or anticipated to be incurred, under the lease. The lessor must include all of the terms of this clause in subcontracts exceeding \$100,000 if the subcontract is a cost-reimbursement, incentive, time and materials, labor-hour, or price redeterminable type; if the subcontract requires cost or pricing data; or if the subcontract requires the subcontractor to furnish cost, funding, or performance reports.

[20.30] E. Socio-Economic Clauses Establishing Affirmative Duties and Reporting Requirements**[20.31] 1. Equal Opportunity Clause**

This General Clause requires lessors to agree not to discriminate and contains a regular reporting requirement for lessors of space to the Government. This clause implements Executive Order 11246 and requires compliance with the regulations, rules, and orders set forth by the Secretary of Labor at 41 C.F.R. part 60-1 *et. seq.* These regulations prohibit the lessor from discriminating against any employee or applicant for employment because of race, color, religion, sex, or national origin, and require the lessor to take affirmative action to ensure that applicants are employed, and that employees are treated during employment, without regard to those characteristics. These regulations also require Government contractors/subcontractors having 50 or more employees and contracts of \$50,000 or more to develop and maintain written affirmative action programs for each of their establishments.

The Department of Labor (DOL) is responsible for the oversight of this requirement and has issued guidelines for determining if a lessor/contractor will be subject to the requirements of an affirmative action plan. DOL uses a “single entity” test for this purpose, so offerors or lessors should carefully review this requirement. The lessor must, in all solicitations or advertisements for employees, state that all qualified applicants will be considered without regard to race, color, religion, sex, or national origin. This clause further requires the lessor to permit access to its leased premises by the tenant agency or the Office of Federal Contract Compliance Programs for the purpose of conducting on-site compliance evaluations,

and that the lessor post, in conspicuous places, the notices provided by the Contracting Officer that explain this clause.

[20.32] 2. Prohibition of Segregated Facilities Clause

This General Clause prohibits the lessor from maintaining any segregated facilities at any of its establishments, or permitting its employees to perform their services at any location under its control where segregated facilities are maintained.

[20.33] 3. Pre-Award On-Site Equal Opportunity Compliance Evaluation Clause

The lessor and its first-tier subcontractors are subject to a pre-award review by the Office of Federal Contract Compliance Programs.

[20.34] 4. Affirmative Action for Disabled Veterans and Veterans of the Vietnam Era Clause

This General Clause prohibits the lessor from discriminating against an individual because such individual is a disabled veteran or a veteran of the Vietnam era. The lessor must take affirmative action to employ, advance in employment, and otherwise treat qualified disabled and Vietnam veterans without discrimination based upon their disability or veteran status in all employment practices. Furthermore, the lessor must post in conspicuous places the appropriate notices provided by the Contracting Officer that explain this clause, and must comply with the regulations, rules, and orders of the Secretary of Labor issued under the Vietnam Era Veterans' Readjustment Assistance Act of 1972. This includes regulations that may require the development of an affirmative action plan.

[20.35] 5. Affirmative Action for Workers with Disabilities Clause

This General Clause is similar to the Vietnam Era Clause, and prohibits the lessor from discriminating against any employee or applicant because of physical or mental disability. The lessor must take affirmative action to employ, advance in employment, and otherwise treat qualified individuals with disabilities without discrimination based upon their physical or mental disability in all employment practices. Furthermore, the lessor must post in conspicuous places the appropriate notices provided by the Contracting Officer that explain this clause, and must comply with the regulations, rules, and orders of the Secretary of Labor issued under the

Rehabilitation Act of 1973. This includes regulations that may require the development of an affirmative action plan.

[20.36] 6. Small Business Subcontracting Plan Clause

If the lessor is a large business, this General Clause requires the submission and implementation of a small business subcontracting plan along with the submission of two reports on a semiannual or annual basis depending on the report and the contracting agency. The Small Business Administration is responsible for the issuance of guidance for ascertaining if a lessor qualifies as a small business. Lessors should carefully review this guidance because control by affiliates may impact this determination. A separate Liquidated Damages Clause provides for the imposition of liquidated damages for failure to make a good faith effort to implement the subcontracting plan required by this clause.

[20.37] 7. Reporting Executive Compensation and First-Tier Subcontract Awards Clause

This new clause was included in the General Clauses in 2012 and essentially requires the lessor to include in its annual registration requirement in the Central Contractor Registration database the names and compensation of each of the five most highly compensated executives for the preceding completed fiscal year if it meets the specified income threshold from federal contracts and the information is not otherwise publicly available.

[20.38] VII. HANDLING LEASE ADMINISTRATION ISSUES

Pursuant to the express terms of a Government lease, the parties agree to pursue resolution of all disputes arising under the terms of the lease either as provided for by the terms of the lease or pursuant to the Contract Disputes Act of 1978, 41 U.S.C. §§ 601–613 (the CDA). Typically, this is either a request of the lessor for equitable adjustment or, under the Disputes Clause, pursuing a formal claim under the CDA.

As previously mentioned, the Changes Clause allows the Government (acting through the Contracting Officer) to direct changes, such as in regard to: (1) specifications (including drawings and designs); (2) work, services, or equipment; (3) facilities or space layout; or (4) the amount of space. These changes may impact the lessor's performance costs or the time required for performance, in which case the Contracting Officer

must provide appropriate relief, such as: (1) modifying the delivery date; (2) equitably adjusting the rental rate; (3) making a lump sum equitable adjustment; and/or (4) equitably adjusting operating costs. Thus, the lessor is entitled to a reasonable equitable adjustment to account for the impact of the Government-imposed change.

Unfortunately, lessors are not always successful in efforts to informally reach an agreement for equitable relief. An aggrieved lessor may therefore need to pursue a more formal means of obtaining relief. The CDA allows a lessor to make a written demand to the Contracting Officer for relief as a matter of right. This written demand is known as a “claim” and the CDA requires that the claim seek the payment of a sum-certain amount of money, the adjustment or interpretation of contract terms, or other relief relating to the lease. To best ensure success of the lessor’s claim, the lessor should include relevant documentary proof reflecting the changes and their cost impact. Notably, any claim for more than \$100,000 must be certified by an authorized person to have been made in good faith, upon supporting data that are accurate and complete to the best of the lessor’s knowledge and belief, and for an amount of money that accurately reflects the adjustment for which the lessor believes the Government is liable.

Following receipt of a claim, the Contracting Officer has sixty days to render a written final decision that explains the rationale for the decision reached. This final decision may grant the relief sought in whole or in part, or deny the claim altogether. If the Contracting Officer fails to issue a final decision within the 60-day time frame, the lessor may treat the claim as deemed denied. In any event, the lessor must continue to diligently perform its obligations under the lease pending resolution of its claim.

Lessors are often disappointed and surprised by a Contracting Officer’s final decision. If the lessor is dissatisfied with the Contracting Officer’s final decision, the lessor may appeal the final decision to the Civilian Board of Contract Appeals or the U.S. Court of Federal Claims. Although the Government is supposed to pursue resolution of a claim by mutual agreement if possible, appealing a claim is commonly required to achieve a fair resolution.

[20.39] VIII. GOVERNMENT HOLDOVER IN LEASED SPACE

The standard GSA lease does not contain a holdover provision, nor will the Government in customary circumstances consider the inclusion of one. Consequently, although the Government is obligated to vacate the leased premises, pursuant to the implied covenant to vacate the premises at the expiration of a lease, as a matter of federal contract law, the ability of a lessor to evict a lessor is essentially not available. If a federal tenant fails to vacate the premises, an action against the Government for damages (pursuant to the Contract Disputes Act) based on the Government's breach of the implied covenant to vacate is essentially the lessor's only remedy. In the absence of action taken by either party to challenge the continued occupancy, federal case law has established that the Government's continued occupancy becomes a month to month tenancy under the same terms and conditions of the lease prior to expiration of the lease.¹¹

Typically, when a lease is due to expire and the parties have not agreed to an extension, the Government may seek the lessor's consent to a stand-still agreement that provides the tenant agency with a legal right to remain in possession of the leased premises subject to the lessor's remedies as of the lease's expiration. Alternatively, should the parties fail to agree to such terms, the Government, as the Sovereign, may pursue in U.S. District Court the condemnation of a leasehold interest.

[20.40] IX. GREENING OF GSA LEASES

GSA promotes energy efficiency and sustainability in all of its leases. GSA's Green Lease Policies and Procedures for Lease Acquisition (Realty Services Letter, RSL-2007-12) (the "Green Lease Policies") is the primary document that outlines the energy and environmental leasing requirements for GSA leases and the implementation thereof.

The green lease paragraphs listed in the attachments to the Green Lease Policies apply to all real property leasing activities and address, among other things: (1) re-use of building materials; (2) maintenance of indoor air quality during construction; (3) use of recyclable and recycled content products required by the EPA's Comprehensive Procurement Guidelines; and (4) use of environmentally-preferable building products and materials.

¹¹ *Modeer v. United States*, 68 Fed. Cl. 131, 141-143 (2005).

Also under the Green Lease Policies, all lease construction and major lease renovation projects of 10,000 rentable square feet and above where the Government is the sole occupant of the entire building, with the exception of retail space, must achieve a Leadership in Energy and Environmental Design (LEED) for New Construction Silver rating. In addition, the requirement for the tenant space to achieve a LEED for Commercial Interiors Certified rating is optional and available for use when specifically requested by a customer agency. If the lessor fails to achieve the required LEED certification within the stated time frame, the Government may assist the lessor in implementing a corrective action program to achieve the required LEED certification and deduct its costs (including administrative costs) from the rent.

Furthermore, the Energy Independence and Security Act of 2007 states that, with limited exceptions, Federal agencies may only lease space in buildings that have earned the Energy Star label (or for new construction, the building must be projected to earn the Energy Star label) within the most recent year (i.e., not more than one year prior to the lease award date), which mandate is implemented by GSA's Realty Services Letter RSL-2010-2. All leases where the anticipated award date is on or after December 19, 2010, must include (and in the case of existing leases, be amended to include) the lease paragraphs relating to such mandate that are listed in RSL-2010-2. In addition, if a building will not have an Energy Star label in accordance with one of the limited exceptions in the Energy Independence and Security Act of 2007, the lessor must, nevertheless, renovate the space for all energy efficiency and conservation improvements that would be cost effective over the life of the lease.

CHAPTER TWENTY-ONE

LEASES WITH NEW YORK STATE

Lloyd S. Lowy, Esq.

[21.0] I. INTRODUCTION

This Section addresses leases of commercial space to New York State. While many of the concerns that arise in New York State leasing transactions are no different than those that arise in a lease between private parties, the State's contracting authority and conduct are subject to legal and practical constraints that do not apply to private sector entities. This Section focuses on the issues that arise because the State is the lessee in the lease transaction.

It is important to note at the outset that there is a difference between a lease with New York State or one of its agencies and a lease with a New York State public authority. The State and its constituent agencies, such as the Department of Labor, comprise a sovereign governmental entity. New York State authorities, such as Empire State Development Corporation and the New York State Thruway Authority, act as instrumentalities of the State but are separate legal entities created by statute. While leasing transactions with State authorities can pose many of the same or similar issues as transactions with the State, there are some important differences. The scope of this section is limited to leases with New York State and its constituent agencies.

Under the Public Buildings Law, the Commissioner of General Services (referred to herein as the "Commissioner" or "OGS") is vested with the authority to enter into leases to provide space for the departments, commissions, boards and officers of the State government, subject to limited exceptions for certain types of special facilities.¹ As a general matter, the Commissioner's staff will require that the OGS form of lease be used.² In some instances, where the transaction is substantial, landlords have been able to use their own form, subject to modification to address a number of specific State issues.

1 See Public Buildings Law § 3 for the exceptions (e.g., buildings that form a part of the State University and mental hygiene facilities). Note, however, that even where another State agency is acting on behalf of the State, many of the substantive issues discussed in this chapter will still apply.

2 The OGS form of lease can be found in the "Real Estate" tab of the New York State Office of General Services website (the "OGS Website") by going to the "Leasing Services" section and clicking on any of the specific procurement hyperlinks.

[21.1] II. GENERAL MATTERS

[21.2] A. Necessary Approvals

Under § 112 of the State Finance Law, leases entered into by the Commissioner involving rent in excess of \$85,000 must be approved by the State Comptroller in order to be binding on the State. The dollar threshold applies over the term of the lease, not on an annual basis. As a practical matter, almost all leases of real estate are submitted to the Comptroller for approval. The Comptroller's review is limited to approval or disapproval of the lease; it is not permitted to modify the lease terms.³

The statute requires that the Comptroller make its determination within ninety days after the lease has been submitted unless the Comptroller notifies the applicable State agency or department—e.g., OGS—that it needs an extension of time, which is not to exceed fifteen days unless the affected agency agrees. A failure to comply with these time limits does not, however, result in approval being deemed given.⁴ In addition, neither the State's occupancy of the premises to be leased nor its acceptance of other landlord services prior to receipt of the Comptroller's approval will estop the State from denying liability if the Comptroller's approval is not obtained.⁵

The State reads § 112 very broadly and the courts have largely supported this approach. As a result, lease amendments also require approval by the Comptroller,⁶ as do extensions of previously approved leases.⁷ There is authority suggesting that the exercise of a renewal right strictly in accordance with the terms of a renewal right set forth in a lease originally approved by the Comptroller might not require further approval.⁸ If there is a modification of any of the renewal terms, however, then an additional approval is required.⁹ While there does not seem to be any authority on

3 *City of New York v. State of New York*, 87 N.Y.2d 982, 642 N.Y.S.2d 611 (1996).

4 *See Hamlin Beach Camping, Catering & Concession Corp. v. State of New York*, 303 A.D.2d 849, 796 N.Y.S.2d 354(3d Dep't 2003).

5 *Id.*; *see also Rosefsky v. State of New York*, 205 A.D.2d 120, 617 N.Y.S.2d 969 (3d Dep't 1994).

6 *See also Nevins Realty Corp. v. State of New York*, 240 A.D.2d 480, 658 N.Y.S.2d 132(2d Dep't 1997) and *Rosefsky, supra*.

7 *230 Park Ave. Assocs. v. State of New York*, 165 Misc. 2d 920, 630 N.Y.S.2d 855 (Ct. Cl. 1995).

8 *Westgate N. v. S.U.N.Y.*, 77 Misc. 2d 611, 354 N.Y.S.2d 281 (Ct. Cl. 1973), *aff'd*, 47 A.D.2d 1004 (1975), *appeal denied*, 36 N.Y.2d 647 (1975).

9 *Id.*; *See also City of New York v. State of New York*, 87 N.Y.2d 982, 642 N.Y.S.2d 611 (1996).

point, the thrust of the cases suggests that if the renewal option requires the determination of fair market rent, then its exercise will likely require Comptroller approval.¹⁰ As a practical matter, the State will generally take the position that its exercise of a renewal option is not binding until the Comptroller has approved it.

Note also that both OGS and the Comptroller look to the Attorney General for legal guidance, so all leases must also be approved as to form by the Attorney General.

[21.3] B. Standard Clauses

The Attorney General has promulgated a series of “Standard Clauses For New York State Contracts” which are to be contained in an attachment to each lease and are known as “Appendix A.” The current form of Appendix A can be found on the OGS Website. These clauses should be reviewed early in the transaction. Many of them will not be controversial for most landlords—e.g., the prohibition on purchase of tropical hardwoods and the certification that the landlord is not a prohibited entity under the New York State Iran Divestment Act. Others, however, are quite substantive and overlap the corresponding provision in the State’s form of lease. Section 13 of Appendix A provides that in the event of a conflict between the lease itself and the Appendix, the Appendix will govern.

Certain of the clauses in Appendix A are either statutorily required or merely incorporate statutory legal requirements that would apply regardless of whether they were included in the lease.¹¹ These cannot be deleted or modified—and even if they were, that would not vitiate the effect of applicable law. Other provisions reflect State policy positions. While these too are typically not negotiable, under certain circumstances modifications may be possible. Note, however, that OGS will not agree to any modifications to Appendix A without the approval of the Attorney General’s Office. As a result, modifications to Appendix A should be viewed as very much the exception.

¹⁰ *City of New York*, 87 N.Y.2d 982 (1996).

¹¹ *SHLP Assocs. v. State of New York*, 262 A.D.2d 548, 692 N.Y.S.2d 421 (2d Dep’t 1999) (a party contracting with the State is charged with knowledge of, and bound by, statutes that regulate the State’s contracting power).

[21.4] C. Remedies; Court of Claims

New York State enjoys sovereign immunity from suit except to the extent expressly waived.¹² As a result, enforcement of legal remedies under a lease with the State requires attention to the special requirements for bringing an action against the State. A comprehensive discussion of those requirements is beyond the scope of this chapter; however, certain basic tenets are noted below.

Section 8 of the Court of Claims Act (the “Act”) contains a limited waiver of the State’s sovereign immunity.¹³ Any action for a money judgment against the State must be brought in the Court of Claims and is subject to the procedural requirements contained in the Act.¹⁴ Since the waiver of immunity is subject to compliance with these requirements they have been construed to be jurisdictional.¹⁵ Among the conditions for prosecuting a claim for breach of contract is either the filing, and service upon the Attorney General, of a claim within six months of its accrual, or the service upon the Attorney General within such time period of a notice of intention to file a claim. If a notice of intention is filed, then the claim itself must be filed within two years thereafter.¹⁶ Under the Act the court may, in its discretion, allow a claim even if the Attorney General was not timely served as long as the claim is not otherwise time barred.¹⁷ Note, however, that ongoing negotiations will not excuse the late filing of a claim under the Act.¹⁸

The Court of Claims jurisdiction is limited to money judgments, with only limited authority to order equitable relief incidental to a claim for money damages.¹⁹ As a result, actions to recover possession must be

12 *Psaty v. Duryea*, 306 N.Y. 413 (1954); *Breen v. Mortg. Comm.*, 285 N.Y. 425 (1941); see also *Ashland Equities Co. v. Clerk of N.Y. County*, 110 A.D.2d 60, 293 N.Y.S.2d 493 (1st Dep’t 1985).

13 Court of Claims Act § 8.

14 *Eale Realty Corp. v. State*, 115 A.D.2d 635, 496 N.Y.S.2d 295 (2d Dep’t 1985); see also *88 S. Kensico Ave. v. People*, 146 Misc. 2d 1037, 553 N.Y.S.2d 970 (City Ct., Westchester Co. 1990).

15 *Henderson v. State of New York*, 115 Misc. 25, 187 N.Y.S. 403 (Ct. Cl. 1921).

16 Court of Claims Act § 10(4).

17 Court of Claims Act § 10(6).

18 *See In re Prof’l Charter Servs. v. State of New York*, 166 Misc. 2d 306, 633 N.Y.S.2d 443 (Ct. Cl. 1995).

19 *Psaty v. Duryea*, 306 N.Y. 413 (1954).

brought in the court of applicable jurisdiction.²⁰ Landlords therefore potentially face the prospect of having to prosecute parallel actions in order to recover both possession and money damages.²¹

A final note on remedies and sovereign immunity—OGS takes the position that arbitration is not an available dispute resolution mechanism unless arbitration has been specifically authorized for a particular purpose by statute, as it would otherwise conflict with the conditions under which the State has waived its sovereign immunity. There is a clause to this effect in Appendix A.²² There is, however, a decision by the Court of Appeals holding that if an arbitration clause were included in a duly approved lease it would be enforceable notwithstanding the general principle that a contracting officer does not have the authority to waive the State’s sovereign immunity.²³

[21.5] III. SPECIFIC ISSUES

[21.6] A. Tenant Versus Occupying Agency

OGS is responsible for providing space for the State and, subject to certain exceptions, its various departments, commissions, boards and officers. OGS procures space from private landlords in order to provide for the needs of a particular occupant, which will be identified in the lease as the “Occupying Agency.” However, the “tenant” under the lease will be The People of the State Of New York, acting by and through the Commissioner of General Services. A consequence of this is that the lease will expressly provide for the right of the Commissioner to substitute other State bureaus, agencies or departments for the initially identified Occupying Agency. A landlord may therefore find at some point that a different State agency will be occupying the leased space.

For many properties the landlord will be indifferent to a change in occupant—the State remains the credit and from an economic perspective

20 See *88 S. Kensico Avenue v. People*, 146 Misc. 2d 1037, 533 N.Y.S.2d 970 (City Ct., Westchester Co. 1990)

21 *Id.*

22 Note that there do not appear to be any legislative authorizations of arbitration applicable to State lease matters.

23 *In re Dormitory Auth. of the State of N.Y. (Span Elec. Corp.)*, 18 N.Y.2d 114, 271 N.Y.S.2d 983 (1966) (note, however, concurring opinion of Bergan, J).

little has changed.²⁴ For some properties, however, such as certain kinds of office buildings, the landlord may be concerned that its tenant could change from a generic state administrative office to one that is perceived as less desirable or even adverse to the landlord's interests in maintaining a certain class of building, such a parole office or an office that attracts a high level of off-the-street traffic.

OGS will not generally give up its right to reallocate leased space among State users. Depending on the size of the transaction, however, OGS may agree to limitations on certain uses that effectively limit the right to reallocate the space and that otherwise protect the landlord's interest in maintaining the character of the building.

Sometimes OGS will seek space with the intention of housing multiple agencies in the space from the outset. Where this is the intention OGS may require a separate lease for each agency or department. This simplifies lease administration for OGS and provides for greater clarity should any appropriations issues arise.²⁵

[21.7] B. Lease Term

The State is limited by statute to lease terms of ten years or less, although a lease term of up to fifteen years is permitted if the Commissioner determines that a longer term is in the best interests of the State. The lease may provide for renewal terms of ten years or less at the option of the State. Note that, like the initial lease, renewals must be approved by the State Comptroller and the Attorney General.²⁶

[21.8] C. Audit Rights

The State lease form provides for broad audit rights on behalf of OGS as well as the State Comptroller and the Attorney General. Notably, these rights are not limited to the basis for expense escalations but rather extend to all information relevant to landlord's performance under the lease. This broad access for the Comptroller is derived from the New York State Constitution and cannot be eliminated.²⁷ As a practical matter, OGS will rou-

24 Arguably, one agency might pose a greater risk of non-appropriation than another. In most instances, however, quantifying the relative risk of this will be largely speculative. See Section III. D. *infra*.

25 See Section III.D. (§ 23.9) *infra*.

26 See Section II.B, *supra*.

27 NYS Constitution, art. V, § 1.

tinely audit lease expense escalations. The exercise by OGS or the Comptroller of the State's broader audit rights, however, is not frequently exercised.

In addition to the typical landlord concerns about allowing tenants to audit their books and records, one concern that landlords may have in providing financial information to the State is the possibility that sensitive information will become available to third parties pursuant to requests under the Freedom of Information Law (FOIL).²⁸ Under the "Records" clause of Appendix A the State agrees to take reasonable steps to protect confidential information from public disclosure to the extent permitted under FOIL, provided that the landlord notifies the State to do so and identifies the information to be protected.²⁹

[21.9] D. Subject to Appropriation

Every lease with the State will have a clause providing that the State's executory obligations are subject to the appropriation of funds for payment of the rent by the State Legislature. A typical formulation of such a clause is as follows:

As required by law, this Lease shall be deemed executory only to the extent of the monies available to the Tenant or the Occupying Agency for the leasing of said Premises and no liability shall be incurred by the State beyond the monies available for such purpose. Notwithstanding the foregoing, if the monies available therefore are monies appropriated for and made available to one or more departments, commissions, boards or officers other than the Tenant or the Occupying Agency, this Lease shall be deemed executory only to the extent of the monies available to the one or more departments, commissions, boards, or officers to which the Premises shall be allotted by the Commissioner and no liability in such cases shall be incurred by the State beyond the monies available for such purposes.³⁰

28 Public Officers Law, art. 6.

29 See Public Officers Law § 87; N.Y.S. Office of General Services, Standard Clauses for New York State Contracts, Appendix A, p. 10, <https://ogs.ny.gov/BU/RE/Leases/Docs/OGSlobby-LawForm.pdf>.

30 See also Appendix A, ¶ 1.

The effect of this provision, which is often referred to as the “executory clause” or “subject to appropriation clause,” is that if, at any time during the term of the lease, the State—e.g., OGS or the Occupying Agency - does not have money that is legally “available” for the payment of rent, it is excused from the ongoing rent obligation and the lease is effectively terminated. This raises several points that landlord and its counsel must understand:

First, this concept is legally required and may not be waived or eliminated. Section 41 of the State Finance Law prohibits any State officer or entity from contracting any obligation on behalf of the State in excess of money appropriated or otherwise available. The purpose of this statute is to address concerns that contracts would otherwise constitute State debt entered into in violation of Article VII of the New York Constitution. To further protect the State’s interest on this issue, § 3(12) of the Public Buildings Law requires that every lease contain a provision to this effect.

Second, the concept of “available” is tied to the legislative budgeting and appropriations process, and not the mere convenience of OGS or any particular Occupying Agency.³¹ As a result, while this provision may be invoked to terminate leases in connection with substantive changes to a department, such as modifying or reducing its operations, it may not be invoked by OGS or an Occupying Agency to prematurely terminate a lease merely to facilitate relocating an office to another location.³² The non-availability of funds must result from a legislative or budgetary determination. As one court put it, the executory clause is

to be utilized as a shield against imprudent use of tax payer dollars . . . [but not] . . . as a sword to divorce the State for its own convenience from contracts fairly entered into and honestly performed.³³

Third, in the event that non-appropriation is invoked, the lease is effectively terminated with all that implies. In the event that the State fails to vacate the leased premises, the lack of available appropriated funds does

31 *Forelli v. State of New York*, 179 A.D.2d 394, 577 N.Y.S.2d 844 (1st Dep’t 1992).

32 *Drislane v. State of New York*, 7 A.D.2d 141, 181 N.Y.S.2d 38 (3d Dep’t 1958); *Adson Indus., Inc. v. State of New York*, 51 Misc. 2d 718, 273 N.Y.S.2d 812 (Ct. Cl. 1966), *modified and aff’d*, 28 A.D.2d 1183 (3d Dep’t 1967), *motion to appeal granted*, 21 N.Y.2d 644 (1968); *cf. Amarnick v. State of New York*, 84 Misc. 2d 112, 372 N.Y.S.2d 947 (Ct. Cl. 1975), *aff’d*, 52 A.D.2d 1007 (3d Dep’t 1976).

33 *Adson Indus., supra*, at 723.

not bar the landlord from recovering payment for use and occupancy.³⁴ As discussed above, however, any such claim must be brought in the Court of Claims, while an action for possession must be brought in the court of applicable jurisdiction.³⁵

Tenant's counsel will sometimes try to negotiate the "subject to appropriation" language in an effort to maximize the chances that there will be "available" funds for the payment of rent. One common approach is to request a covenant by OGS, in all events, to seek an appropriation for rent.³⁶ Another approach is to seek agreement that, in the event there is no specifically applicable appropriation, the State will apply any other funds legally available for the payment of rent.

The State does not readily deviate from its standard language. Moreover, while there is authority suggesting, but not holding, that a breach of an agreement to seek an appropriation might give rise to a claim for damages,³⁷ presumably in order to recover damages for a breach a landlord would have to be able to show that the appropriation, if sought, would have been granted by the Legislature.³⁸ In addition, while there does not appear to be any case law at present, to the extent that a covenant to seek an appropriation purports to supersede the proper exercise of the State's budgetary discretion it may not be enforceable.³⁹

Finally, note that, in addition to the "subject to appropriation" provision, the State's form of lease contains a contractual termination right,

34 See *SHLP Assocs. v. State of New York*, 262 A.D.2d 548, 692 N.Y.S.2d 421 (2d Dep't 1999).

35 See Section II.C. *supra* and 88 S. *Kensico Ave. v. People*, 146 Misc. 2d 1037, 553 N.Y.S.2d 970 (City Ct., Westchester Co. 1990).

36 Note that there is case law suggesting that, separate and apart from any covenant, the State may have an implicit obligation to seek an appropriation to meet its contractual obligations, subject to the good faith exercise of its budgetary discretion. Compare *Starling Realty Corp. v. State of New York*, 286 N.Y. 272 (1941), *rearg. denied*, 286 N.Y. 696 (1941), with *Drislane v. State of New York*, 7 A.D.2d 141 (3d Dep't 1958); see also discussion in *TM Park Avenue Assocs. v. Pataki*, 986 F. Supp. 96 at 109, *vacated and remanded on other grounds*, 214 F.3d 344 at 349 (2d Cir. 2000).

37 See *TM Park Ave. Assocs.*, 214 F.3d at 349. The court also notes that there may be an implicit duty on the part of the State to fulfill its obligations under the lease by seeking an appropriation regardless of whether there is an express covenant to do so, however this seems to be another way of inquiring whether the failure to seek an appropriation results from something other than a proper budgetary determination.

38 See *Starling Realty*, 286 N.Y. 272 at 278.

39 *Id.* ("... it could hardly be said that funds not necessary to a proper and efficient administration of the department would be 'money available for such purposes' ...").

regardless of whether funds are available. This provision is rooted in State business and policy determinations separate from the State's legal constraints.

[21.10] E. Janitorial Services

State agencies and authorities are under a mandate to establish policies and procedures to promote environmental sustainability and, to the maximum extent practicable, purchase “green” paper and janitorial products.⁴⁰ The State leases require that landlords cooperate in implementing these policies. Where a landlord is unwilling or unable to do so, the State may require that the Occupying Agency take over janitorial services for its space.

[21.11] F. Build Out and Alterations

The State is not well equipped to build out space in privately owned buildings and, if it were to do so, would need to go through its normal procurement procedures, which would in many instances be cumbersome in the context of a commercial building space lease. As a result it will require that the landlord perform the entire build out at the landlord's expense, subject to any limit provided for in the business terms of the deal, in accordance with the State's requirements and specifications. In addition, it will reserve the right to require the landlord to carry out most alterations, although where the alterations are at the State's request, or required of the State under the terms of the lease, the State will reimburse the landlord for the cost of the alterations. Note that even though this work is carried out for the State's occupancy, the result is considered a private improvement. As a result, it is not exempt from sales tax or mechanics' liens.

In all such instances the lease will require the landlord to submit plans, specifications and cost breakdowns for the State's approval, based on a layout and specifications submitted by the State. The lease will also establish a cap for the landlord's fees and profits on the job. Note also that pursuant to certain of the clauses in Appendix A, the landlord may be required to include certain provisions in its construction contracts.

⁴⁰ See Executive Order No. 4 of 2008 and the relevant portion of the OGS website, <https://www.ogs.ny.gov/EO/4/>.

[21.12] G. Repairs

The State requires landlords to maintain and repair the buildings in which the State leases space. In addition, it requires landlords to be generally responsible for repairs to the leased premises, except that the State will be responsible for repairs necessitated by acts or omissions of the Tenant. In some instances the State will also retain responsibility for specifically identified property, such as removable fixtures or special installations.

Regardless of the scope of the State's repair responsibility, for the reasons described in Section F above, it will typically retain the right to have the landlord actually carry out the repair at the State's expense.

[21.13] H. Right to Set-Off

Both the form of lease and Appendix A provide for a right of set-off in the event the landlord defaults. The Appendix A provision reserves all common law, equitable and statutory rights to set-off. The form of lease provides for notice to the landlord and a right of self-help, the costs of which may be deducted from rent, in the event the landlord fails to make repairs or perform services for which it is responsible. Alternatively, the form also allows the State to eschew self-help and simply deduct from its rent a "reasonable amount" for the diminution in value of the leased premises resulting from the lack of repair or failure to provide services.

While the State is concerned about protecting the public fisc against expenditures for which it is not receiving the full benefit of its bargain, this provision appears to be based on business and policy determinations by the State and not on specific legal mandates. As a result, in certain transactions it may be subject to negotiation.

[21.14] I. Subordination and Non-Disturbance

The form lease contains fairly basic subordination language, including the requirement for a non-disturbance agreement. It should be noted, however, that the typical lenders form of subordination, non-disturbance and attornment agreements with various successor landlord exculpations will likely be viewed as a modification of the lease and thus require approval by the Comptroller and the Attorney General, which may not be forthcoming. If the landlord or its lender follows that route it is important to submit the form requested as early as possible in order to allow adequate time for review. Alternatively, the parties can either include an

agreed-upon form to the lease when it is submitted for the initial Comptroller approval or they may agree to use the State's then-current form.

[21.15] J. Non-Assignment

One of the most nettlesome issues for landlords who lease space to the State is the prohibition on assignments, transfers or other dispositions of the lease by the landlord, which is contained in every State lease. This prohibition derives directly from State Finance Law § 138 and cannot be avoided. It effectively requires State consent to any sale of the building and to any mortgage financing.⁴¹ There does not seem to be any direct authority on the issue of whether it also applies to a refinancing involving the assignment of a mortgage to which consent had previously been given.

A principal purpose of the statute, which applies to all procurements, is to allow the State to identify, at all times, those with whom it is doing business.⁴² Strictly construed, the statute requires the State to revoke or annul any contract assigned without its consent.

As a practical matter, the State will agree not to withhold its consent unreasonably. Landlords have in the past, and with mixed results, sought, at the time the lease was executed, to have the State consent to future financings and arms-length transfers. The State's current position, however, is that it will no longer do this due to its increased emphasis on the State's policy of knowing and vetting who it does business with. For similar reasons, it will not agree to mechanisms by which it can be deemed to have consented to a transaction.

Landlords seeking approval for a transaction should submit their request for approval as soon as possible in order to avoid potential delays to the transaction. The approval may require submission to the State Comptroller and the Attorney General. As part of the submission the landlord will need to submit certain information relating to the proposed transferee, including whether it has been the subject of a prior "non-responsibility" determination⁴³ and whether it is a registered New York State vendor.

41 The assignment of a right to receive payment under a State lease does not require State consent. *Peets Motors v. New York*, 147 Misc. 218, 263 N.Y.S. 762 (Sup. Ct., Franklin Co. 1933); see also 1943 N.Y. Op. Atty. Gen. 111, 1943 WL 54037.

42 See, e.g., *Penn York Constr. Corp. v. State of New York*, 92 A.D.2d 1087, 462 N.Y.S.2d 80 (3d Dep't 1983).

43 See State Finance Law §§ 139-j, 139-k.

Foreclosing mortgagees and bidders at foreclosure are also subject to the consent requirement. As a practical matter, notwithstanding the language of the statute this typically occurs following the foreclosure. Note, though, that until the approval has been received the new landlord/assignee may have trouble collecting the rent, since the Comptroller's office will not have a record of the approved transfer.

State Finance Law § 138 contains language permitting the waiver of prior consent to an assignment where it arises in connection with a merger or reorganization. The State will not typically grant such a waiver in advance, however, where there is no change in control then the new entity typically is required only to update certain information on file with the Comptroller for purposes of facilitating payment (e.g., its federal employer identification number). Where a change in control occurs, the merger or reorganization will be viewed as an assignment requiring consent and the submission of an assignment request, including vendor responsibility information.

[21.16] K. Late Payment of Rent

Under article 11-A of the State Finance Law the State is required to make timely payment of its obligations. In circumstances where payment is not made within thirty days after it is due the State is obligated to pay interest at the rate determined by statute.⁴⁴ As a result, the State will not agree to other late payment penalties.

[21.17] L. Indemnity

The State form does not contain the typical indemnity language. OGS will resist any such language that, in its view, could be construed as broadening the scope of the State's liability for damages under the lease. In the event the point becomes negotiated any language will likely reflect the need for a Court of Claims judgment and an appropriation of funds for payment and will be limited to acts or omissions of State employees acting within the scope of their employment. As a result, landlords should expect to rely on insurance directly for matters that are typically the subject of indemnification.

⁴⁴ See State Finance Law § 179-g.

[21.18] M. Insurance

The State form imposes extensive insurance requirements on the landlord, including a requirement to provide evidence of workers compensation coverage. The latter is required under Workers Compensation Law § 220 and State Finance Law § 142.

The State will not generally agree to purchase third-party insurance but will instead elect to self-insure. Depending on the transaction, however, it may be possible to require that the State obtain third-party commercial coverage. One implication when the State does self-insure is that they will not generally agree to a mutual waiver of subrogation.

[21.19] N. Holdover and Other Damages

The State does not typically agree to holdover rent or liquidated damages in the event of a lease termination for default, although these may be matters for negotiation. Where the State does holdover, the landlord may seek use and occupancy damages.⁴⁵ The basis for any such claim is trespass and unjust enrichment. Accordingly, landlords should be careful in accepting the continued payment of the previously payable rent, as at least one court has construed that as evidence of consent to the State's continued occupancy and, therefore, inconsistent with a claim for unjust enrichment.⁴⁶

[21.20] O. Security Deposit

As noted above in § 21.16, "Late Payment of Rent," under Article 11-A of the State Finance Law, the State has a statutory obligation to make timely payments under its contracts. As a result it, will not agree to deliver a security deposit.⁴⁷

[21.21] IV. CONCLUSION

Leases with New York State are subject to legal and practical parameters that are not present in leases with private sector entities. Counsel for

45 *SHLP Assocs. v. State of New York*, 262 A.D.2d 548 (2d Dep't 1999); *230 Park Avenue Assocs. v. State of New York*, 165 Misc. 2d 920, 630 N.Y.S.2d 855 (Ct. Cl. 1995).

46 *SHLP Assocs.*, *supra*.

47 The State also argues that, under § 179-f(2)(f) of the State Finance Law, it does not have the ability to deliver a security deposit because it would not be payment for goods or services that have been delivered. There do not, however, appear to be any cases confirming that construction of the statute.

landlords in these transactions need to understand the special rules and considerations that apply to the State so they can properly assess and address the risks to their clients without devoting undue time and effort to issues that are inherent in State leasing transactions.

CHAPTER TWENTY-TWO

**LEASE TRANSACTIONS WITH THE
CITY OF NEW YORK**

Leonard M. Wasserman, Esq.

[22.0] I. THE “WAITING-PERIOD”: PATIENCE AND ACCOMMODATION

This chapter will be dedicated primarily to issues peculiar to leases with the City of New York (the “City”). Real estate transactional lawyers negotiating deals involving space and ground leases with the City should be aware of the features in such leases—and the antecedent conditions precedent for the effectiveness of such leases—which may resonate with idiosyncratic transactional significance for their clients.

[22.1] A. ULURP and 195

In order for the City to execute a lease with a private party, either a “lease-in” or a “lease-out,” the City must establish its authority to do so. The foundational condition to such authority is established by the City’s following the protocols and procedures required by section 197-c of the New York City Charter (the “Charter”), known as the Uniform Land Use Review Procedure or by the acronym ULURP. ULURP requires that, in order for the City to be authorized to lease out (viz., a disposition of real property) or lease in (viz., an acquisition of real property), the City must have received authorization therefor pursuant to ULURP. As a condition precedent to the commencement of ULURP, the City must first submit an application for such authorization to the New York City Department of City Planning (DCP). Such application must then be certified as complete by DCP in order to formally commence ULURP.

As per the New York City Charter, the ULURP process is required to be conducted within 150 days from DCP’s “certification” of the application as complete. During those 150 days, the certified ULURP application must be reviewed first by the Community Board in whose Community District the real property is located, then by the Borough President in whose Borough the Community District is located. The Community Board will have up to 60 days to complete its review, and the Borough President will enjoy a 30-day opportunity for he or she to do the same, after which, each of the Community Board and the Borough President must either *recommend* approval, approval with modifications or disapproval of the application for the City’s leasing-out or leasing-in. Thereafter, the New York City Planning Commission (CPC) will be entitled to up to 60 days to review and either authorize approval of the application, or authorize approval of the application with modifications or disapprove the application.

Upon the completion of CPC's action to authorize approval a lease, or approval of a lease with modifications, the City Council, pursuant to Section 197-d of the Charter, has the right to review and either endorse the approval, approve the application with modifications, or simply disapprove the application. The City Council has up to 50 days to act—provided it exercises its right to review the CPC's action by majority vote of the Council taken no later than 20 days after it has received notice of CPC's action with regard to the lease application—whatever the approval action theretofore taken by CPC may have been. (It should be noted, however, that if both the local Community Board and the Borough President recommend disapproval of the CPC's approval or approval with modifications, of the lease applied for, and the Borough President notifies the Council, within five days of the CPC's decision, that both he or she and the Community Board disapprove the application, the Council must review and take action on the decision of the CPC with regard to the authorization for the lease.)

The aforescribed ULURP process commonly takes about six months (though sometimes, not infrequently, longer) to complete after the application is first submitted to DCP. If one counts the maximum time periods within which each of the City governmental entities must take their respective actions with respect to the ULURP process, one observes that the post-ULURP-certification time period could aggregate up to 200 days. One should also note that there is no precise time period for DCP's preliminary review for certification purposes. Accordingly, in the case of any lease deal with the City, the private party involved, either as lessee or lessor, should be aware of the potential length of time that could pass before City authorization might be achieved.

The one exception to this requirement for ULURP authorization for a proposed lease involving the City as a party is a proposed office lease with the City as tenant (see section 195 of the Charter). The process for approval and authorization of such a lease, as an alternative to ULURP, is a comparatively expeditious review and authorization process pursuant to section 195 of the Charter for leases-in to the City as tenant, for office use purposes. If City agencies believe they need office space, the agency authorized to arrange for such space (usually the New York City Department of Citywide Administrative Services or DCAS) may submit to DCP a "notice of intention" to acquire such space. DCP then proceeds to send a copy of the notice of intention to the local Community Board and to all five Borough Presidents and, within thirty days of the receipt of the notice

of intent, DCP must hold a hearing and act to either approve or disapprove the proposed acquisition.

The submission of the notice of intent and the review thereof must also take into account the requirements and criteria of section 203 of the Charter—the so-called “Fair Share” criteria for the “fair” distribution around the City of facilities providing municipal services, “fairness” to be measured in terms of both the benefit and the burden the new space imposes on the local community. Very importantly, following approval by DCP within the 30-day period, the City Council may, within 20 days of any such approval, vote to disapprove the proposed lease for office space. The council presumably would disapprove because of a perceived unfairness to the interests of the community, or other communities, in the application of the Fair Share criteria.

In any event, the Section 195 procedure, while much abbreviated from the 197-c ULURP, nonetheless could consume up to 50 days. So, in short, a lease deal with the City, be it a lease of space by the City from others or from the City to others, must accommodate an opportunity for the submissions, reviews and approvals described above. As indicated, the time periods for obtaining the necessary approvals may extend from up to 50 days for office leases to the City as lessee out to up-to 200 days (not counting the DCP pre-certification period) for any other leases in or out.

Accordingly, whenever the City approaches a proposed landlord to rent space, or a prospective lessee is negotiating with the City to lease space, the parties must build into their expectations the time necessary to comply with these conditions precedent to any lease deal. Until these conditions precedent have been satisfied, the lease cannot be executed. It should also be noted, in terms of anticipated time lags, that what constitutes “office space” is construed very strictly. So, for example, space sought by the City for lease in an office building to accommodate courtroom facilities, which certainly is the case in a number of boroughs, would not be treated as a notice of intent to lease office space. The leasing thereof by the City would therefore be subject to the further burden of a full ULURP rather than to the far more abbreviated Charter Section 195 process. The same is true, for example, with respect to relatively modest medical care facilities or educational facilities. They would simply not be treated as office space. In either case, office or any other use, a lease deal with the City imposes these required legislatively prescribed and idiosyncratic waiting periods. For such reason, the astute practitioner would be well-advised to so inform his or her client before embarking down the road of a prospective lease deal with the City. Such advice would represent a mere caution,

however, and certainly represents no reason to not do a deal, but the attorney should be aware of the “wait-period” challenge and make sure his client takes the wait-period into account as an ingredient in the transaction.

[22.2] B. SEQRA and CEQR

Furthermore, and producing even more governmental complication in what would seem, otherwise, to constitute a simple transactional event, lease approvals and authorizations, inasmuch as they are discretionary actions that may have an impact on the environment, must also be supported by an environmental review pursuant to the New York State Environmental Quality Review Act (SEQRA). In the City, SEQRA is implemented through a local regulatory scheme called City Environmental Quality Review (CEQR). In CEQR, the City undertakes to analyze the potential impact on the environment of its proposed leasing. In the case of a leasing-in for the provision of City services, in addition to the Fair Share evaluation, the City must analyze what the impacts of the new facility may be on the surrounding environment. So, for example, if the facility might produce substantially more foot traffic than what the existing real property generates, how that foot traffic might impact the local neighborhood would have to be taken into account. The possibility or likelihood of increased automobile or truck traffic would most certainly precipitate the need for serious review and analysis. Everyone involved in such a transaction hopes that any impacts shown will not indicate that there might be a potential for a “significantly adverse environmental impact,” as such an impact would necessitate the preparation of an Environmental Impact Statement—which can consume months. The wished-for vision of everyone is that the analysis will result in the felicitous “neg dec” or negative declaration, i.e., a declaration based upon competent environmental analysis that concludes that there is no substantial likelihood that the proposed lease would precipitate any significant adverse environmental impacts. Such analysis can consume as little as a few weeks, depending on the nature of the proposed use. If it is possible that the contemplated use can fit into what is called the “Type II” category, then no environmental analysis whatsoever is necessary. Type II lease projects are presumed by their nature to not implicate significant environmental impacts. So, for example, if the City is merely leasing space in an existing building for office use, and the same space was previously being used for office use, and no tenant fit-out work changing the configuration or character of the building is to be performed, the lease will be considered a Type II action.

Nevertheless, EIS or no EIS, except for Type II leaseholds, the necessity for CEQR review ineluctably extends the time period of the lease

transaction. Satisfaction of CEQR, either by a “neg dec” or an EIS (if no Type II is indicated), is a necessary, and primary, condition to DCP’s certifying a ULURP application as complete. Accordingly, the time period to complete the CEQR, and the cost of preparing the environmental analysis, must be baked into the transactional process. If the landlord is not prepared to patiently accommodate the City’s need to satisfy all requirements necessarily antecedent to its executing a lease, the deal cannot be consummated. So, here, in lease deals with the City, patience is not merely a virtue. It is a sine qua non for successfully getting a lease deal with the City done.

[22.3] II. BUDGETARY CONSTRAINTS AND THE RENT OBLIGATION

In the case of leases-in for City use, the educated practitioner embarking upon a possible negotiation with the City on behalf of a landlord client should be aware of the following frequently demanded provision of a commercial lease transaction with the City as tenant. In a leasing-in deal, the City usually demands that there be included in the lease document an unequivocal right on the part of the City that the lease be terminable after the fifth year of the lease term at the City’s election. The basis for this request arises from the circumstance that the rent obligation under a lease is an operating expense of the City. For the City, this means that the rent obligation must be paid-for out of the City’s expense budget, with a line-item available for such purposes. Section 227 of the Charter prescribes, “No money shall be paid from any fund under the management of the City . . . except in pursuance of an appropriation by the [City] council.” Accordingly, rent must find a home in an expense budget appropriation for the fiscal year for which rent is sought to be paid. Nothing can be paid-for without an available budget appropriation.

Accordingly, the Charter restricts the extent to which agencies can spend money during a fiscal year to the annual budget appropriation for the line item, in our case “rent.” The lease provision for an option in the City, as tenant, to terminate the lease after the fifth lease year is the product of this concern that no money can be paid “except in pursuance of an appropriation.” The City Budget is adopted each year by the Council, usually in June. The City’s fiscal year is July 1 to June 30. The Budget for expense items, like rent, covers that year but, important for our present topic, that year only. (Capital appropriations can cover multiple years, but that is not the subject here.) Next year, a new Budget must be adopted. If the new budget does not include a line item which will be available for the

rent, then rent cannot be paid. Although this limitation is rarely, if ever, a prominent concern in the city's lease administration process, nevertheless, the apprehension that in an ensuing year the Council may not appropriate sufficient funds to cover the rent in question leads the City, usually acting through DCAS, to do its best to hedge the deal with protections against the risk that the rent obligation incurred may, in the future, exceed the one-year expense budget appropriation. The termination-after-five-years clause is the transactional expedient designed to protect City agencies, at least to a modest extent, from running afoul of the spending constraints imposed by a future budget. If a lease has been executed for City use but, in an ensuing year, the funds to pay for rent do not materialize, the termination clause can be invoked—after the fifth year—so that the agency can free itself of that contractual obligation and not run afoul of the Charter constraint.

As a practical matter, this provision has not proven-itself to be overly inhibiting for the City in its efforts to negotiate and find space for its needs, because this idiosyncratic constraint has been recognized, understood and accepted by most of the commercial real estate community. Also, in order to protect City space leases, the agencies will structure their annual expense budget requests to accommodate the need to pay rent to their private landlords. The real estate community, insofar as it is aware of the issue, understands that the City seeks to maintain a reputation as a responsible and reliable tenant. The City also embodies a rather prime candidate for leasing-up space which may have been lying fallow on the real estate marketplace. Correspondingly, DCAS, as the City's real estate manager, recognizes that its ability to consensually negotiate for available commercial space within the real estate community in New York City is necessarily a product of maintaining a reputation for reliability as a tenant. Accordingly, while this is a curious lease provision that the practitioner should be aware of, i.e., the right to terminate after the fifth lease year, it nevertheless enjoys a place within the pantheon of municipally important lease clauses. The clause is, for marketplace purposes, largely recognized as driven by the Charter requirements and not as the product of overreaching by the City's real estate representatives. As such, it has largely become an accepted demand and is not ordinarily made the subject of furious negotiating clamor. While this clause usually will be demanded by the City in the negotiation for any commercial space, for the foregoing reasons, it is not a phenomenon that has historically given the real estate community tremendous agita when dealing with the City.

[22.4] III. THE PUBLIC AUCTION REQUIREMENT AND ITS ALTERNATIVES

Let us turn now to an aspect of a lease deal with the City that is implicated in any significant “leasing-out” deal, and that is the phenomenon of the requirement that sales and leases (dispositions) of City real property must be achieved, with but a few exceptions described below, through “public auction.” This requirement is prescribed in Section 384(b)(1) of the Charter. The simple meaning of it is understandable. If the City has surplus real property in its inventory, the Charter seeks to ensure its citizens that such property cannot simply be sold at bargain prices at the expense of the public fisc, either because of commercial improvidence or naiveté or because of an apprehension of the intrusive influence of “politically connected” individuals. So, therefore, how does the City negotiate major lease deals with private developers or users in light of this affirmative requirement of public auction? Why does the City not simply adhere to the expedient of conducting public auctions for available real property and take the highest price offered at the auction—and be content with it?

The answer is that surplus real property represents an opportunity for City leaders to promote major policy initiatives to make the City a better place to live. The highest bidder at an auction may simply seek to warehouse its purchase for a long term and wait for someone to come along and pay it a lot more money than it had paid the City for the property. Urban planning leadership within City government, however, may recognize certain properties as shining opportunities for salubrious and economically efficacious redevelopment to recharge a failing, sleepy or unproductive neighborhood and transfigure it into a booming success.

For example, in the last 20 years we have witnessed the remarkable success of the Forty-Second Street Redevelopment Project, the Metrotech Project in downtown Brooklyn, the Renaissance Plaza Project immediately next door to and across the street from Metrotech, and the Coney Island Project, which is attracting hundreds of thousands of vacationers and City residents seeking a satisfying beachfront recreational opportunity in New York City in the heat of the summer. Also in downtown Brooklyn we are watching how the Atlantic Center/Atlantic Terminal Project, together with the new Barclay Center development, is transforming a long sleepy neighborhood into a vibrant center of retail, office, cultural and residential life., accompanied by concomitant growth in employment opportunities and increased revenues to the City through increases in real property taxes and sales taxes in the surrounding neigh-

borhoods. These are not project successes that have been achieved through public auction.

So, what gives rise to a right on the part of the City to negotiate large development lease transactions given the statutory constraint of 384(b)(1)? The answer is straightforward but must be understood by the real estate practitioner in order to successfully engage in a development lease transaction with the City. The answer, primarily, is Section 384(b)(4) of the Charter and Section 507.2(b)(2) of the New York State General Municipal Law. Section 384(b)(4) provides that the City may lease or sell real property directly to a specialized breed of New York State not-for-profit corporation called a local development corporation. The local development corporation (LDC) is a creature of Section 1411 of the New York State Not-for-Profit Corporation Law. Section 384(b)(4) provides that the Mayor may lease or sell real property of the City to an LDC “without competitive bidding and for such purpose or purposes and at such rental or for such price as may be determined by the Mayor to be in the public interest.”¹

Accordingly, and stated simply, the public auction requirement does not apply to sales or leases by the City to LDCs. Section 1411(a) articulates an LDC’s purposes as “the charitable and public purposes of relieving and reducing unemployment, promoting and providing for additional and maximum employment, bettering and maintaining job opportunities . . . carrying on scientific research for the purpose of aiding a community or geographical area by attracting new industry to the community or area by encouraging the development, or retention of an industry in the community or area” as well as lessening the burdens of government and acting in the public interest. As can be observed from the text of 1411(a), the primary purpose of LDCs is job creation and retention within a municipality. LDCs exist all over the State, and they may be privately formed or formed by municipalities, “which [municipalities] may cause such corporations to be incorporated....”

In 1966, the City caused an LDC to be incorporated—viz., the New York City Public Development Corporation (PDC). Its original purpose was to manage the City’s then emerging industrial parks built on City-owned land throughout the City. In the early years of the administration of Mayor Edward I. Koch, however, its mission was enlarged to undertake major urban redevelopment deals which the mayor envisioned as a vehicle to lift New York City out of the fiscal crisis which had strangled the local New York City economy in the 1970s. As a result, PDC became the vehicle through which many deals were, and continue to be, negotiated, docu-

mented and closed with private developers in order to achieve particularized economic development objectives—viz., the creation, expansion, and retention of jobs within New York City.

One must recognize, however, that the avoidance of public auction was not implicated in many of the major projects undertaken by PDC (Metrotech and the Atlantic Terminal projects, for example). Section 507.2(d)(2) of the New York General Municipal Law, known more popularly as the Urban Renewal Law, also provides a dispensation from the public auction requirement for City dispositions of real property; but dispensation can only be applied to designated sites within an Urban Renewal Area approved by the City Council.¹ It should just be noted that dispositions to private developers through 507.2(d)(2) are achieved directly from the City through the New York City Department of Housing Preservation and Development (HPD) rather than through the intermediary of an LDC.² Many of the major redevelopment projects of the 1980s and '90s were undertaken as urban renewal projects, or the New York State analogue—projects undertaken by the Empire State Development Corporation under the Urban Development Corporation Act.³ Nevertheless, NYCEDC has served, and continues to serve, as the professional development medium responsible to the City, under its annual “Master Contract with the City,” for managing the City’s interest in all of these economic development projects. (Residential development is the responsibility of the HPD, which also functions as the City’s Urban Renewal Agency.)

1 Notwithstanding the express dispensation from public auction set forth in Section 507.2, it should be noted that at least one appellate court has found that a municipality must be careful in negotiating and approving the price to be paid for urban renewal property. In *Grand Realty Co. v. City of White Plains*, 125 A.D.2d 639, 510 N.Y.S.2d 172 (2d Dep’t 1986), the Second Department found that the price to be paid for a particular piece of urban renewal land was so disproportionate to its value that it could be deemed to constitute a “Gift” in violation of the “Gifts and Loans” prohibition of Article VIII, Section 1 of the New York state Constitution (discussed further below in footnote 4), and therefore invalid and void under New York law. This case stands as a stark caution to municipalities and to private parties negotiating real estate deals with municipalities with respect to the negotiation of the rent or purchase price in connection with a disposition to an LDC or with respect to an urban renewal disposition. One cannot be too cavalier about the dispensation from public auction and the right of the City, for example, to lease its surplus real property for any rental or other price that the Mayor may deem to be in the public interest.

2 It should be noted that in 1991, PDC was merged with another City entity, the Financial Services Corporation, and the name of the merged entity was changed to the New York City Economic Development Corporation (NYEDC). Going forward, we will use NYCEDC as the reference instead of PDC, in order to be consistent with current understandings, local understandings since 1991.

3 See New York Urban Development Corporation Act, sections 2-16.

NYCEDC uses its power and authority under 384(b)(4) to negotiate, document and close most non-auction deals focused on real property owned by the City. For example, if the City owns property, the public use of which may have become obsolete or obsolescent and which is ripe for a redevelopment (think an old parking lot or garage), such languishing property could enjoy the potential to be redeveloped to invigorate the local economy, or even be co-located with or integrated into, a larger urban redevelopment project. NYCEDC enjoys the power to offer such a property for lease or sale to a private developer with the vision of achieving the salutary redevelopment of such land pursuant to a negotiated lease or sale deal with a qualified developer. The deal can be negotiated with a view to achieving the most desirable project which will benefit the community at large-- rather than merely to get the City the highest price for the property. Through NYCEDC, the City can arrange to obtain the necessary authorizations, prescribed by the Charter, for a 384(b)(4) “no public auction” lease. These authorizations are: (1) the approval by majority vote of the Borough Board (i.e., a Board composed of all the City Council members, the Borough President, and the Community Board Chairperson of the Community Board in which the project is located) in the borough in which the property is located and (2) the Mayor. Upon the obtaining of the last authorization, the Mayor’s, the deal theoretically has all the approvals it needs, and the City can sign the lease and deliver it to NYCEDC for assignment to the designated lessee or developer.

In practice, the lease is primarily negotiated between a designated lessee/developer and NYCEDC, but it is also thoroughly reviewed, and ultimately approved, by the Deputy Mayor for Economic Development, acting for the Mayor, and the New York City Law Department. The 384(b)(4) lease, in form, names NYCEDC as the lessee, as it is the conduit for the legislatively authorized avoidance of public auction. The post-assignment relationship will then be created between the ground lessee/developer and the City through an assignment of the lease from NYCEDC to the developer, who, thereupon, assumes the obligations under the lease. Such assignment from NYCEDC to the developer ordinarily occurs simultaneously with the closing of the conduit lease transaction between the City and NYCEDC. Notwithstanding that “direct transactional relationship” between the City and the developer, the practice has become over the years that NYCEDC is identified as the designated Lease Administrator for the City in connection with managing lease compliance by the lessee/developer. This designation is set forth, as a general matter, in the City’s Annual Contract (a public document available electronically)

with NYCEDC, but the lessee/developer is notified of such role in either or all of the lease, the instrument of lease assignment or otherwise.

Notwithstanding that all the authorizations are in place, for waiting period purposes, however, the closing cannot take place for an additional ninety days following the Mayoral Authorization (and NYCEDC board approval) at the conclusion of the ULURP and 384(b)(4) process. This additional waiting period is the product of legislation enacted by Albany in 2005 and amended in 2009. That legislation, known as the Public Authorities Accountability Act (PAAA), is embodied in the New York Public Authorities Law (§§ 2800 et seq.). For real estate transaction purposes, including, for our purposes, commercial leases, private parties should be aware that Section 2897 of the Public Authorities Law mandates that a “public authority” prepare an “explanatory statement” of a “disposal by negotiation” of “any real property disposed of by lease if the annual estimated rent over the term of the lease is in excess of fifteen thousand dollars.”⁴ The PAAA requires that the “explanatory statement” so prepared be sent to the Public Authorities Accountability Board in Albany at least 90 days prior to any proposed disposition by a “public authority.”

In section 2 of the PAAA, an LDC is defined, for purposes of the PAAA, as a “public authority.” Therefore, the closing of a negotiated lease deal with an LDC (in New York City usually through the 384(b)(4) process with NYCEDC as the counter-party) cannot take place until 90 days have passed after the transmittal of the “explanatory statement” to Albany. The explanatory statement must also be accompanied by an appraisal showing fair market value or fair market rental value.⁵ After the 90 days pass, the deal can finally close.

Accordingly, lease deals with the City for City-owned real property, through NYCEDC as conduit in order to avoid public auction, must be planned so that the pre-closing period will include not only the block of time for the negotiation of the transaction and any necessary site-testing but also a parallel block of time to conduct the necessary CEQR analysis and certification into ULURP, the ULURP and the 384(b)(4) process (which, as a pragmatic matter, usually, but not necessarily, takes place

4 A “public authority” under the PAAA is defined to include a LDC. *See Griffiss Local Dev. Corp. v. State of N.Y. Auth. Budget Office*, 85 A.D.3d 1402, 925 N.Y.S.2d 712 (3d Dep’t 2011), *lv. to appeal denied*, 17 N.Y.3d 714, 933 N.Y.S.2d 655 (2011).

5 The PAAA legislation was enacted because of perceived, alleged abuses involving the disposition of real property owned by a public authority created by State statute.

after ULURP authorizations have been obtained). Then, on top of that, one must add on the PAAA 90-day waiting period after the submission to the State of the explanatory statement. In contradistinction, it is worth noting, however, that because municipalities are not defined as public authorities for PAAA purposes, leases for real property subject to an urban renewal plan can be closed more promptly after ULURP authorizations are in place. By reason of Section 507.2(d)(2) of the Urban Renewal Law, the lease transaction can be achieved directly from the City to the ground lessee/developer without the need for a 384(b)(4) authorization or the need to prepare an explanatory statement followed by the 90-day PAAA waiting period.

With respect to commercial leases between the City and a private party, take note, as well, that lease dispositions of wharf property along the waterfront can also be accomplished without the need to comply with the PAAA. As in the case of Urban Renewal property, wharf property may be disposed of directly by the City, by lease, because such lease dispositions directly by the City, without public auction, are expressly authorized by Sections 1301.2(f) and (g) of the New York City Charter.⁶ A lease pursuant to 1301.2(f) can be achieved without ULURP by a three-fourth's vote of the City Council. This is because the 2(f) lease is limited to leases for "waterfront commerce" and "in furtherance of navigation." The premise for such approval by the Council without ULURP is that the use of wharf property for such purposes is not effecting any change to the established land use of the waterfront. Such uses are fundamentally the reasons such wharfs were built. 1301.2(g) leases, in contradistinction, are for any other uses. Accordingly, 1301.2(g) uses must be approved and authorized pursuant to ULURP—but the PAAA does not apply because the lease will be directly from the City as lessor.

The foregoing dispensations from the general requirement that City dispositions must be achieved through public auction, and not negotiation, are restricted in scope. Urban renewal development ground leases are, for the most part, implicated only in the case of very large-scale urban redevelopment projects where the city has usually acquired the disposition sites as part of an urban renewal plan—to remove blight or develop "low-

6 The statutory opportunity to lease wharf property embodies, as set forth in sections 1301.2(f) and (g) of the Charter, a special dispensation from the common law "public trust doctrine," which doctrine prohibits the "alienation" of waterfront property (as well as "parkland") under government control without express legislative dispensation. See *Miller v. New York*, 15 N.Y.2d 34, 255 N.Y.S.2d 78 (1964). A lease of "wharf property" would represent such an "alienation" and, therefore, would, be impermissible without an express legislative dispensation like 1301.2(f) or (g).

income housing.”⁷ The Urban Renewal dispensation from public auction is, therefore, not applicable in the case of more surgical dispositions of City-owned surplus property. Similarly, 1301.2(f) and (g) lease dispositions are very narrow and apply only to wharf property directly along the City waterfront.

[22.5] IV. THE “PILOT”

A City lease deal may implicate the opportunity to “negotiate” certain annual real estate tax obligations. This feature stands in sharp contrast to private leases in which the lessor ordinarily passes-through the real estate tax obligation either directly, by requiring the tenant to pay the tax bill to the taxing authority or, for instance in a space lease, by requiring the tenant to pay as part of the “Common Charges” or “Common Area Maintenance Charges” taxes charged to the property owner/lessor by the municipality. Sometimes such charges are anticipated and included in the base rent, particularly for short term leases, or included within rent “bumps” when the taxes have increased over a prescribed period of time.

In leases with municipalities, however, the following idiosyncrasy can resonate through the deal. Pursuant to Section 406(1) of the New York State Real Property Tax Law, municipally owned land is exempt from the otherwise applicable real property tax obligation. A close reading of the statute, however, discloses that such “exemption” is only available if the subject property is “held for a public use.” This term “public use” has been delimited by case law to mean uses where the use is for the benefit of the general public. Such uses, therefore, would include facilities like schools, police stations, fire stations, sanitation garages etc. If, however, a municipality leases its real estate for “private uses,” then the RPTL 406(1)

7 See N.Y. General Municipal Law §§ 501 *et seq.*

“exemption” is not available as a strict matter of law.⁸ Notwithstanding the foregoing general proscription against exemptions for other than public uses, one must be aware of the general proposition that all municipalities in New York State may lease “surplus” or “excess” real property to a private user for a private, revenue generating purpose. Because, however,

⁸ A 1963 landmark Court of Appeals case, which illuminates just how opaque this analysis may be, is *Town of Harrison v. County of Westchester*, 13 N.Y.2d 258, 246 N.Y.S.2d 593 (1963). In that case, the Town of Harrison challenged a determination by the County of Westchester, whose tax jurisdiction “overlapped” the Town’s tax jurisdiction, that airport property owned in fee by the County was entitled to the 406(1) exemption for public use. The airport property had been owned by the County ever since title thereto was conveyed to the County by the federal government after the end of World War II. The property was deployed for public airport purposes but was operated by a private, for-profit entity through a lease. In the first instance while the Court of Appeals observed that “although what comprises ‘a public use’ . . . ‘has never been defined with exactitude’ and ‘must necessarily depend upon the peculiar circumstances of each case’,” it nevertheless came to the conclusion that public use necessarily comprehends the notion that real property claimed to qualify as “public use” property for purposes of the RPTL 406(1) exemption must be “occupied, employed, or availed of, by . . . the community at large.” *Id.* at 263. Applying this analytical measure, the Court of Appeals found that in the airport case before it the exempt status was legally supportable with respect to those portions of the airport which were being used by the general public, e.g., for commercial flights to and from the airport available to the public in general. The use of the airport for such purposes was deemed by the Court to be “public” in nature inasmuch as access and use were for the general public’s benefit. To the contrary, however, certain portions of the airport which were being leased by the private operator to private airplane owners to store and maintain their personal airplanes was not deemed by the Court to legally merit the exemption. As a result, two hangars being used by private parties for private purposes were deemed not entitled to the exemption, and therefore the Town was entitled to its share of taxes attributable to those hangars and the land under the hangars. Of fascinating interest in this field of “overlapping tax jurisdictions” is the case of *Fallica v. Brookhaven*, 69 A.D.2d 579, 419 N.Y.S.2d 102 (2d Dep’t 1979). In that case, five local fire districts entitled to be compensated by the Town of Brookhaven out of tax receipts for fire protection services provided challenged an initiative by the Town of Brookhaven to make 42 acres of Town-owned land in Holtsville available to the federal government to establish a large regional center for the Internal Revenue Service. The purpose was decidedly to boost economic development in a fading local economy. As we all know, the center was built and has been, for many decades, the address where we send our federal income tax returns every year. The Appellate Division held that the use by the federal government did not benefit the residents of the Town or of Holtsville and that therefore the property was not entitled to the 406(1) exemption. Citing the Court of Appeals in the Westchester County airport case, the Appellate Division determined that the secondary benefits of economic development and promoting the character of the community did not qualify the use as a “public use” because the facility itself did not benefit the residents of the Town. When the Court of Appeals visited the facts of *Fallica v. Brookhaven* on appeal (52 N.Y.2d 794, 436 N.Y.S.2d 707 (1980)), however, it reversed the decision of the Second Department and found that the use by the federal government for the IRS facility did constitute a “public use” qualifying the property for exemption under 406(1) because of antecedent legislation that authorized the Town to purchase the 42 acres and lease it to the federal government. The Court of Appeals found that this legislation necessarily rested on a determination that use by the federal government would redound to the advantage of the residents of the Town and that, therefore, the use was “public.” These two cases prominently illustrate the proposition that outside of New York City efforts by a municipality to confer tax exempt status on real property the municipality owns may give rise to sharp conflict with overlapping tax jurisdictions who may regard the initiative as stripping them of much needed revenue to pay for their public services.

the Real Property Taxes are owed, under law, by the fee owner of property and not a lessee, it is the municipality, as fee owner, which is responsible for paying the Real Property Tax on property leased by the municipality to a private owner for a private use. Theoretically, however, municipalities, which are *both the taxing jurisdiction and the fee owner of the real property at issue*, could structure a lease such that the private lessee using the property for a private purpose need not be made responsible for the Real Property Tax through the usual “pass-through” of the Real Property Tax obligation as “Additional Rent.”

Notwithstanding that “theoretical possibility,” the *Town of Harrison* and *Fallica* cases illustrate the proposition that, “overlapping tax jurisdictions,” i.e., municipalities which do not own the subject real property, from time-to-time initiate legal proceedings against another municipality within the “overlap” that seeks to take advantage of the “theoretical possibility.” The cases are driven by municipalities which own real property and seek to benefit the jurisdiction by registering property as “exempt” from real property taxes, which property is owned in fee by the “exempting” municipality but leased by that municipality to a private enterprise for a “private use.”

Notwithstanding the foregoing cases which blocked municipalities from realizing their objectives by taking advantage of the “theoretical possibility, it can be understood that , while all other municipal jurisdictions in New York State, from Lake Erie to Lake Champlain, from Suffolk County to Monroe County consist entirely of “overlapping tax jurisdictions,” New York City is an exception. A “municipality” is defined in the New York State General Municipal Law as each of a County, a Town, a City, a Village and, very importantly, a School District. Each of these municipalities is entitled by statute to a proportionate share of real property taxes collected attributable to real property within such municipality’s jurisdiction. For example, a County may seek to induce a particular private development within its boundaries by means of a development ground lease providing that full taxes will not have to be paid by the tenant as a pass-through. Notwithstanding the County’s effort to so induce the private development, a town, whose jurisdiction covers the same property,⁹ has the right to protest, because it very well could be stripped of its right to a proportionate share of the total real property tax obligation. The described private use in this example, notwithstanding the benefits directly to the county by increasing the county’s revenues through the lease, is clearly not a “public use.” Accordingly, the taxes will continue to

9 See *Town of Harrison*, 13 N.Y.2d 258; *Fallica*, 69 A.D.2d 579.

be owed to the Town. Even if it desired to treat the property exempt in order to participate in the inducement of the development, it would not be empowered to do so because, and this is not always understood by the private bar, a municipality cannot “grant” a tax exemption. It has no power to do so. Only the State legislature can produce tax exemptions through duly enacted legislation.

New York City, in sharp and curious contradistinction to the rest of New York State, constitutes a unified real property tax jurisdiction. There is only one tax jurisdiction that covers the City, and that is the tax jurisdiction of the City. All “municipalities” in New York City are organically and legally part of the City of New York by virtue of the Great Consolidation of 1898. Each Borough constitutes a County (Brooklyn/Kings, Queens, the Bronx, Manhattan/New York and Staten Island/Richmond), but none of these Counties enjoys separate sovereignty and taxing authority. The “School District” is the School District of the City of New York, and, while theoretically independent of the City, it does not enjoy its own separate taxing power. Towns and Villages existing before 1898 were all abolished. Accordingly, as the sole and exclusive real property tax collector within the boundaries of the City, the City can, theoretically, “waive” the taxes it owes to itself. Observers may have noticed that, from time to time in the past, NYCEDC, on behalf of the City, has, on a surgical basis, transaction by transaction, negotiated special arrangements with respect to the tax obligation otherwise owing with respect to the property at issue—all in an effort to appropriately induce salutary development.

In contrast to the conventional landlord, who is in the business of leasing property it owns primarily for the purpose of realizing a return on its investment consistent with market demand, and, accordingly, has, as its first objective, to break even, the City, as landlord may, and frequently does, have, as noted above with respect to Section 384(b)(4) of the Charter, different motivations in seeking to lease-out its real property to private for-profit entities. Two prominent motivations may be, as alluded to earlier, (1) promoting the local economy and (2) upgrading the physical character of neighborhoods. Such initiatives resonate with the potential to achieve, for the larger good of the City, increases in real estate and sales taxes from privately-owned real property within the redeveloped neighborhood and to make employment opportunities available to the local

population.¹⁰ Accordingly, financial return from the ownership of real property may be subordinated to these other, larger policy motivations.

With this background, let us now take a look at the dynamics with respect to a municipal lease deal transaction involving real property owned by the City. Let us assume the City of New York, through NYCEDC, has issued a “request-for-proposals” (colloquially referred to by its acronym, the RFP) to redevelop, pursuant to a ground lease, a vacant expanse of City-owned land in the South Bronx, the North Shore of Staten Island, Eastern Queens or any other section of New York City where promoting private redevelopment could significantly increase quality of life experiences for local residents—particularly with respect to job opportunities—and which may resonate with the potential of promoting private market demand for real property in the neighborhood of the contemplated redevelopment project. Let us also assume that the RFP contemplates that the City/NYCEDC is seeking proposals to achieve the City’s goal of reshaping the target neighborhood into a modern, attractive community. The proposed redevelopment would be designed further to extend to its residents the opportunity to live within easy commuting distance of their places of employment at affordable rentals or affordable home ownership prices.¹¹ With respect to ground rental and other lease obligations, the RFP may seek to solicit from prospective developers “proposals with respect to the financial consideration the developer is prepared to offer to the City in return for the opportunity to redevelop the property consistent with the redevelopment goals set forth in the RFP.”

Let us now fast forward to the point where the City/NYCEDC has received the ground lease proposals and is narrowing them down. In our theoretical construct, let us assume that the proposer has offered a redevelopment plan that is very attractive to the officials acting on behalf of the City, and the City/NYCEDC officials arrange to invite the proposer down to City/NYCEDC offices for an interview and discussion. After a discussion of the redevelopment plan, the parties turn to a discussion of the rental and, as “additional rent,” other financial obligations that the developer/proposer would be required to satisfy. After a few minutes, the discussion turns to the subject of real estate tax pass-throughs. The devel-

10 Another prominent policy initiative that will support a taxing jurisdiction’s reducing real property taxes is, of course, enlarging “affordable housing” opportunities for its residents who have been priced out of the local housing market. Such “affordable housing initiatives, however, rarely implicate leases of City-owned property for such purposes.

11 This species of development is colloquially defined as creating “live/work communities.”

oper explains what its return on investment formula requires in order for it to be willing to undertake the costs of the proposed project.

The parties thereupon discuss base rent, percentage rent, and capital transaction proceeds sharing. While very engaged by the developer's proposal, the City is not prepared to give the property away or to completely waive the real estate taxes otherwise attributable to the property. As the supplier of the land, the City wishes to participate in the development's success—on behalf of the residents of the City as a whole. The developer thereupon explains that low rent in the early lease years may not be sufficient for it to undertake the project. If the developer/proposer should be required to pay full real estate tax, it could suffer significant compromises in its ability to afford debt service on the financing necessary to pay for construction of the project, as well as the return on equity it must offer investors to raise the necessary cash to finance the project.

It is at this point that the phenomenon of the “PILOT”—or Payment-in-Lieu-of-Tax—may emerge. The PILOT is a transactional feature of a municipal lease that derives from the legal foundation described above, i.e., that New York City is the only single-municipality district (i.e., no overlapping tax jurisdictions) in New York State. Accordingly, as the tax collector and the tax payer when it owns the subject land, the City, theoretically, can “waive” the real estate tax. The City, as owner of the land at issue, however, as discussed above, is not technically exempt from the obligation for the applicable Real Property Tax obligation, by virtue of the operation of Section 406. Nevertheless, as noted above, theoretically, the City has the power to not collect the Real Property Tax from itself. This legal dispensation, therefore, presents the City, theoretically, with the opportunity to negotiate a “special arrangement,” if you will, with the prospective lessee/developer, with respect to the pass-through of real estate taxes. PILOTs embody such special arrangements. The purpose, of course, would be to serve as an incentive to the developer to undertake the presumably high-risk project contemplated in the RFP and to therefore execute the lease with the City.

It should be carefully noted, however, that while the PILOT may be available as a tool for getting the deal done, the City does not cavalierly enter into such PILOT arrangements. For the most part, the City seeks, as a matter of understandable policy related directly to its fiscal needs and to a sense of “fairness” to the real estate community as a whole, to correlate the PILOT to a statutory tax exemption-tax abatement program, enacted by the State legislature, that corresponds to an analogous program that might be available to a real estate developer, were the developer to be the

fee owner of the subject real property. The most common statutory Real Property Tax abatement program used to prescribe a PILOT in commercial/industrial ground leases with the City is the Industrial/Commercial Abatement Program (ICAP). It should also be noted that it is relatively rare that the City will agree to a PILOT payment schedule, in connection with a significant development ground lease with a private developer, which will substantially reduce Real Property Taxes attributable, on the City's tax records, to the real property which is the subject of the ground lease.

All that said, the PILOT provisions of a City long-term development ground lease usually, if agreed to at all, will assume the form of a schedule of Payments in Lieu of Real Estate Taxes that will be required to be paid to the City, as landlord, as Additional Rent over the ground lease term.

Although PILOT payments theoretically can be made certain pursuant to fixed PILOT payment schedules, nevertheless, as a matter of City policy, where the PILOT Additional Rent payment may be correlated in some fashion to the Real Property Tax obligation otherwise attributable to the real property at issue, the PILOT Additional Rent payments will very likely fluctuate. In this regard, ground leases from the City to developers usually afford the ground lessee with the opportunity to step into the City's shoes, as fee owner, and challenge the assessment of the real property in a hearing before the New York City Tax Commission, and, if the ground lessee is not satisfied with the Tax Commission's decision, it will be afforded the right under the ground lease to appeal the Tax Commission's decision to the State Supreme Court in a tax certiorari proceeding. As a result, the ground lessee will not be subject to the sole and exclusive determination of the City, either as landlord or tax collector, with respect to the amount of PILOT Additional Rent it will be required to pay under the ground lease.

Concluding the discussion of the PILOT provisions of a City development ground lease, we should observe that, as "Additional Rent," the remedy of the City for non-payment would be the same as that of any landlord in a non-payment proceeding. Nonetheless, one of the comforts of the PILOT as Additional Rent to prospective developers, their investors and their lenders should be that they, as the tenant (or, in the case of the lender, the party assumably enjoying the right to substitute for the tenant pursuant to an assumed subrogation clause in the leasehold mortgage) will enjoy the opportunity to negotiate a landlord-tenant "work-out" with respect to alleged defaults in the payment of PILOT owed under the lease. If the les-

see/developer were the fee owner of the property, or if it were the lessee of a private entity, this straightforward work-out opportunity to negotiate resolution of Real Property Tax defaults would not necessarily be available, and the taxing authority could simply foreclose on the fee interest.

[22.6] V. OTHER SPECIAL LEASE FEATURES

[22.7] A. Rent Discounts and Recoveries Through Participations

In addition to negotiating tailored PILOT provisions with regard to the pass-through to the developer ground lessee of payment of the Real Property Tax obligation attributable to the real property at issue on the City's tax rolls, the City/NYCEDC may negotiate specially tailored rental provisions, with a view to incentivizing investment in the particularized development objective. Such specially tailored rental provisions may implicate below market rentals for the early years of the lease term. The City, however, in such cases, will ordinarily negotiate with the lessee/developer for a future participation in the financial success of the project. If the project is successful and the developer/ground lessee, or its successors in interest in the event of a lease assignment (a municipal lease phenomenon to be discussed later in this chapter), realizes a substantial return on its investment, then the City will usually seek to participate in such success in an effort to recover its rent discounts attributable to the early years of the lease term. It may do so not merely through negotiated rent bumps over the lease term but also through income participation provisions. These provisions can take the form of percentage rent payments (i.e., payment by the lessee of a percentage of revenues realized annually by the lessee) calculated on a net or gross basis.¹² One may encounter "Adjusted Gross Percentage Rents" where certain clear fixed costs are deducted before the percentage is calculated. Such adjustments, if agreed to and incorporated in the lease terms, commonly include the deduction of PILOT payments and required insurance premiums. The prescribed permissible deductions, will, of course, affect the percentage participation. In addition to percentage rent participations, the City will also usually insist on participating in the revenue received by the lessee/developer upon an assignment or refinancing of the lease (a "Capital Event") with a cash out after the property has manifested its potential for success. Such participation will usually

12 Over the years, the city has come to favor "gross percentage rent" over "net percentage rent." The City has largely concluded, from experience, that gross percentage rent participations, although representing a lower percentage than net percentage rent participations, has a far higher certainty of calculation associated with it than net percentage rent. The likelihood of extended disputes over the amount of the percentage rent due is, therefore, significantly reduced.

take the form of a percentage participation in net assignment/sale/refinancing proceeds and the calculation of a breakpoint or baseline where the lessee/developer will have recovered its investment, satisfied any existing indebtedness and returned the investors' equity with a prescribed return. At that breakpoint, the lessee/developer will share with the City an agreed-to percentage of the net proceeds from a successful assignment to a new lessee/operator of the completed project.

[22.8] B. "Standard" Provisions

[22.9] 1. Transfer, Assignment, and Sublease Clauses

Because the City will have selected a lessee/developer not particularly to maximize immediate financial return to the City but to achieve a far more ambitious public purpose for the redevelopment of the real property at issue, and because the achievement of such purpose is an objective of immediate importance, the City will carefully proscribe the designated lessee/developer's ability to alienate its leasehold interest—particularly before construction completion and the issuance of a Temporary Certificate of Occupancy. Without a lease's carefully circumscribing a lessee's right to assign the lease, leasehold rights, like fee interests, are freely alienable. Also, since the designated developer is the party to whom the City is looking to achieve the development, the City will substantially circumscribe a lessee's ability to transfer an interest in the designated developer which would have the effect of shifting control from the individuals being relied upon by the City to deliver the project to other individuals whom the City has not vetted. Accordingly, with respect to assignments, the City has adopted the policy to absolutely prohibit assignments prior to a point in time when the City's expectations with respect to redevelopment will have been achieved—or not. Although a lessee/developer may still petition the City/NYCEDC for consent to assign the lease, nevertheless, the City reserves the right, exercisable at its sole discretion, to decide whether it will accept a new party to realize the objectives of the lease. With respect to transfers, the City permits certain transfers, such as the transfer of interests to family members or through a testamentary transfer, or minority interests in the lessee/developer entity, provided, that effective control has not passed from the individuals to whom the City is looking for realization of the project, either individually or collectively, to other individuals. Subleasing is also limited for the same reason. Certainly, however, if the objective of the project is the creation of new space expected to be made available to third-party users, subleasing will be permitted for that purpose. Strict guidelines are, however, usually established in the designated lessee/developer's lease so that effective management of

the new facility cannot be transferred to a third-party in violation of the City's expectations.

[22.10] 2. Use

In these public/private partnerships (referred to in the industry as “P3” deals) the City usually has a vision for the use of the property. If the property is expected to be used as a manufacturing facility, for example, the City will not want the property being used as a retail center, assuming such a retail center is permitted in the applicable zoning district. While both a retail center and a light manufacturing facility may both generate jobs for the local population, the city's vision for the redevelopment of the site may be focused on promoting affordable space for light industrial use, in order to create opportunities for attracting light manufacturing businesses, which businesses have been rapidly evaporating over the years. If a lessee/developer, although originally acknowledging that objective, believes it can substantially increase its revenue by reconfiguring the space for a retail center, it might very well make an attempt at a “bait-and-switch.” In order to preclude such a possibility, the City will negotiate particularized use criteria into the lease. If the use criteria are violated, the City may very well resolve to call a default, terminate the lease and seek out a new manager/lessee for the project. The lessee/developer could discover that, if it acts in such a brazen way, it very well may have forfeited its investment as a result of such a lease violation, without any opportunity to recover that investment. Since these species of real estate projects are entwined in a mesh of very focused governmental objectives seeking particularized benefits for the community, developers engaged with the City in negotiating leases for these kinds of projects must be aware that such projects will be burdened with constraints that they will not necessarily encounter in analogical private development leases. “Public Purpose” stands as the bastion supporting the undertaking of these deals by the City/NYCEDC, and leases for such projects will be fashioned to ensure, to the extent possible, that the public purposes will be achieved.¹³

13 It should be noted, at this point, that § 507 of the General Municipal Law prescribes that leases for urban renewal sites must provide that the deed or lease for the property to be disposed of pursuant to § 507 “shall contain provisions... insuring the use of such real property for purposes consistent with the urban renewal plan.” NYCEDC's use clauses are usually more surgical than what the GML § 507.3 requires, but § 507.3 does denote the legislative concern that property to be redeveloped with a mission in mind, must contain enforceable use provisions. NYCEDC's purposes in negotiating lease development deals for the City is co-extensive with that legislatively articulated purpose.

[22.11] 3. Construction Obligations

One of the other rigorously negotiated and enforced provisions in City/NYCEDC development leases is, understandably, the construction obligation. In this respect, the City/NYCEDC is, for the most part, walking hand-in-hand with the developer's lender. The objective of the construction lender is to make sure its borrower completes the project and is issued a certificate of occupancy when the job is completed. So it is the City/NYCEDC's primary objective as well. Because the City/NYCEDC will have bargained with the developer for a particular project in order to satisfy a number of negotiated features baked into the development lease's provisions (largely as exhibits in the form of plans and specifications), the lease will contain strict requirements regarding NYCEDC's review and approval of all design development drawings and specifications that evolve out of the original schematics or later phase of design development as may be incorporated into the lease. One may therefore expect to find in any NYCEDC-negotiated development lease a somewhat complex set of provisions regarding submission of plans for review and approval by NYCEDC's professional construction team, with time periods for submission and for review and approval by NYCEDC before the next stage of design development may proceed. Once contract documents have been reviewed and approved, NYCEDC will have oversight of the bidding of the job to ensure that the contractors selected by the lessee/developer are not deemed to be contractors who would be unacceptable to the City, both from an ethics and competency point of view.¹⁴ As construction proceeds, any material change orders would likewise have to be reviewed and approved by NYCEDC. In connection with getting the job done, the City, though in this matter the City is usually at-one with the lender, will insist on the General Contractor's furnishing payment and performance bonds to the City and NYCEDC, both of which may be named as co-obligees. Occasionally NYCEDC will accept subguard insurance in lieu of bonds, but the matter must be negotiated on a case-by-case basis with a hard look at the risks involved.

Frequently, one should be aware, NYCEDC will demand completion guaranties from its lessee/developers—plus, understandably, individual and/or corporate principals of the developer/lessee. These guaranties may take any number of forms, including the posting of cash deposits, letters of credit or contractual commitments from companies with a substantial

14 If the contractors default and the project is left hanging in limbo, it very well could be the City/NYCEDC that is left holding the bag of a botched project—particularly if the lender decides to walk away rather than to step in and cure.

credit rating and net worth. Such companies may be the principals of the lessee/developer (which lessee/developer frequently is an SPE—a single purpose, judgment-proof entity) or a high net worth company which, for a fee, has agreed to execute and deliver a guaranty to the City/NYCEDC that the job will be completed as set forth in the approved construction documents. In any case, the completion guaranty becomes a central aspect of the deal and must accompany the lease execution-- or be furnished prior to the commencement of construction. If it is not so furnished, the lessee/developer may not be permitted, under the lease, to commence construction. The failure to furnish the completion guaranty may give rise to a default under the lease, which default will likely have to be cured within a prescribed period of time to avoid lease termination. In any event, the foregoing illustrates just to what extent the construction provisions in a development lease negotiated by the City/NYCEDC represent a central, critical feature of the lease negotiation.

[22.12] 4. Leasehold Mortgage Protective Provisions

Lastly, I would like to briefly summarize the City/NYCEDC's position with respect to leasehold mortgages. NYCEDC recognizes the importance of promoting financeability of its proposed development projects. As a result, it will agree to make certain accommodations so that project lenders will enjoy the opportunity to cure any default on the part of its borrower. It is never the City's intention to put a lender in the position of forfeiting its collateral if the lender's borrower is unable to complete the bargained for development. That said, the City/NYCEDC is rarely prepared to subordinate the public's land so that a lender will have the right to seize the land in a mortgage foreclosure proceeding and repackage the property for any development it wishes in order to recover its loan advances in the event of a borrower's default. The City views the risk of a developer/lessee's default as a shared risk with the lender. In such cases it extends to the lender/leasehold mortgagee the opportunity, through provisions set forth in the leases, of generously extended cure periods for the lender to step in and achieve the objectives and requirements bargained for by NYCEDC in the development ground lease. One thing, however, it will not accept is that the City's fee interest be subordinated to the

lender's leasehold mortgagee. No lender on a City/NYCEDC development lease deal should ever expect such an accommodation.¹⁵

[22.13] VI. CONCLUSION

The foregoing discussion is not intended as an in depth or comprehensive presentation of all significant aspects of negotiating leases with a municipality in New York State, and with the City of New York in particular. Rather, if, you will, it attempts to embody a bird's eye view of salient points that a real estate lawyer representing a private party in the negotiation of a transaction with a municipality, and the City of New York in particular, should be expected to encounter in the course of such a negotiation. I have attempted to introduce the reader to certain lease provisions that are idiosyncratic to City lease deals and arise out of the legal constraints imposed by the New York City Charter and other constraints imposed on the City and the NYCEDC, as the City's representative with respect to this species of real estate transaction, in connection with getting certain deals done. I also sought to introduce those unfamiliar with the dynamics involved in negotiating lease deals with the City to particularized "policy" matters that drive certain discretionary decisions by the City in the course of negotiating a deal. Other features, such as the relatively standard commercial leasing business matters addressed at the end, merely seek to alert the real estate practitioner to matters that could be encountered in any development ground lease transaction. When dealing with the City, or with any municipality, however, these features resonate with peculiar transactional ramifications that must be understood in the context of the expectations of a municipality in seeking to achieve particular public purposes through the dedication of surplus property otherwise lying fallow in public real estate portfolio. I have elected not to discuss a number of features that one will necessarily encounter in negotiating a

15 In this latter regard I would note that it has been the City's unequivocal view that if the City were to subordinate its fee interest to a mortgage, doing so would constitute an illegal guaranty of a private indebtedness in violation of section 8.1 of the New York State Constitution—the so-called "Gifts and Loans" prohibition in the Constitution. That provision precludes a municipality from giving or loaning any... property to or in aid of any private... undertaking or giving or loaning its credit..." for the same. The lease or sale of municipally owned land to an LDC or for urban renewal purposes is not deemed a "gift or loan" because the legislature has declared the purposes for which the lease or sale would be made to be public purposes supporting the disposition. Subordinating City-owned land, however, to support a private mortgage loan, however, has been considered by the City to constitute a "gift or loan" to a or in aid of a private undertaking. While the Urban Renewal Law, Section 507.4, does permit the subordination by a municipality of its interest in the real property in order to achieve the purposes of an urban renewal project, there are circumscriptions on a City's power to do so set forth in the statute. In the case of 384(b)(4) dispositions, there are no dispensations from what is understood to be the effect of the Gifts and Loans prohibition.

City lease deal. These include the immutable “Investigations” clause, the MWB/E clause, and the Comptroller’s audit authority with respect to a lease. These are all completely standardized provisions that do not admit of any form of negotiation. The Comptroller’s audit authority, by the way, precludes the opportunity for arbitrating any monetary issue that might arise between the parties. Certain non-monetary matters, however, may be arbitrated, such as whether construction satisfies the design requirements of the Construction provisions.

CHAPTER TWENTY-THREE

THE RESTAURANT LEASE: SELECTED CONSIDERATIONS

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[23.0] I. INTRODUCTION

To paraphrase William Shakespeare, a lease by any other name is just a lease. With apologies to the Bard and to the great chefs of the world, a restaurant is just another type of retail operation (although a restaurant has a greater tendency to lead to culinary pleasure and concomitant weight gain), and for that reason, a restaurant lease is essentially a retail lease, with a few distinguishing characteristics. These specific characteristics arise out of the unique nature and economics of a restaurant operation, and the specific needs and requirements of restaurant tenants and operators and their landlords.

In any type of commercial lease transaction, the tenant and landlord invariably have a complicated relationship, with each wanting to maximize its own benefits when negotiating the lease. In the case of the traditional retail lease, the negotiations are often about the typical lease terms, such as the rental, assignment, and the build out and alteration provisions. Often, once those terms are negotiated, there is minimal interaction between the parties other than maintenance or repair requests and delivery of the rent payments. That is not the case, however, in the relationship between a restaurateur and his or her landlord. In this situation, the needs of both parties often create a more interdependent relationship than is found in a traditional retail leasing arrangement. The result is that the parties negotiating a restaurant lease must consider the requirements and goals of the other more than in other leasing transactions. In a very real sense, a good restaurant lease is a lot like a good marriage—it requires compromise and understanding by both sides.

At the outset of a restaurant lease negotiation, the unique nature of the transaction is apparent. The restaurateur has a vision for the restaurant. The landlord has a particular type of tenant and rental rate in mind for the premises. These basic elements may comprise the majority of negotiations for a typical retail lease, but they are just the beginning terms for a lease involving a restaurant.

For example, a prospective tenant may want the establishment to serve alcoholic beverages and have sidewalk seating. The tenant may also wish to cater to a younger crowd and stay open until late at night. Moreover, while the intended leased space may be in the right location, it may need major renovations and completely new fixtures that not only will be expensive, but will make it difficult for a tenant to amortize the costs over the term of a 10- or 15-year lease. Because of the significant infrastructure and pre-opening costs involved in opening a restaurant, the tenant may

also want the ability to transfer the business to a successor owner in order to recoup and realize a return on its investment. The tenant will no doubt ask for the landlord's assistance in these matters.

Correspondingly, while the landlord may be generally comfortable with the restaurateur's vision, the intended use may create some concerns. Perhaps there are residential tenants living above the restaurant who will not be happy with a late night meeting spot. The landlord may want to impose certain use restrictions and establish operating, safety and hygienic standards so that the restaurant does not create a nuisance in the landlord's property. The landlord may not be willing to assume the risks inherent in the tenant seeking government approval for such amenities as a liquor license or outdoor seating. Moreover, the landlord may not be receptive to sharing in the cost of improvements, even though such improvements will become fixtures. It is in the negotiation over issues such as these, where not only the vision of the restaurateur is at stake, but the venture's financial viability is as well, that negotiations concerning restaurant leases take on their unique aspects.

Set forth below are examples of this often Manichean form of negotiation as they relate to issues such as use provisions, operating standards, infrastructure requirements, the ability to assign, and the extent of the landlord's investment in the success of the restaurant.¹

[23.1] II. USE PROVISION AND LIMITATIONS

[23.2] A. The Use Clause

The use provision in a restaurant lease defines and limits the specific purposes for which the premises may be used. Often, in addition to restaurant usage, the premises may be used for the on-site consumption of alcoholic beverages and limited auxiliary offices. A typical use provision in a restaurant lease may read as follows:

Full-service restaurant [featuring a concept as set forth in Exhibit ___ to the lease], including the sale of alcoholic beverages for on-site consumption if an appropriate license is obtained, and for no other purpose whatsoever.

¹ Management or other arrangements relating to the operation of a restaurant in a hotel property are beyond the scope of this chapter.

The landlord may want a higher level of specificity in the use provision. The following provision could be adapted to fit the needs of a particular landlord and tenant:

Operation of a first class restaurant for on-site consumption [and for delivery and pick-up] of food and beverages [with a minimum of ___ sit-down lunch and dinner servings, seven days a week], with tablecloths and professional and efficient waiter service, and with a bar, but no cabaret and no live music or dancing, in an upscale physical setting, and for no other purpose.

Conversely, the tenant will often prefer a less restrictive use provision (similar to the first use provision above), which would not limit the restaurant to a particular food concept, in order to facilitate an assignment or sublease of the premises.

[23.3] B. Auxiliary Office Space

When a landlord enters into a restaurant lease, it has a reasonable expectation that most if not all of the space will be used for restaurant or bar purposes. This may be important in a situation in which percentage rent (which is based upon the tenant's annual gross sales) is a component of the aggregate rent to be paid by the tenant. A tenant, however, may need to utilize a portion of the premises as office space. In such an instance the lease could accordingly provide for such use but also limit the portion of the square footage of the premises to be utilized for non-restaurant purposes. For instance, the lease may provide that:

Tenant may use for office purposes only such space as is reasonably required for tenant's business in the premises, but in no event shall the space used for such purposes exceed ___ percent of the square footage of the premises.

[23.4] C. General Restrictions and Limitations

Equally important in a restaurant lease are the usage restrictions or limitations. Restaurants have externalities which may affect the quiet enjoyment of other tenants in their spaces as well as the reputation of the building, mall, or other development in which the premises are located. A landlord will typically provide in a lease (sometimes in the use clause but more usually in a separate provision) that the premises may not be used or occupied in violation of law or of the certificate of occupancy issued for

the premises and that the failure of the tenant to discontinue any unauthorized use within a stipulated period of time after notice shall constitute a breach of the lease. A landlord may also want to be more specific about the impermissible uses or broaden the range of such uses. For instance:

No use shall be made of the premises which would (i) violate any law, ordinance, or regulation applicable to the premises; (ii) constitute a nuisance in or about the premises or cause damage to or interfere with the efficient and economical maintenance, operation and repair of the building or the premises or any equipment, facilities or other systems therein; (iii) adversely affect any service provided to, or the use and occupancy by, any building tenants or occupants; (iv) constitute a hazardous use or one which emits, produces or otherwise creates hazardous materials; (v) violate, suspend, void or increase the premium on any policy or policies of insurance covering the building or any premises therein; or (vi) impair the appearance of the premises or the building or adversely affect the image or reputation of the building as a first class location.

The landlord could also seek to include in the lease a provision giving it discretion (either reasonable or unfettered) to determine if the tenant has engaged in any such proscribed activities.

[23.5] III. OPERATIONAL COVENANTS AND INFRASTRUCTURE REQUIREMENTS

In addition to the use clause and usage restrictions, landlords may employ other provisions to require tenants to operate their restaurants at high standards of practice, to maintain their premises at all times in a condition of proper cleanliness, orderliness, and attractive appearance, and to comply with safety and hygienic standards. For instance, a lease for an upscale property may provide generally that:

Tenant shall conduct and operate its restaurant in a manner consistent with the highest standards of practice of first class restaurants in [geographical location] and in keeping with the standards of a first class building.

The installations of modern restaurants, however, are often far more elaborate than the restaurant and kitchen in the film *Big Night*, although

Tony Shalhoub and Stanley Tucci managed to create at least one memorable dinner in their simple establishment. Modern restaurants, particularly those in larger cities, are complex operations. They not only involve the storage, preparation and cooking of food but also the disposal of organic garbage. They have specific plumbing, venting and exhaust requirements and needs such as fire and smoke detection and suppression systems, as well as grease traps. For these reasons, while general requirements or restrictions like the above are helpful in establishing expectations, it is advisable for a landlord to incorporate specific requirements in a restaurant lease so as to mitigate possible issues arising from a restaurant's operations and to have legal recourse in the event its operations or sanitary and health conditions are not at a sufficient level.

Accordingly, the comments and sample provisions in this section are primarily oriented towards the landlord's perspective, but should generally be acceptable to most restaurant tenants. As in any retail lease, a restaurant lease should also contain provisions as to the landlord's rights in the event the tenant fails to perform any of its covenants, including the right of the landlord to take self-help actions to cure such failure and collect from the tenant the costs of such actions as well as an appropriate, specified administrative fee or interest charge.² For purposes of brevity, such provisions are not included in the sample covenants provided in this chapter.

Set forth below are some illustrative examples of covenants relating to maintenance standards and infrastructure requirements.

[23.6] A. Extermination

The presence of food products invites unwanted guests, and the lease should impose specific obligations on the tenant to establish a protocol to control such pests:

2 The following is an example of such a cure provision:

If tenant fails to carry out the proper maintenance, repair or other acts as required hereunder to the satisfaction of landlord, within seven (7) days after written notice from landlord to do so, landlord may enter upon the premises and perform or cause to be performed such repair, maintenance or other acts, without any liability to tenant for trespass or any loss or damage to tenant's property or business by reason thereof, and tenant shall pay, as additional rent hereunder, landlord's cost thereof and an administrative fee equal to 15% of such cost within 20 days of receipt by tenant of a bill therefor.

During the term of the lease, tenant shall use all reasonable diligence in accordance with best prevailing methods to prevent and exterminate vermin, rats and mice in the premises. In furtherance of the foregoing, tenant shall engage a professional exterminator licensed in the City of [_____] to service the premises, including all food preparation, storage and waste disposal areas, on a regular basis, and in no event less than one (1) time per month. Upon request from landlord, tenant shall provide to landlord evidence that such extermination is being performed in accordance with this Section. Commencing on the rental commencement date, and then on each anniversary thereof (and within five (5) business days after landlord's request if landlord shall request such copies on a more frequent basis), tenant shall deliver to landlord a current executed copy of such extermination contract, including any amendments or renewals thereof.

[23.7] B. Disposal of Trash

Additional provisions are often included to require a restaurant tenant to maintain sanitary means of disposing of food waste:

Tenant shall store all garbage, trash, rubbish and other refuse in rat and insect proof containers with watertight plastic liners in temperature controlled areas inside the premises and remove same frequently and regularly by such means and methods through such areas as are reasonably designated by landlord. Tenant shall provide such safeguards as, in landlord's reasonable judgment, are necessary or advisable to prevent the escape of fluids, vapors and odors from tenant's waste, trash and rubbish. Tenant shall not dispose of any food waste, cooking oil, grease, plastic products, or other foreign substances into any utility waste lines or plumbing facilities and may not use any such lines or facilities for any purpose for which they were not constructed.

[23.8] C. Grease Traps or Interceptors

Although not very appetizing, grease and other food waste are necessary byproducts of a kitchen's operations, and grease traps are important ingredients of a restaurant's infrastructure:

(a) Tenant shall remove grease from all exposed surfaces of the premises daily and retain a bonded degreasing service to clean and degrease the kitchen area at least monthly during the term.

(b) Tenant shall install a grease trap or interceptor system within the premises, which shall be above slab, and access for maintenance of such system shall be through the premises only. Prior to installing such system, tenant shall submit to landlord plans and specifications therefor for landlord's review and approval and shall obtain all required governmental approvals and permits.

(c) Tenant shall enter into and keep in full force and effect throughout the term a grease trap or interceptor maintenance contract with a contractor licensed in the City of [_____] to perform on no less than a monthly basis the services described in such contract, which contract and contractor shall be approved by landlord. Such contract shall provide that the grease traps or interceptors shall be rooted and cleaned and all oil removed therefrom as frequently as is necessary to prevent clogging or discharge. Tenant shall deliver to landlord a current executed copy of such contract, including any modifications and renewals thereof, annually commencing on the rental commencement date and on each anniversary thereof (and if landlord shall request such copies on a more frequent basis, within five (5) business days after landlord's request).

(d) Tenant shall not use any chemicals or other cleaning methods which could damage the utility waste lines, plumbing and other systems in or serving the building or the premises.

(e) Tenant shall be liable for any damage to the building or its systems caused by tenant's failure to comply with the provisions hereof.³

[23.9] D. Ventilation

While some cooked foods have fragrant, tempting smells, a tenant should be required to install and maintain an exhaust and ventilation system to dispel unwanted kitchen fumes, odors and smoke:

(a) Tenant shall provide and install all necessary components of a high velocity forced draft ventilation system in a manner acceptable to landlord and in accordance with all Legal Requirements (as defined in the lease), at tenant's sole cost and expense. Said system shall include, but not be limited to, exhaust hoods, exhaust ducts, fire dampers and fire rated duct chases/shafts where required, exhaust and make up fans, controls and grease drip pans. Such system shall discharge to the atmosphere via the [roof] area. No fumes, smoke, latent vapors, odors, gases and other kitchen emissions shall emanate from the premises, except through such system. Tenant must maintain a negative pressure within the premises and shall be responsible for the proper diffusion of the exhaust in such manner as to prevent odors from entering adjacent air intakes.

3 If the building has a grease trap system servicing multiple restaurant tenants, the following provision could be included:

Landlord will deliver the premises with a grease trap or interceptor installed outside of the premises for the common use of tenants in the building (the "Common Interceptor"). Tenant will install and maintain, at its sole cost and expense, the kitchen waste and exhaust systems, including all risers, pipes, ducts and fans used by tenant in connection with such systems, but with respect to the grease trap or interceptor pipes, only up to the point of connection with the Common Interceptor, in a manner consistent with the operation of a first class restaurant and in accordance with all applicable laws, codes and regulations of any governmental authority having jurisdiction. Tenant's allocable share of the capacity of the Common Interceptor shall be ____ gallons, which tenant represents and warrants, is sufficient for tenant's use of the premises. Commencing on the date tenant opens for business and during the term, tenant shall pay as additional rent, within 10 days after receipt by tenant of a statement therefor, ____% of (i) the costs of maintenance, repair and operation of the Common Interceptor and (ii) any cost of cleaning any blockage caused by the introduction of grease and/or food waste by any tenants using the Common Interceptor.

(b) Tenant shall clean or cause to be cleaned its kitchen exhaust hoods, fans and ductwork on a schedule of not less than four (4) times per year and shall submit evidence of such cleaning (including inspection reports) to landlord promptly after such cleaning.

(c) In the event that landlord or any other occupant of the building is disturbed by any fumes, smoke, odors, gases and other kitchen emissions which are caused by tenant's use of the premises, tenant shall immediately take such corrective action as may be necessary to resolve such problem to landlord's reasonable satisfaction.

(d) Tenant shall not be permitted to use the premises in any matter that would require venting in excess of [10,000] CFM's.⁴

[23.10] E. Kitchen Facilities—Health and Maintenance Standards

The landlord may want to incorporate provisions into the lease relating to the standards, both regulatory and otherwise, concerning the construction and maintenance of food facilities of the restaurant. For instance, the lease could include some or all of the following:

(a) Tenant shall construct all kitchen facilities in accordance with all Legal Requirements (as defined in the lease) including all applicable state and municipal health codes. Prior to tenant commencing operations, tenant's kitchen facilities shall have all required permits, approvals, and certificates, including a current [New York City

4 If there is a common exhaust system in the building shared by multiple restaurants, the following is a sample provision:

Landlord shall provide tenant with a point of connection within the premises to the main horizontal trunk line of the common kitchen exhaust system which shall simultaneously service tenant and other restaurant tenants in the building (the "Common Exhaust System"). Tenant shall be responsible for all maintenance, operations and repair of exhaust hoods, fans and ducts within the premises to such point of connection with the Common Exhaust System in a manner consistent with the operation of a first class restaurant and in accordance with all applicable laws, codes and regulations of any governmental authority having jurisdiction. Landlord shall control and operate the Common Exhaust System in a manner and on a schedule that landlord, in its sole discretion, shall deem desirable, which may be modified by landlord, in its sole discretion, from time to time.

Food Service Establishment Permit] and a current [New York City Food Protection Certificate].

(b) Tenant shall comply with all state and local health inspection requirements and shall promptly forward to landlord the written results of any such inspection.

(c) Tenant shall, at its sole cost and expense, clean and remove daily any food spills, dust, dirt and other substances from all tables, chairs, fixtures, floors, floor coverings and furnishings with an approved disinfectant detergent.

[23.11] F. Waterproof Membrane

The landlord may wish to require a waterproof membrane under the kitchen and bathrooms in order to prevent damage to the structure of the building in case of leaks:

Tenant shall install a waterproof membrane to waterproof all floors and slab penetrations in all kitchens, bathrooms and similar water prone areas and shall slope floor surfaces to an area drain to prevent damage to the building resulting from the passage of water and other liquids out of such areas.

[23.12] G. Fire and Smoke Detection and Suppression Systems

A restaurant lease often contains specific provisions regarding the installation of fire and smoke detection and suppression systems, which are in addition to any sprinkler system required to be installed and maintained in the premises. Set forth below is an example:

(a) Tenant shall install a fire/smoke detection system within the premises, which shall include all devices, equipment, wiring, conduit and controls as may be required by landlord and which shall be in compliance with all applicable Legal Requirements (as defined in the lease). At landlord's discretion, tenant shall engage, at its expense, a fire-life safety contractor as designated by landlord for such portions of tenant's work as may be specified by landlord, which may include, without limita-

tion, final programming and connection to landlord's fire alarm system.

(b) Tenant shall install chemical extinguishing devices (such as Ansul) approved by Underwriters Laboratories, Inc. (UL). Such installation shall be approved by all appropriate governmental authorities having jurisdiction thereof. Tenant shall maintain such devices under service in accordance with such standards as may be established by UL, any such governmental authorities, and any insurers under any applicable insurance policies of landlord or tenant.

[23.13] H. Landlord's Disclaimer

The landlord may wish to include a specific disclaimer of responsibility with respect to any improvements or installations made by the tenant:

Landlord shall not, by its approval of the location, construction or installation of any of tenant's improvements, including without limitation, tenant's exhaust system, smoke and fire detection or suppression systems, or waste liquid disposal facilities or any of their components, be deemed to have represented that same are adequate or comply with any applicable Legal Requirements (as defined in the lease), nor shall such approval constitute a waiver by landlord of the right to require tenant to modify any such improvements so as to perform their intended functions or otherwise comply with the provisions of the lease.

[23.14] I. Additional Infrastructure and Operational Considerations

In addition to the above, there are other matters involving a restaurant's installation and building services that should be considered during the negotiations of a restaurant lease. For instance, because of the significant volume of water used by restaurants, landlords generally provide in a restaurant lease that the tenant shall install and/or use a separate water meter or submeter to measure its water usage at the premises. A landlord may also want other utilities separately metered or billed directly to a restaurant tenant, or in the alternative, the landlord and tenant may agree

in advance to an allocation of the building expenses relating to those utilities.

In addition, the landlord may also want to provide that the tenant shall cause the premises to be compliant with the Americans with Disabilities Act of 1990, and correspondingly, the tenant may want a similar covenant from the landlord as to the compliance of the building (other than the leased premises) with such Act. If necessary, the parties should agree as to which party is responsible under such Act for any shared bathroom or other facilities or the entrance into the restaurant, particularly if there are steps, stoops or elevated sections over vaults in the area adjacent to the entrance, or if there are planters or other objects which could obstruct the entranceway.

Further, if the restaurant is to be located in an office building and will not have separate dedicated air conditioning or heating systems, the tenant should also negotiate for the provision of such services, as well as elevator service, if required, after normal business hours or on weekends.

[23.15] IV. COVENANTS RELATING TO CONDUCT AND ACTIVITIES

As the restaurateurs in *Big Night* knew, restaurants need a significant volume of customers to be viable, and often it takes more than well-prepared, delicious food to entice them. Since the atmosphere of a restaurant establishment is often critical to its success, amplified sound is often employed. The more popular a restaurant, the more crowded it will be, and the noise and crowds may impinge upon other tenants in the building and upon the neighborhood. A landlord often will seek to include provisions in the lease regulating such activities as music, customer traffic and other conduct, which could adversely affect people outside the premises or the reputation of the building.

[23.16] A. Noise/Sound Levels

Recorded and live music are often integral aspects of a restaurant's ambiance, and a landlord may want protection against high noise levels. At a minimum, a landlord should seek a provision in the lease to the effect that:

Any such sound making or sound reproducing equipment or system in the premises must be operated by tenant: (i) in a manner and under conditions such that no sound or

vibration shall unreasonably disturb any other tenant in the building or otherwise constitute a nuisance and (ii) in conformity with all applicable Legal Requirements (as defined in the lease).

The lease may also include a covenant requiring the tenant (either at the outset or during the term, at the landlord's request) to install appropriate acoustical insulation, sound dampening materials, and/or baffling in the ceiling or walls of the premises, so as to mitigate, to the landlord's reasonable satisfaction, sound and vibration transmission to common areas or to other spaces in the building. The landlord may also want to provide that the components of any sound making, amplifying or sound reproducing device or system must be suspended on isolation rods and may not be attached or placed on structural elements of the building. If the landlord desires more specificity, the lease could provide that the tenant shall install sufficient acoustical insulation so as to prevent the transmission of any sound or noise in excess of a specific decibel level (e.g., 40 dB) from the restaurant premises.

Of course, if a maximum decibel level is not specified in a lease, the tenant may want the landlord to acknowledge that the tenant's business is a restaurant and may have an amplified music system in its premises. The tenant may also want the landlord to agree in advance as to the specifications of its proposed sound system.

[23.17] B. Residential Building Covenants

If the restaurant is located in a building with residential tenants, it may be advisable from the landlord's perspective to have the tenant acknowledge the occupancy of such tenants and agree to certain basic standards. One example of such a covenant applicable to a mixed use or residential building is the following:

Tenant, recognizing that the building (other than the tenant's premises) is residential in nature, and as an additional inducement to landlord to enter into the lease, covenants and agrees that at all times (i) the business to be conducted at the premises and the kind and quality of the merchandise, food, beverages and services offered therein will be reputable in every respect, (ii) the sales and service methods employed in said business, as well as all other elements of merchandising, will be dignified and in conformity with the standards of practice of first

class sit-down style restaurants, i.e., not “franchise” type fast food, (iii) the sound level in the premises and the operational standards of tenant shall be in keeping with the residential nature of the building, (iv) the appearance and décor of the premises (including the lighting and other appurtenances thereto), and the appearance and deportment of all personnel employed therein shall be that which is customary in a first class restaurant and (v) tenant shall strictly comply with the provisions herein regarding the permitted days and hours of operation of tenant’s business.

[23.18] C. Customer Control

A restaurant, in order to be successful, needs significant customer traffic, and it may be advisable to have specific provisions in the lease regarding the handling of customers. For instance, the landlord may want to provide that:

Tenant shall provide for the orderly control of all customers and invitees of the premises, including directing the queuing of customers and invitees through a roped off or designated area or through another method of segregating the queuing area from the remainder of the building, provided that any such method of controlling customers shall be subject to the prior written approval of landlord and shall in no event interfere with or impede the use of the building by landlord, other tenants or their respective employees, customers and invitees. Tenant shall not permit any loitering or other congregating of customers or invitees outside of the premises and within the building, except within the roped off area or other queuing area.

[23.19] V. SIDEWALK AND GARDEN SPACE USE

[23.20] A. Conditional Use of Outdoor Space

Restaurant tenants often desire to use available sidewalk or garden space for table service, and this is often consistent with the interests of landlords in maximizing the rental derived from their properties. Such use, however, should be conditioned on the tenant obtaining all necessary permits and approvals and complying with all legal requirements applicable to such use. In addition, the tenant should have the sole responsibility

of maintaining any such space during the term of its use, and the landlord should disclaim any responsibility with regard to the tenant's operations in such space. The landlord may also want to provide that the tenant shall not permit any music, live entertainment or excessive noise in the outdoor seating area, in order to avoid any interference with other tenants in the building or with other people in the area. The rental rate for such area may either be included in the rental provision for the premises or may be the subject of a separate provision which would become effective when the tenant commences its use of the outdoor space.

The following is a fairly comprehensive provision with regard to sidewalk café or outdoor use (but it does not include a separate rental provision):

(a) Tenant shall have the right to place tables and chairs for outdoor dining in the area immediately outside of the premises on the ____ Street frontage of the premises as more fully delineated on Exhibit ____ hereto (the "Sidewalk Café Area"), for the operation of a sidewalk café ancillary to the use of the premises and for no other purpose during the term of the lease; subject to the following conditions: (i) tenant, at its sole cost and expense, shall procure prior to such use and maintain any and all permits, approvals, certificates and/or licenses required by law, rule and/or regulation of any applicable governmental or quasi-governmental authorities, (ii) tenant's operation thereof shall comply with any and all applicable laws, orders, regulations and legal requirements of all federal, state and local governments, and the New York Board of Fire Underwriters or any similar body asserting jurisdiction thereof and the requirements of tenant's and landlord's insurers with regard thereto, (iii) landlord shall have no liability or obligation of any nature whatsoever to tenant, its employees, agents, contractors, employees, customers or invitees with regard to the Sidewalk Café Area or its operations, (iv) tenant shall obtain and keep in full force and effect all insurance coverage required by the lease covering the Sidewalk Café Area, and (v) tenant shall maintain the Sidewalk Café Area in a clean condition and in good repair and order and shall comply with all applicable terms of the lease as if the Sidewalk Café Area were part of the premises hereunder.

(b) Tenant shall be solely responsible for, and shall promptly pay, any and all taxes, filing fees, charges, or license fees imposed by any local, state and/or federal government or any agency thereof upon landlord or tenant by virtue of the use of the Sidewalk Café Area. Tenant shall promptly deliver to landlord copies of any filings or statements which tenant may now or hereafter be required to make, from time to time, with any local, state and/or federal agency with respect to the use of the Sidewalk Café Area. Landlord agrees to cooperate reasonably with tenant in connection with any applications for necessary licenses or permits with respect to the Sidewalk Café Area, provided that landlord incurs no expense or liability in connection therewith.

(c) Tenant's operation and use of the Sidewalk Café Area shall be at tenant's sole risk, and tenant acknowledges that landlord shall not be obligated to provide any security or other services to the Sidewalk Café Area.

(d) Tenant shall be responsible for cleaning and removing on a daily basis any materials left in the Sidewalk Café Area by tenant or tenant's invitees and shall not store any materials whatsoever in the Sidewalk Café Area.

(e) Landlord's approval shall not be construed to imply that the Sidewalk Café Area or its appearance or operation complies with any Legal Requirements (as defined in the lease), and landlord shall be under no duty to permit the Sidewalk Café Area to be operated if such operation is prohibited by any such Legal Requirements. Landlord makes no representation or warranty, oral or otherwise, with respect to whether tenant may use the Sidewalk Café Area in the manner set forth herein pursuant to applicable Legal Requirements. If tenant is unable for any reason to use the Sidewalk Café Area in the manner set forth herein pursuant to applicable Legal Requirements, landlord shall have no liability or responsibility whatsoever therefor, nor shall such inability be construed as an actual or constructive eviction of tenant under the lease or entitle tenant to any abatement of rent under the lease or relieve or release tenant from any of its obligations under the lease.

[23.21] B. Restrictions on Use of Outdoor Space

Of course, the landlord may not want to permit the restaurant tenant to operate an outdoor café because of potential problems that could arise with neighbors, other tenants or governmental authorities. Further, even if the tenant does not contemplate such a use, the landlord may want the lease to include specific restrictions on the use of any outdoor space adjacent to the restaurant premises. For example, the landlord could seek to provide that:

Tenant shall not use the sidewalks or any open areas adjacent to the premises or any part of the common area of the building for business purposes, except for ingress and egress and except as otherwise provided in the lease, without the prior written consent of landlord exercised in its sole discretion.

[23.22] VI. RIGHTS TO TRANSFER LEASE AND RESTAURANT ASSETS

[23.23] A. Transferability Provision

There are two principal reasons why the transferability provision in a restaurant lease may have more impact on a tenant than a comparable provision in a non-restaurant retail lease. First, restaurants often entail significant infrastructure costs. It can be very expensive to install kitchens, storage and refrigeration units, and other restaurant equipment and systems. Moreover, in order to differentiate themselves and enhance their customers' dining experience, restaurants often invest significantly in the design and installation of dining and bar areas as well as in their furniture and furnishings. As a result of such costs, it may be difficult for the restaurant tenant to amortize and recoup its capital investment over the term of its lease, which is typically 10 or 15 years. Second, a restaurant's reputation (unless it is part of a multi-restaurant brand) is often significantly tied to its location and the distinctive design and décor of its space. The restaurant tenant may accordingly wish to capitalize on its location and design by selling its lease, name and other assets.

Of course, a landlord may have a countervailing interest in assuring that the space is leased to a reputable and reliable restaurant operator or is used for a particular culinary style. Often, from the landlord's perspective a principal factor in leasing the space to a restaurant tenant is the identity of its owner, chef, or management, and a landlord may wish to require

continuity during the term of the lease. Furthermore, a landlord of a mall or other similar development may want to have a certain mix of restaurant styles located within the project and may want to restrict the type of restaurant in a space to a particular culinary or dining style.

Accordingly, the assignment and sublease sections in a restaurant lease may, in addition to the customary provisions in a retail lease, include specific clauses to reflect these additional interests.

If a tenant has bargaining leverage, it may try to negotiate a carve-out to the usual restrictions on transferability. Generally, retail leases contain provisions (often referred to as “permitted transfer” provisions) permitting a tenant in certain qualified transactions to sublease the premises or assign its interest in the lease without the landlord’s consent and without any sharing of profits resulting from such a transaction. In a retail lease, such permitted transfers may involve a sublease or assignment by the tenant to the following: any entity which controls, is controlled by or is under common control with the original tenant (a “related entity” provision); or an entity which results from a merger, consolidation or other reorganization in which the tenant is not the surviving entity, so long as the surviving entity assumes the liabilities of the tenant under the lease and immediately after giving effect to the transaction has a net worth that is equal to or greater than the net worth of the tenant immediately prior to such transaction (a “successor entity” provision). In addition to those transfers, a restaurant tenant may have a compelling reason to request that a permitted transfer under the lease also include a sublease or assignment to an entity which purchases or otherwise acquires all or substantially all of the assets of the restaurant or all the restaurants operated under the same brand (an “acquiring entity” provision), with the same caveat as above as to the net worth of the acquiring entity. Such a provision would provide greater comfort that the restaurant tenant would have the right to sell its business, or in the case of a branded operation, the owner could sell all of its branded locations in one transaction.

Rather than giving a restaurant tenant the unfettered right to sell its business and lease, however, a landlord may want to provide that it shall have reasonable discretion to approve any such transfer or that the “acquiring entity” or “successor entity” provisions may not be relied upon by the tenant until a specified period of time has elapsed after the commencement date of the lease. The landlord may also want to condition any proposed transfer under such provisions upon the landlord’s reasonable determination of such factors as: (1) the transferee or its key principals or its management having not less than a significant number of years of

operating restaurants of similar quality as the tenant's operations (for instance, 10 years); and/or (2) the transferee or its principals having a net worth of a stipulated amount; and/or (3) the transferee, its principals or its management being of good moral character and business reputation.

[23.24] B. Control and Management Restrictions

Of course, the landlord may be of the opinion that the success of a particular restaurant will be based upon the performance of a specific operator or chef. This is particularly true where the landlord has agreed to invest significantly towards the construction of the tenant's installation and would like to assure it recoups its capital investment. For that reason, instead of agreeing to broaden the permitted transfer provision, the landlord may want to provide that at all times during the lease, the restaurant be owned, operated or controlled by a specific person or group and that any changes in that person or group require the landlord's consent (based upon a standard, either the landlord's sole discretion or reasonable discretion, to be set forth in the lease). The landlord may further wish to require that the key person or group devote substantial time and attention to the business of the tenant to ensure that the premises are operated in a consistent, first class, high-quality manner, and that any failure by the tenant to comply with such terms shall constitute a material breach under the lease.

[23.25] C. Rights to Furniture, Fixtures and Equipment

At a bare minimum, a restaurant tenant should attempt to assure that at or immediately before the expiration or termination of the lease, it will be entitled to sell its movable furniture, fixtures and equipment (often referred to as "FF&E"). Normally, a retail or store lease will provide that the tenant may remove its trade fixtures, movable office furniture and equipment, provided it repairs and restores the premises to the condition existing prior to the installation of such items and repairs any damage to the premises due to such removal.⁵ However, most such leases, including the aforementioned Standard Form of Store Lease, also provide that fixtures, paneling, partitions and like installations installed in the premises at any time, either by the tenant or by the landlord on the tenant's behalf, become the property of the landlord and at the landlord's option either remain in the premises or be removed by the tenant at its expense. The language in many leases is unclear as to what constitutes a fixture which is part of the premises in contradistinction to movable or trade fixtures,

5 See Article 3 of the Standard Form of Store Lease published by the Real Estate Board of New York, Inc. (July 2004 edition).

and also leaves the tenant uncertain as to whether it may retain or sell its FF&E upon the expiration of the lease.

This uncertainty may be remedied in at least two ways. One is to have the lease require that the landlord set forth in writing at the time of the installation of any fixture, paneling, partitions or the like whether any such items must be removed at the expiration or termination of the lease. The other is to specify in the lease or in a side agreement executed contemporaneously with the lease which items are the property of the tenant. Below is a portion of a side letter which can be employed to clarify the extent of a restaurant tenant's rights to remove and or sell such property:

This letter is intended to clarify provisions in the lease relating to the obligations of tenant upon the termination of the lease to vacate and surrender the premises in the condition required under the lease. For purposes of the lease, such condition shall mean that (i) tenant shall not be entitled to remove any installation or any fixtures installed by tenant in the premises other than movable trade fixtures, which shall include ovens and stoves (which are on moving canisters) and refrigerators (other than walk-in refrigerators) which are not attached to the walls or floors of the premises; tables, chairs and other furniture; equipment not attached to the walls or floors (including dishwashers); all kitchenware and table top packages; electronic systems, computers, CCTV, POS systems and office equipment; inventory, including food and alcohol; framed photographs; air compressors and water jackets for the air conditioning system (but not air handlers); and similar items of personal property; and (ii) tenant shall be further obligated to leave the premises vacant, broom clean and in good condition, reasonable wear and tear excepted.

[23.26] D. Creation of Security Interests

In order to assure that no other third party may be able to claim ownership rights by foreclosure or otherwise of any components of the tenant's installation, the landlord will typically restrict the creation of any security interest under the Uniform Commercial Code in anything other than the tenant's personal property, movable trade fixtures and movable equipment. Further, the landlord may want the lease to provide that as security for the performance of the tenant's obligations under the lease, the land-

lord shall be entitled to a first priority security interest in all of the tenant's FF&E and replacements thereof, whether or not movable, subject and subordinate to the lien or security interest of any vendor or lessor in any equipment. The lease may further provide that in addition to all rights or remedies of the landlord in the lease and under law, including the right to a judicial foreclosure, the landlord shall have all rights and remedies of a secured party under the Uniform Commercial Code of the state in which the premises are located. For purposes of the tenant's financing, however, the landlord may permit the tenant to grant to a lender or vendor a security interest in certain FF&E, typically moveable non-kitchen FF&E, including furnishings, furniture, merchandise, inventory and all other personal property placed in the premises by the tenant. Notwithstanding the foregoing, a landlord should provide that upon expiration or earlier termination of the lease, and notwithstanding any such liens or security interests granted by the tenant on its property, any and all property of the tenant remaining on the premises at such time shall automatically become the property of the landlord, and the landlord shall have no obligations to the tenant, its lender or any other person or entity with respect to such property.

[23.27] VII. LIQUOR LICENSE

[23.28] A. Liquor License Contingency

If a restaurant intends to have a bar or provide wine or liquor service, it will need to procure a liquor license from the local liquor licensing authority. Since an executed lease is often required for the issuance of a liquor license, a restaurant tenant will not know with certainty at the time it executes the lease that it or its principals will qualify for a liquor license for that particular location. Accordingly, the tenant will want to condition the effectiveness of the lease on the issuance of the liquor license within a stipulated period of time.

The landlord will have a countervailing interest to ensure that the tenant expeditiously applies for the license and prosecutes the same with diligence. In the event, after a stipulated time, the tenant is not able to obtain a license, or the tenant receives a denial of its application, both the tenant and the landlord will want to have the right to terminate the lease. A sample liquor license contingency provision for a New York City restaurant is set forth below:

Tenant agrees that within 20 days after the date of full execution and delivery of the lease (the "Execution

Date”), tenant shall, at its sole cost and expense, apply for a liquor license (the “Liquor License”) to be issued by the Liquor Authority of the State of New York (the “SLA”) to sell wine and other alcoholic beverages in the premises, such application to be made in accordance with any rules and regulations promulgated by the SLA, and to be filed with the New York City Alcoholic Beverage Control Board (the “ABC”). Tenant shall prosecute the application diligently and expeditiously. Tenant represents that all of its officers, directors, managers, members, partners, stockholders and other equity interest owners, as the case may be, are persons of good repute without any criminal record which might disqualify tenant from being granted the Liquor License. Tenant agrees to advise landlord within five (5) days of all actions taken by tenant in connection with such application and of all communications received from the ABC or SLA, including, but not limited to, the approval or denial of such application and the issuance of the Liquor License. Prior to tenant’s receipt of the Liquor License, tenant shall not sell or offer for sale any wines or other alcoholic beverages in or from the premises. If, despite tenant’s good faith, diligent efforts to obtain the Liquor License expeditiously in accordance with the terms of this Section, the Liquor License is not issued to tenant on or prior to the date that is 60 days after the Execution Date, then either landlord or tenant shall have the option, within 15 days thereafter, as to which time shall be of the essence, to terminate the lease by giving the other party notice thereof. In the event landlord or tenant shall elect to terminate the lease pursuant to this Section, the lease shall cease and terminate with the same force and effect as though the date on which the terminating party gives its termination notice as provided above were the date set forth in the lease for the expiration of the term, and each of the parties hereto shall be released from any further obligations hereunder except for those obligations that are specified in the lease to survive the expiration or earlier termination of the lease.

[23.29] B. Indemnities and Insurance Regarding Service of Alcoholic Beverages

In addition to including a contingency with respect to the procuring of a liquor license, a landlord may also want to incorporate into the lease provisions which would make explicit the restaurant tenant's obligation to serve alcoholic beverages in compliance with applicable law. For instance, the lease could contain a provision that the tenant will comply with all applicable laws, regulations and ordinances from time to time in effect with regard to the serving of alcoholic beverages, including but not limited to restrictions as to the age of customers being served such beverages, the age of persons serving such beverages and the hours and days during which such beverages may be served. In addition, while retail leases often include a general indemnity in favor of landlords which is very inclusive and encompasses claims arising from a tenancy, the landlord may want to provide explicitly that the indemnity (as well as tenant's required commercial general liability insurance policy, by endorsement or rider or otherwise) covers any claims based upon negligence, breach of warranty, strict liability or other product liability law, arising out of the serving of alcoholic beverages (or food) in the premises, including but not limited to liability arising under any host liquor law, dramshop law or similar laws applicable to the premises.

[23.30] VIII. RETAIL LEASE PROVISIONS WHICH SIGNIFICANTLY AFFECT RESTAURANT TENANTS

In addition to the above considerations, which are primarily of concern to restaurant tenants, there are a number of other matters which impact on retail tenants generally but may have a significant and disproportionate impact on restaurant tenants.

[23.31] A. Sidewalk Sheds

The installation of a sidewalk shed or scaffolding by a landlord in order to perform facade repairs or for some other purpose may have a material adverse effect upon a restaurant tenant. Not only may such a shed or scaffolding deprive a restaurant of visibility from the street, and thereby reduce customer traffic to the restaurant, it may also affect the ambience of the restaurant and its customers' enjoyment of the dining experience. In addition, it may also deny a restaurant its outside eating area. For these reasons, a restaurant tenant may have more significant reasons than other

retail tenants to seek to obtain a diminution of the base rent in the event such a shed is constructed during the lease term. Of course, the landlord, particularly if it has financed its building, will be reluctant to agree to a provision which could interfere with its rent flow, and in fact such a provision could affect the ability of landlord to finance its property by decreasing its debt service coverage ratio and may require the approval of any existing lender.

Often, retail leases provide that unless the premises are damaged, the tenant shall not be entitled to any diminution of the rent in the event the landlord erects scaffolding or a sidewalk shed at the building. At a minimum, the tenant should see that there is a covenant in the lease requiring the landlord, in making any repairs, alterations or improvements, including any work involving the installation of a sidewalk shed or scaffolding, to use all reasonable efforts to minimize interference with the tenant's use and occupancy of, and access to, the premises and to take all commercially reasonable measures to reduce to a minimum any disruption or interference with the tenant's business.

If a landlord is amenable to an adjustment of the base rent in the event it must install a sidewalk shed or scaffolding, it may agree to a stipulated reduction per month, adjusted on a per diem basis for the actual number of days that a sidewalk shed or scaffolding is in place in front of the demised premises. While there is no specific formula or standard for such a reduction, some leases have provided for reductions in base rent during all or part of the period the shed or scaffolding is standing in the range of 20% to 30%. In other instances, a landlord may require proof that a restaurant's revenues decreased from a comparable period prior to the installation of the shed or scaffolding, and the rent reduction would be based upon such demonstrated reduction.

Below is an example of a lease provision allowing for a stipulated reduction of the base rent during the period a shed or scaffolding is in place:

In the event that landlord erects any scaffolding or so-called "sidewalk shed" in the area in front of the premises, landlord shall use reasonable efforts to minimize the interference with the access to, use of, or visibility of the premises, and to minimize blockage or concealment of tenant's signs or windows, including providing additional illumination should the scaffolding or shed darken the entrance or the front of the premises; provided, however,

that if landlord maintains scaffolding or a sidewalk shed obstructing ____% of the frontage of the premises for a period of 60 consecutive days, the base rent shall be reduced by twenty (20%) percent thereafter until such time as the scaffolding or shed is removed.

[23.32] B. Percentage Rent: Exclusions From Gross Sales

In certain properties, such as malls and hotels, a retail tenant, including a restaurant tenant, is often required to pay percentage rent in addition to base rent. The provisions relating to percentage rent in a restaurant lease are comparable to those in any other retail lease and are typically based upon a tenant's "gross sales". The percentage rent may, but not always, become payable when the tenant's gross sales during an annual period exceed a "natural" breakpoint. That breakpoint is determined by dividing the amount of base rent during an annual period by the specified percentage rent. Any gross sales in excess of that quotient will be subject to the stipulated percentage rent during that annual period.

For purposes of percentage rent, "gross sales" may be defined as all sales made and all cash and credit revenue of a tenant derived at, in or from the premises, including finance charges to customers. Some leases will require that the menu prices of items served be included in that definition. A retail lease often excludes and/or deducts from the definition of "gross sales" various items, including sales taxes, refunds or credits made for returned merchandise, sales made to employees or discounts not otherwise reflected in the actual sales receipts, fees paid to credit card companies or financial institutions in connection with credit card transactions and other items which are not typically deemed to be revenue realized by the tenant from sales. In addition to the usual exclusions, a restaurant tenant should also request the following exclusions: (1) sales and meals provided for free or discounted to bona fide employees of the tenant; (2) the amount of redemptions of gift certificates (to the extent the face value of the gift certificates was included in "gross sales"); (3) tips to or service charges of bona fide employees; (4) complementary meals for promotional or other business related purposes (particularly if the lease requires the inclusion in gross sales of the menu price of items served); and (5) the amount of any actual bad debt write offs for the failure of the tenant's customers to pay in-house accounts, provided such amounts were previously included in the tenant's gross sales. If the tenant requests such exclusions, the landlord may want to limit them, particularly items (1) and (4), to a specific percentage (often in the range of 3%) of gross sales, not including the amounts of such exclusions.

In addition, if the restaurant is located in a hotel, the following exclusions may be relevant: (1) gratuities paid by patrons for room service or otherwise, to the staff or paid to the hotel, restaurant tenant or operator and then paid to the staff; and (2) amounts collected by the restaurant tenant or operator from a patron for the account of, and for direct payment to, unrelated third parties providing services specifically for a patron's function which generates gross sales, such as flowers, music and entertainment.

A restaurant tenant may also wish to contend that the breakpoint for the commencement of percentage rent should not be at the natural breakpoint, but rather should be upon the achievement of a higher amount of gross sales, because the operating margins of a restaurant are so low and the infrastructure costs are so high. By delaying the imposition of percentage rent until a higher level of gross sales is attained, the tenant may be able to recoup its investment faster and realize a higher return than it would otherwise be able to achieve.

[23.33] C. Radius Restrictions; Competing Business Area Restrictions

In conjunction with a percentage rent provision in a restaurant lease, the landlord may wish to incorporate into a lease a provision which restricts the principals of the restaurant tenant from owning, operating or otherwise engaging, directly or indirectly, in any similar or competing business to that conducted by the tenant within a stipulated radius from the premises. The purpose of such a provision, which is often referred to as "competing business area restriction" or "radius restriction" is to avoid any reduction in the tenant's gross sales that may otherwise be realized from the premises. When such a provision is utilized, the nature of the business of the tenant (e.g., a French bistro restaurant) will often be specified in order to provide some clarity as to what constitutes a similar or competing business. The landlord may also wish to provide that in addition to the other remedies available to it in the event of a breach of such a provision, including but not limited to the right of injunction, any gross sales earned in such similar or competing restaurant shall be reported to the landlord and considered "gross sales" for purposes of the percentage rent provision, and the landlord shall have the further right to audit the books and records of such other restaurant in the same manner as if such restaurant were located at the premises.

[23.34] D. Existing Exclusives

What is good for the goose is also good for the gander, and the tenant may wish to request a clause restricting the landlord from renting space in the building or development to a restaurant which is similar to or competitive with the tenant's restaurant. Such a clause, which is often referred to as an "existing exclusive," often requires the landlord to provide in future leases to other tenants in the building or development a description of the prohibited use (i.e., tenant's specific use). For instance, by virtue of the granting of such existing exclusives, the form of restaurant lease in one development contained a prohibition against using other premises for such uses as: the sale of open flame style specialty pizzas and pastas; full-service seafood restaurants; full-service steak restaurants; Mexican, Latin, El Salvador or Tex-Mex restaurants; casual themed sit-down American restaurants whose price point and menu offerings were substantially the same as those of a specific restaurant; and sushi restaurants.

The prohibition against certain types of restaurants may also be subject to exceptions. Existing tenants would of course not be subject to such prohibitions. New tenants could also be allowed to sell items which would otherwise be prohibited, such as open flame style specialty pizzas or pastas or steak, as the case may be, as incidental uses or auxiliary menu items (i.e., not a primary featured item). If the prohibition relates to a more upscale or sit-down style restaurant, the lease could make explicit that fast casual type restaurants and food court tenants would be permitted, or could permit restaurants specializing in primarily one ethnic, cultural, regional cuisine or specialized food category (e.g., sushi, burgers, steak or some other single food type).

[23.35] E. Landlord's Contribution to Tenant's Installation

Restaurant installations are generally more expensive per square foot than many other retail installations. As a result, a restaurant tenant may need the landlord to contribute to the cost of construction. Such contribution may take three forms: a landlord may construct some or all of the installation as landlord's work (also known as a "work letter"); a landlord may make additional rent concessions or allowances over a period of time in order to assist the tenant in defraying the cost of such construction; or a landlord may directly contribute a monetary amount (often referred to as a "construction allowance") to the tenant or its contractors to pay the cost of such work, as well as contribute to such soft costs as architectural and expediter fees, permit costs and the like.

If the landlord agrees to make a construction allowance, the payments are usually made on a specified schedule based upon the tenant's expenditure of specific amounts of its own funds toward the tenant's work or the tenant's architect's certification that a specific percentage of the tenant's work is completed. If the lease is conditioned upon the issuance of a liquor license for the premises, the lease will provide that the tenant will not be permitted to commence construction, and the landlord will not make any contribution to the tenant's soft costs, until the liquor license is obtained. As in any other retail lease, the landlord should incorporate various protections, such as the right of the landlord to deduct from any such construction allowances any rental amounts owed by the tenant to the landlord during the period in which the construction allowance is paid, and the obligation of the tenant to deliver lien waivers and other proof that the work performed has been paid in full to the date of payment of the construction allowance.

While the provisions relating to the various forms of the landlord's contribution to a tenant's installation in a restaurant lease are comparable to those in a retail lease, the negotiations are often more complex due to the comparatively higher per square foot amounts expended by a restaurant tenant. Such negotiations will often turn on the relative bargaining leverage of the parties and on the landlord's perception of whether the restaurant will be a value-added amenity to its property. The outcome of such negotiations, however, will often be crucial to a restaurant tenant's profitability under its lease.

[23.36] IX. CONCLUSION

In the words of one successful restaurateur, it takes a lot of chicken soup to pay the rent. The process of negotiating a restaurant lease is often complex and involves balancing the restaurateur's needs to attain his or her vision and the landlord's needs to protect its building and other tenants. From a landlord's perspective, the inclusion in a lease of comprehensive provisions dealing with operating standards, use limitations and infrastructure requirements are important to assure that the landlord's interests in preserving the quality of the property and the enjoyment by other tenants of their premises in the property are protected. It is also in the landlord's interest, however, to see that the lease provisions are not unduly burdensome on the tenant's ability to develop customer traffic and operate a successful restaurant. If the protective provisions are reasonable, a restaurant tenant should be amenable to them. The two parties should then concentrate their deal making efforts on structuring the financial terms of the lease, with appropriate rent levels, construction contributions

and reasonable transfer provisions, so as to maximize the likelihood of the tenant being able to realize sufficient revenues to pay its rental and operating obligations and receive a reasonable return on its investment. If proper accommodations regarding those key terms are reached between the parties, the restaurant lease will serve the interests of both the landlord and the tenant.

CHAPTER TWENTY-FOUR

RETAIL LEASES

Bradley A. Kaufman, Esq.

This chapter is intended to serve as a practical guide to the review and negotiation of retail leases, focusing on issues unique to retail leases, or for which retail leases create unique concerns. I will review standard clauses found in typical retail leases—highlighting in some cases concerns that retail Tenants would have in complying with those provisions (and what we, as practitioners, can do to either alleviate or address those concerns for our clients), and highlighting in other cases potential retail Landlord responses and suggested areas of compromise.

[24.1] I. BASIC LEASE INFORMATION

While obvious, there is nothing more important than clearly identifying the leased premises, both in terms of designation (i.e., store number 000A) and on a floor plan, including where the leased premises are situated within a mall, including as to each particular level of the mall, as applicable. The lease should also set forth the square footage and, in representing retail Tenants, practitioners should seek the right to have Tenant’s architect or an independent third party verify such square footage and make appropriate changes to the lease following such verification (i.e., adjustments of fixed rent and other charges in the lease based upon square footage).

The commencement date is perhaps the most critical element of the lease, at least initially, inasmuch as the Tenant will need to retain architects, contractors and other professionals, as well as order inventory, specialty and trade fixtures and the like, and hire employees to staff the store. It is imperative, therefore, for Tenants to have a firm target delivery date so they can gear up to open on a timely basis. From a Tenant’s perspective, penalties for late delivery (see Part II.B.) are desirable as both a deterrent against a Landlord’s late delivery of the space so as to compromise the Tenant’s ability to timely build, staff and open, and also as a means of compensation to Tenant for the items mentioned for Landlord’s failure to timely deliver the space. An ultimate termination right with reimbursement of Tenant’s expenses is also desirable, but usually obtainable by only the most “desirable” or larger Tenants.

Landlords will want to get Tenants in possession and open for business as soon as possible, so as to start collecting rent and other charges, and will want to deliver space to Tenants with as little “down time” as possible, thus keeping the rental stream unimpaired. If there is percentage rent potentially payable to the Landlord, this is, of course, particularly important. Landlords also need to make sure there is as little closed square footage in mall situations as possible, to ensure customer traffic for all

Tenants and to avoid so-called co-tenancy violations. Accordingly, Landlords regularly seek penalties for failure by a Tenant to timely open, particularly in mall situations where there is a “grand opening” of a mall or a section of the mall involved, or the Landlord has agreed to co-tenancy clauses in other leases.

In any event, the lease should set forth clear parameters for what would constitute delivery of the space, with appropriate notices and sign-offs by, and to, each of the parties.

The lease should clearly define substantial completion of “Landlord’s work,” whether that be delivery of the shell (building structure) only, “vanilla box” (including Landlord’s standard build-out, but subject to Tenant’s “finish work”) or partial or complete build-outs for particular Tenants and, again, notices and verification of same. Fixed rental, percentage rent rate, breakpoints, taxes, common areas maintenance, contributions to promotional funds and any other charges, and when payment of same is to commence, should also be clearly spelled out under the basic lease provisions.

With respect to a Tenant’s permitted use, Landlords will want to set forth with specificity what the Tenant can sell from the demised premises and prohibit sales of all other items. Tenants will seek as broad a definition as possible of what they can sell from the demised premises. Landlords must be cognizant of restrictive covenants and so-called “exclusives” in major and other leases. Landlords also desire to achieve a good mix of Tenants in terms of items sold from the premises—not just in the center as a whole, but in particular areas of the center. As with permitted use, trade names should also be dealt with specifically, from a Landlord’s standpoint. Moreover, Landlords usually prohibit Tenants from changing their trade name at the particular location during the term, while Tenants should seek the right to change trade names, provided the change is on a uniform (i.e., local, regional or national) basis.

[24.2] II. SPECIFIC LEASE PROVISIONS**[24.3] A. Security**

Landlords need to thoroughly investigate exactly who the actual named Tenant under the lease will be, and to review financial and, in some cases, organizational and corporate material about the Tenant's structure. In the case of single-purpose entities attempting to lease space in local or even regional malls, Landlords will often seek either significant security deposits or so-called "Good Guy Guarantors," or in some cases even parent company guarantees. Tenants, from their standpoint, should have the right to substitute letters of credit for security deposits. Landlords usually prefer that substitution anyway, from a potential bankruptcy standpoint.

[24.4] B. Construction, Landlord's and Tenant's Work

As noted above, items of Landlord's and Tenant's work should be dealt with specifically, either by attaching detailed schedules and exhibits, or by referencing plans and specifications, so as to alleviate the potential for confusion (who performs what work within the demised premises, or with respect to the systems serving same). For the reasons outlined above (i.e., inventory, ordering of items and lining up professionals), Tenants should seek penalties for late delivery of the demised premises or late completion of Landlord's work. The types and amounts of these penalties will be subject to negotiation, but in a retail—as opposed to an office—situation "day-for-day" (abatement of rent) penalties often do not make the Tenant whole for late delivery. I would generally suggest that Tenants should seek liquidated damages more closely corresponding to their actual losses. In the event of Tenant's failure to open for business, Landlords usually have a provision in the lease whereby similar liquidated damages are required. This is particularly true in connection with a new center, or when a grand opening (or "reopening") is planned and Tenant's failure to open for business contemporaneously with other stores in the center would cause significant harm to Landlord (and other Tenants). In such events, liquidated damages in excess of rent (sometimes significantly so) and often the norm.

With respect to Tenant's work, Landlords usually require that plans and specifications be subject to Landlord's approval, and with respect to structural work, work involving any of the mall or building systems, exterior work and often finish work that may be seen from the exterior (whether mall or street deals) that such approval be in Landlord's sole discretion (though for the credit-worthy and higher end retailers, interior finish work

of any kind or nature sometimes may be done. To avoid the Landlord “sole discretion” criteria, Tenants may seek to reference other store locations in terms of the nature and quality of build-out and to have same effectively pre-approved by Landlord, subject to physical constraints and compliance with local laws. I have often seen this as the case in mall leases with repetitive (regional or national leasing program) Tenants.

Mechanisms for permitting and approvals, certificates of occupancy, sign-offs, notices and releases of mechanic’s liens, etc., must be specifically provided for in the lease document, for the protection of both parties. So, too, must issues such as compliance with applicable laws, distribution of utilities and life safety systems and the like be clearly spelled out in terms of whose obligation they are, and the timing and scope of delivery of same.

[24.5] C. Percentage Rent

Perhaps the greatest difference between the commercial office lease and the retail lease is the commonplace payment of percentage rent by a retail Tenant, particularly in malls. Based upon gross sales from the demised premises and usually over a “natural breakpoint” (i.e., rent divided by the percentage of gross sales to be payable under the lease), percentage rent can be payable in any number of ways and can include and exclude any number of items, all negotiated on a lease-by-lease basis. Landlords often attempt to have the natural breakpoint divided into either monthly or quarterly breakpoints, and thereby have Tenants pay percentage rent on a monthly or quarterly basis, respectively, after achieving same. This would not be in the best interest of the Tenant, inasmuch as the Tenant may exceed the breakpoint in one or more months or quarters, but nevertheless on an annualized basis would not achieve the breakpoint and thereby otherwise not have percentage rent payable. Even if there is a reconciliation and adjustment at the end of the year, the Tenant would have paid percentage rent, and the Landlord would have had use of same, often without any interest factor, subject to a subsequent “true-up.” This negotiation, as with most every other, is usually determined by the respective leverages of the parties, so that large regional or national retailers often are not required to pay any percentage rent until having achieved their breakpoints or, in some cases, until the end of the respective lease year.

While the traditional definition of gross sales would include any income derived from the operation of the demised premises and sales therefrom, what is excluded from gross sales is often one of the more difficult issues to negotiate in a retail lease. Tenants will seek to exclude

numerous items from gross sales, such as sales at a discount to employees (perhaps “up to the amount of the discount”), returned goods, charges incurred by the retailer for returned checks, credit cards, etc. Landlords will seek to limit those items and, in many cases, seek to cap them at a certain small percentage of gross sales (anywhere from 1% to 5%) either on an item-by-item and/or an aggregate basis in any one lease year. From a Tenant’s perspective, exclusions exceeding any such cap would amount to “phantom percentage rent”; Tenant paying Landlord percentage rent on a gross sales level not actually achieved.

Perhaps the most vexing issue involving the definition of gross sales is the issue of internet sales and returns. When is an internet sale included, if ever, in gross sales from a particular store, and when are returns of items purchased over the internet and returned to a particular store ever excluded from the gross sales from that store? The answers are clearly fact-based and include variables such as: Do salespeople carry internet-accessible devices? Who actually places the order? Where is it shipped from? Where is it picked up? And, as to returns, are they returned to current inventory? Negotiations of these particular issues of late have been aggressive and, obviously, for good reason.

Leases will often allow the Landlord to audit the Tenant’s books and records regarding sales from the demised premises. Tenants will seek to limit such audits—in terms of the number, the scope and the time after the expiration of the particular lease year within which an audit can be performed, as well as, of course, including confidentiality provisions. It is important from a Landlord’s standpoint that those confidentiality provisions not be too broadly written. The Landlord wants to be able to give prospective lenders, purchasers and joint venturers access to the financial information obtained by Landlord.

[24.6] D. Taxes

This is not usually a hotly negotiated issue in retail leasing, but Tenants should be mindful that if the Landlord conducts tax reduction proceedings, and there is a refund during the term when the Tenant has paid taxes for the year in which the refund is obtained, the Tenant should be paid or credited for its pro rata share of the benefit of the reduction proceedings. Also, items included or excluded from taxes are often negotiated, with Tenants seeking to exclude income, franchise taxes and the like, as well as penalties incurred by Landlords for late payments, etc. Tenant’s must, however, be particularly mindful of taking into account any payment in

lieu of taxes (PILOT) programs or other abatements which may artificially reduce taxes initially, but with a big bite in the future.

Taxes on Tenant's sales, as well as on the particular occupancy of the demised premises, are usually specifically included as an obligation of the Tenant and, depending on jurisdiction, these items could be quite costly. Landlords will routinely seek the right to make payment of these taxes in the event Tenant fails to do so (usually following notice and opportunity to cure) so as to avoid "tax liens" on the property.

[24.7] E. Common Area Maintenance (CAM)

What is and is not included in CAM charges in any particular retail lease is, again, a matter of leverage. Landlords, of course, will attempt to put every and all costs and expenses incurred in connection with the operation of the property within the definition of CAM and thereby pass those expenses on to the Tenants in the center (excluding, in most cases, "anchor" (or "major") and certain "specialty" Tenants). The concerns of the Tenant are that certain items should be excluded and the percentage of those expenses borne by the Tenant needs to be limited. One item of particular concern to Tenants is what the Landlord includes in terms of managers fees, and Tenants, obviously depending upon leverage, will want to either exclude or cap that particular expense and the type of cap used. Percentage of CAM itself or rents received from the center are likewise negotiable if the Tenant has significant leverage. The Tenant would want to limit its share to the percentage obtained by dividing the actual square footage of the demised premises by the actual square footage of the center as a whole. This is usually not the end result after negotiation and would certainly be unusual if found in any Landlord's initial draft of lease. Instead, Landlords will exclude certain anchor, major, and specialty Tenants from the calculation of square footage to be used as the denominator in calculating Tenant's percentage (the numerator being the square footage of the demised premises). The negotiation is often over the type of major or specialty Tenants to be excluded, the square footage of which is (or is not) to be included in a particular calculation and ultimately the "floor" (minimum percentage of included square footage of Tenants of the center—i.e., a minimum threshold) for the center. It has been my experience to see this percentage range from 50% to 100%, but sometimes there is no limitation or threshold at all. Again, it is a matter of leverage.

[24.8] F. Utilities and Services

The Tenant must understand how utilities are brought to the demised premises for distribution, as well as the utility capacities to be provided, and the scope of the charges for all these items. Utilities are either directly metered, with the public utility company furnishing them and billing the Tenant directly, or submetered and billed by the Landlord (with or without a premium), or sometimes provided and priced in some other way, such as electricity provided by the Landlord and changed to the Tenant on a per square foot basis. In each case, Tenants should understand the scope of these charges as well as the capacities to be provided. While smaller Tenants will likely be required to install a check meter or be part of a submetered group (with a premium payable to Landlord), larger Tenants will often seek and obtain the right to connect directly to the public utility.

Provision of heat, ventilation and air-conditioning, as well as the charges and capacities for same, should be specifically dealt with in the lease. Whether by means of “dry bulb criteria,” “central plant criteria” or otherwise, Tenants should attempt to negotiate specifically in the lease documents the level of service for HVAC throughout the term and the charges for same. Many retail leases will provide that the general or central plant costs and expenses are included within CAM, but that any one Tenant’s specific needs will be dealt with separately. Mall Landlords will frequently use central plant charges as a significant profit center, so Tenants must be particularly wary of same and have an engineering expert review these clauses.

Another concern of Tenants is what happens when these utilities cease. If the problem is not directly the fault of the Landlord or its agents, employees or contractors (and, in some cases, even if it is), there is usually no abatement of rent, at least in Landlords’ first draft of leases. Tenants will, of course, seek to have clauses inserted so that some abatement of rent under these circumstances (usually following some reasonable period of time for the Landlord to take care of such cessation) is permitted. If a Tenant is unable to obtain such an abatement, it might want to cover the exposure through insurance products, to the extent available.

[24.9] G. Rules and Regulations

Rules and regulations are critical to any retail Landlord, inasmuch as one Tenant’s conduct could adversely (even significantly so) affect the sales and operations of other Tenants in the adjacent area and thereby create significant losses of gross sales and percentage rent. So long as rules

and regulations are not discriminatorily enforced, Tenants should generally be amenable to complying with commercially reasonable rules and regulations for the operation of the center, including parking areas. Tenants should seek to have the Landlord agree to give notice of any new or amended rule or regulation and a reasonable time to protest same. Landlords will generally require Tenants to have their employees comply with those rules and regulations regarding parking, even to the extent of charging the Tenant, as opposed to the employee, for failure to comply.

[24.10] H. Maintenance of the Leased Premises, Mall or Building

While specific requirements on the part of Tenants are often set out in Landlords' proposed form of lease documents, Landlords usually provide either minimal or no comfort to Tenants in terms of how they will operate the center. At a minimum, Tenants should seek to have the lease document say what the operational standards of the center will be (i.e., "first class for a regional mall of this size in the area in which the center is located," etc.).

Larger Tenants may be able to negotiate more specific Landlord covenants on maintenance and, in the cases of the largest Tenants and many Tenants of varying sizes in so-called "street deals", self-help and offset rights if the Landlord fails to comply with those standards (but usually with long lead times and additional notice requirements).

[24.11] I. Alterations Within Leased Premises

From the Tenant's operational standpoint, perhaps the most important clauses in retail leases (after operational standards and requirements and percentage rent) are those dealing with alterations within the demised premises, including Tenant's initial build-out. Again, Landlords are greatly concerned over what the Tenant plans to construct within the demised premises, as it will have an impact upon not only this Tenant's sales, but those of adjacent Tenants and in other areas of the center. Accordingly, Landlords will seek to have stringent approval rights and controls over Tenant's alterations, sometimes attempting to have same reviewable in their sole discretion. This is obviously not in the best interest of Tenants. Larger Tenants can usually negotiate a more satisfactory standard and the largest and most credit worthy, Tenants are usually able to perform decorative alterations without any Landlord consent.

No element of retail operations is more important than “branding,” which is not only encompassed by the particular retail Tenants’ retail goods or services, but also in their build-out, signage, store front, packaging, etc. It is therefore critical that a Tenant maintain control over these branding items. If references can be made to particular signage, storefronts or build-outs at the Tenant’s other locations and can be reduced to either pictures, specifications or renderings, etc., it is in the best interest of the parties to attach these to the lease as exhibits or otherwise reference them. If not, Tenants must be wary as to what approval rights they give Landlords over their particular interior design, signage and storefront. In malls, the storefronts are usually uniform and Tenants will have little discretion other than in terms of signage and window displays. Again, depending on leverage, Landlords will or will not have control over even these items (signage, window displays and interior design). Again, larger and more desirable Tenants will, however, successfully negotiate away these Landlord constraints and, to a certain extent, approval rights, and try to carve away any Landlord approval rights, or at least limit Landlords to not acting unreasonably in approving or disapproving same (other than for approval over anything adversely affecting systems, structure or the exterior). Tenants must be particularly mindful not to give Landlord any approval over their advertising to, from, or of the demised premises.

Landlords often impose requirements to remodel during the term. The frequency of same—and, again, the discretion over such remodeling—are, of course, the subject of negotiation, the outcome of which usually depends on the size and/or desirability of the Tenant.

As to what items can be left in the leased premises by Tenant at the end of the lease term, or what must be removed by Tenant and the scope of Tenant’s obligation for such removal and, even, demolition of the demised premises back to the condition prior to delivery by Landlord to Tenant upon the commencement of the lease term—this should be thoroughly set forth in the lease documents. Larger Tenants will seek to have merely the obligation to remove signage, personalty and trade fixtures, and to walk away. Smaller Tenants will sometimes even be saddled with the obligation to demolish the demised premises back to the core and shell, at the discretion of the Landlord. Mid-size Tenants tend to reach a middle ground.

[24.12] J. Subordination, Nondisturbance, and Attornment

Inasmuch as in mall leases, retail Tenants are often relatively small in size (square footage) and depending upon whether these type of smaller Tenants are part of regional or national chains, the issue of subordination,

nondisturbance and attornment is usually not heavily negotiated, nor is nondisturbance regularly, if ever, given. The flip side is that larger Tenants (and often regional or national Tenants, regardless of smaller square footage locations), which provide significant income streams upon which lenders will rely, and those Tenants deemed a “draw” to the mall, will often successfully obtain nondisturbance agreements. In a “down” economic environment and with the potential of mall Landlord bankruptcies, this of course becomes a more important issue for the Tenant. Particularly if there is a Tenant improvement or construction allowance to be paid, or significant work to be performed by the Landlord, the larger and more desirable Tenants will want to see these recognized (as payment, performance, or off-set rights) in non-disturbance agreements.

[24.13] K. Assignment and Subletting

Perhaps the next most important issue for any retail Tenant is assignment and subletting. It likely provides the sole exit strategy for the Tenant if the demised premises don't live up to expectations, or in connection with a change in retail strategy. Again, for the smaller retail Tenants, an absolute prohibition is often imposed, leaving the Tenant with no rights to assign or sublet. As the size of the Tenant increases, the right to assign and sublet becomes less and less restricted, but Landlords will certainly look for recapture rights, sole discretionary approval over the use of the demised premises (subject to Tenant-mix), and other traditional controls over the identity of the assignee or subtenant. Most of the time, even larger Tenants cannot negotiate releases in the event of assignment or subletting (though major Tenants and specialty stores may sometimes prevail in individual circumstances). Often there are increases in rental rate, security deposit, threshold of guaranty, etc. in the event of a proposed assignment or subletting, though, again, not usually for the larger or more desirable Tenants. It is also unusual in retail tenancies, as opposed to commercial office tenancies, to have Tenants share in the profit—although specialty Tenants (i.e., health clubs, movie theaters and the like) will often at least recoup the cost of the build-out, either through the reduction before profit-split of unamortized build-out expenses incurred by Tenant, or, in some rare cases, the entitlement of the Tenant to any (or a share in) profit in connection with same.

Within the assignment and sublet clause, another hotly negotiated issue is corporate or affiliate transactions. Landlords will again seek to have control over the demised premises being utilized by another party—even in connection with the sale of all or any portion of the business or assets of the Tenant—and Tenants will likewise seek to have the unfettered right

to transfer the demised premises in connection with such corporate or affiliate transactions. Tenants can almost always successfully negotiate the right to transfer the leasehold in connection with these corporate or affiliate transactions, with the Landlord often negotiating thresholds (such as in connection with all, or substantially all, of the other stores or assets of the Tenant, either in the particular region or, in some cases, nationally). The assignment and sublet clauses are often filled with numerous roadblocks through which the Tenants must pass in order to try to transfer the lease. But, even the smallest Tenants need an exit strategy, and this is usually the most palatable for a Landlord to accept, as opposed to the inclusion of “going dark” provisions and the like, dealt with below.

[24.14] L. Promotional Fund and Advertising Programs

Most malls, and even some urban leases, provide for the contribution by the Tenant in some fashion (i.e., either by payment of a percentage of gross sales, a fixed dollar amount, or a requirement to spend funds in certain activities such as promotional events, a certain number of advertisements in specified media, etc.) to Landlord-controlled promotional and advertising funds. These are usually acceptable to the Tenant, so long as the costs are not extravagant, the Tenant can approve any use of its brand or logo, and the substantial majority of Tenants in the center or building are likewise participating. In urban or street leases, Tenants should make sure to negotiate the right to hold after-hour opening and special events to promote the store, without Landlord consents.

[24.15] III. GENERALLY

Issues such as damage and destruction of the leased premises, eminent domain, and defaults by, and cure notices to, the Tenant are generally comparable to those found in commercial office leases, the negotiation of which will again depend on leverage. One difference, when dealing with retail Tenants, is occupancy requirements. Where commercial office Tenants can often negotiate the right to close the door and leave the demised premises intact—so long as they are currently paying rent and have arranged for the securing and extermination of their space—retail Tenants often cannot negotiate that right, since any “dark” premises will have a bearing on the area of the mall or building in which it is situated, and, potentially, the entire mall or building. This is also dealt with below in the discussion of “going dark.”

[24.16] A. Access by Landlord

As in commercial office leases, retail leases usually allow the Landlord to have access to the demised premises, particularly in cases of emergency, but also in connection with the sale, refinancing or potential leasing of space in the center. While commercial office Tenants usually have little problem with this Landlord right (other than for access by Landlord to certain “secure areas”), the practitioner will usually try to negotiate reasonable notice and for Landlord’s access to be at reasonable times, with a representative of the Tenant present, and in a manner so as to minimize inconvenience. Even these safeguards are not enough for the retail Tenant, which must safeguard its inventory in the demised premises. Accordingly, even in emergencies, retail Tenants will attempt to get telephonic notice to store managers and, potentially, even prohibit the Landlord itself from entering the demised premises under any circumstances (as opposed to entry by fire departments and other governmental agencies).

[24.17] B. Holding Over

Again, while clauses for retail leases often mirror clauses for commercial office leases with respect to holding over, it is an area of great importance for Landlords, inasmuch as they must satisfy the needs of the next Tenant. As dealt with above, the next Tenant intending to occupy the particular space needs to order inventory, specialty items, line up professionals, etc. Therefore, it will likely try to have liquidated damages or other concessions on the part of the Landlord if the Landlord cannot timely deliver possession of the demised premises. By the same token, the Landlord must have stringent requirements and, sometimes, significant penalties if the existing Tenant fails to move out on time. Any liquidated damages should include not only rent and percentage rent, but also take into consideration what the Landlord may need to pay (if anything) to subsequent Tenants taking the space in the event of the delay in delivery of same.

Another method for dealing with holding over is to obtain a “good guy” guaranty from a creditworthy individual (preferably) or entity related or affiliated with the Tenant. The good guy guaranty provides, *inter alia*, that in the event of the holding over in the demised premises by Tenant after the expiration or sooner termination of the Lease, the guarantor would be “personally” liable for all damages occasioned thereby including, without limitation, accrued and accruing rental obligations through the date that the demised premises is surrendered to Landlord in accordance with the provisions of the Lease. From the Landlord’s per-

spective, personal liability can be a most effective deterrent to holding over.

[24.18] IV. RETAIL TENANT SPECIAL CONCERNS

As a practitioner who has historically represented more retail Tenants than Landlords, I have noted a number of issues that are of particular concern to retail Tenants, many of which this chapter covers. The following is a checklist of these items:

- Condition of, and timing for, the initial delivery of the premises (including compliance with laws, particularly those relating to the Americans with Disabilities Act (ADA) and hazardous materials)
- Temporary and permanent utilities (capacities of and locations for distribution within the premises)
- Use of existing improvements and systems
- Compliance with laws, including ADA and those governing hazardous materials, upon delivery of the premises
- Punch list items and latent defects
- Verification of square footage (and adjustments of rental items based upon same)
- Landlord delays in delivery of demised premises (and penalties and termination rights in connection therewith)
- Commencement of term and extension of term through “peak” selling periods
- Continuous operations (i.e., the threshold above which other stores similarly situated in the shopping center must be operating in order for Tenant to be required to continuously operate and pay rent)
- Co-tenancy and “going dark” (“going dark” being the right of Tenant to close its doors for certain periods of time for reasons such as taking inventory, remodeling and alterations, transition to permitted assignees and subtenants, strike, fire or other casualty, breach by Landlord of its obligations under the lease and otherwise poor business in the premises)—the existence and breadth of any such rights of Tenant,

again, being almost completely dependent upon leverage; these rights are particularly significant to a Tenant in a “down” economy

- Restrictions upon Landlord (kiosks, access and visibility, “pop-out” protection, and the like)
- Exclusions from gross sales in calculating percentage rent
- Abatement of rent and interruption of utilities and other services
- Landlord obligations regarding common areas
- Assignment, subletting and disposition of the demised premises—the “exit strategy”
- Tenant’s right to cure Landlord defaults
- Landlord indemnity
- Subordination/Nondisturbance
- Landlord estoppel
- Waiver of Landlord’s lien upon Tenant’s personal property, trade fixtures, inventory or stock in trade
- Impact of Landlord’s renovations and remodeling upon Tenant’s operations in the demised premises
- Tenant’s right to change its trade name, signage and storefront during the term to conform to its local, regional or national branding requirements
- Control over design and construction of interior

Each of these items must be thoroughly reviewed by Tenant’s counsel and negotiated in a manner to suit the operational needs of the particular Tenant. Each Tenant will have different concerns for branding requirements, alterations and marketing, exit strategies, corporate transfers, etc. It is imperative for Tenant’s counsel to have a thorough understanding of these issues, as well as a clear understanding of the Tenant’s standing and leverage in the retail community.

The foregoing is not meant to be exhaustive, but to give the retail leasing practitioner a general feel for issues particular to the retail Landlord/Tenant lease negotiation and relationship. While mentioned numerous times throughout this chapter, it cannot be emphasized enough that these negotiations often come down to the relative leverages of the parties. The range is great: small retail Tenants will often be required to sign leases “as is” (or pretty close, with minimal if any significant revisions thereto), while the larger or more desirable Tenants will often either provide their own form of lease or rider, or be able to negotiate significant revisions to the Landlord’s form. It is the practitioner’s assessment of where the particular Tenant fits in between those two models in the retail community that will make for an effective negotiation.

CHAPTER TWENTY-FIVE

ANCHOR TENANT RETAIL LEASING

Deborah L. Goldman, Esq.

This chapter will focus on special leasing provisions that an anchor tenant or major retail tenant in a shopping center or building would want in its lease. An anchor tenant (or major tenant) typically refers to a large store in a retail shopping center (usually a department store or a movie theatre), which the landlord has strategically rented space to in order to draw in large crowds and funnel them to other stores in the shopping center. It can also refer to stores that have major brand name recognition rather than a large floor plan, like a Starbucks or an Apple Store, which tend to be less than 8,000 square feet. Name recognition and the prestige of these tenants are the appealing factors that will drive in other tenants and shoppers. Because of the value that an anchor tenant can provide the landlord as far as appeal to other smaller tenants and heavy traffic draw, these anchor tenants can negotiate discounted rental rates as well as better lease terms. For example, it's not uncommon for an anchor tenant to reserve the right to approve the selection of the shopping center's other tenants in order to prevent competing (and much smaller) tenants from taking away customers.

Anchor tenants may lease an in-line space in the shopping center or a stand-alone retail space with a large open floor plan of at least 20,000 square feet (usually referred to as a “*big box*”). A big box lease will typically be a ground lease for a pad site where the tenant will construct its own building, and although this discussion does not delve into ground lease provisions, many of the lease terms set forth in the rider below will also apply to the big box lease.

Although retail tenants will usually pay a proportionate share of Common Area Maintenance (CAM) charges, this author has been seeing a trend to move away from CAM charges and towards a fixed percentage increase per year of the lease term. Many tenants prefer this as it provides certainty on the rent. Landlords apparently do as well since it simplifies the billing procedure and eliminates the need to negotiate countless exceptions to what a landlord is allowed to push through to the tenant.

The easiest way to document the negotiated provisions that any lease for a major tenant should contain is to attach to this chapter a standard rider (the “*Rider*”) that tenant’s counsel for an anchor tenant should, whenever possible, attach to a landlord’s form of lease. Ideally, an anchor tenant will have their own form of lease which includes many of the concepts included in this Rider. However, many shopping center owners and Real Estate Investment Trusts (REITs) prefer to use their own form. This Rider collects in one place all anchor tenant-specific provisions that an anchor tenant should seek to obtain in any lease it signs. These provisions

supplement ordinary “reactive” negotiations of the landlord’s form of Lease. These leases would be similar to triple-net leases in that there are few landlord responsibilities, but one common difference is that the tenant might be governed not only by the Lease, but also by a shopping center declaration or reciprocal access and easement agreement, which tenant’s counsel must also review carefully.

- *Comments.* In using this standard rider, consider these issues, among others:
- *Timing.* We recommend presenting this Rider to landlord early in discussions, ideally as soon as (or even before) the parties sign a letter of intent. Anchor tenants should proactively make this Rider the agenda for discussion before landlord makes its Lease the agenda. Even if landlord rejects the whole idea of this Rider, it offers a reliable source for standard language to add to landlord’s Lease.
- *Reference to Rider.* In landlord’s Lease form, typically just before the signature blocks, include a reference to this Rider, such as this:
- See attached Lease Rider (the “*Rider*”), which supplements and modifies this Lease. To the extent inconsistent with this Lease, the Rider governs. The Rider is part of this Lease.
- *Defined Terms.* The Rider defines some terms specific to the Rider. The Rider assumes that landlord’s Lease defines all other capitalized terms. Check that assumption and conform or adjust the Rider as appropriate. For example, the Rider refers to the “Project.” If landlord’s Lease refers instead to the “Center,” adjust accordingly.
- *Exhibits.* The Rider requires some exhibits, all self-explanatory. Work on those exhibits should start as soon as possible during Lease negotiations.
- *Footnotes.* See footnotes for a few specific comments on some provisions in this Rider. The footnotes cannot possibly highlight every provision of this Rider that require thought. Anyone using this Rider should review and adjust everything in it to reflect the business deal for this particular location.
- *Due Diligence.* To the extent that due diligence discloses any issues (e.g., insufficient electric capacity), the Rider can also address them.

LEASE RIDER

This **LEASE RIDER** (the “*Rider*”) is attached to and modifies the _____ Lease dated _____ (“*Landlord’s Lease*”; with this Rider, the “*Lease*”) between _____, a _____ (“*Landlord*”) and [_____], a _____ (“*Tenant*”). Landlord and Tenant modify and supplement Landlord’s Lease as this Rider states.

1. **Rider.** In the event of any inconsistency between Landlord’s Lease and this Rider, this Rider governs and binds the parties. Capitalized terms (a) not defined in this Rider shall have the same meanings as in Landlord’s Lease, as modified here; and (b) may be used in before being defined.

2. **Commencement Date.**

A. The “**Commencement Date**” means the date on which all of the following conditions have been satisfied or waived by Tenant in writing:¹

- (i) Landlord has substantially completed Landlord's Work as set forth on **Exhibit** __ attached hereto and made a part hereof;²
- (ii) Landlord has delivered actual possession and control of the Premises to Tenant, broom clean, vacant and free of all tenancies;
- (iii) Landlord and Tenant have executed and delivered a written notice of delivery and acceptance of the Premises in the form attached hereto as **Exhibit** __;
- (iv) Tenant has received all Government Approvals (as defined below);
- (v) [if there are Hazardous Substances present, add “Landlord has abated all Hazardous Substances from the Property and Premises and provided evidence

1 Everything that must occur before the Commencement Date should be included here. For example, if subordination, non-disturbance and attornment agreements (SNDAs) are required to be delivered prior to the Commencement Date, add that condition here.

2 The concept of Landlord’s Work is not addressed in this Rider, other than with respect to timing. See below.

thereof from the applicable government agency or certified environmental consultant.”]

- (vi) [if new construction, add “Landlord has completed the Common Areas (hereinafter defined) and all improvements thereto, including without limitation the grading and surfacing of all parking lots, drive-ways and sidewalks serving the [Building/Shopping Center] and the installation of all parking lot lighting and landscaping.”]³

As used in this Lease, “*substantially completed*” means that minor “punch list” items remain to be performed, and can be completed without interfering with Tenant’s initial alterations or Tenant’s opening for business at and use of the Premises.

- B. The parties anticipate that the Commencement Date will occur on or about _____ days after a fully executed counterpart of this Lease is delivered by Landlord and Tenant (the “*Scheduled Delivery Date*”). Landlord shall keep Tenant apprised on a bi-monthly basis of the status of Landlord’s Work.
3. ***Delay In Delivery Of Possession.*** Landlord shall satisfy all conditions listed in order for the Commencement Date to occur on or before the Scheduled Delivery Date. Landlord acknowledges that Tenant intends to start construction of Tenant’s improvements on the Scheduled Delivery Date, and that a delay beyond such date will cause Tenant to suffer certain losses which are difficult to quantify including, by way of illustration and not of limitation, lost profits, construction delay costs and employee wages. If the Commencement Date does not occur within 14 days of the Scheduled Delivery Date for any reason, then Landlord shall pay to Tenant, as liquidated damages and not as a penalty, the sum of \$_____ per day accruing from the Scheduled Delivery Date to the actual Commencement Date. **[OR Tenant shall be entitled to 2 days of free Minimum Rent for each day of delay accruing from the Scheduled Delivery Date to the actual Commencement Date]**; provided, however, that if such delay is caused by a Force Majeure Event (as defined below), the Scheduled Delivery Date shall be deemed extended by a period

3 Check with tenant to see if there are more detailed requirements for the premises and the common areas that tenant requires prior to accepting delivery. Some of these may be added as “post-delivery work” rather than as Landlord’s Work.

during which said Force Majeure Event shall cause such delay, but such deferral of the Scheduled Delivery Date shall in no event be deferred by a Force Majeure Event for more than 45 days. Landlord and Tenant agree that the foregoing sum is their best estimate of the daily damages, including but not limited to lost sales that Tenant will incur as a result of Landlord's failure to deliver the Premises. **[If Landlord fails to pay such liquidated damages by the Rent Commencement Date, Tenant shall be entitled to offset such sums against Minimum Rent and, at its option, Additional Rent until fully recouped.]**⁴ If the Commencement Date does not occur within 90 days after the Scheduled Delivery Date for any reason whatsoever, Tenant, at its option, may terminate this Lease upon written notice to Landlord. Such termination date shall not be subject to extensions for any reason whatsoever. If Tenant elects to terminate this Lease, the Lease shall be deemed null and void and of no further force or effect, Landlord shall within 10 business days refund Tenant's Security Deposit (or return and consent to the cancellation of any letter of credit) and any unearned prepaid rent, Landlord shall return to Tenant any guaranty of the Lease or any Lease obligations marked "cancelled" and otherwise confirm the termination of any such guaranty, and neither party shall have any further rights or obligations under the Lease, except those which expressly survive its expiration or termination (all of those events, collectively, a "*Lease Termination*"), and **[in addition to liquidated damages due for the period of delay,**⁵] Landlord shall reimburse Tenant for all of Tenant's expenses incurred in connection with this Lease, including, Tenant's leasing costs, Tenant's store development costs incurred in connection with the Premises, attorneys' fees, design fees, consultant fees (whether the foregoing fees are incurred by outside or in-house personnel), permitting fees, site selection costs, and construction costs, plus all other costs and expenses incurred by Tenant in connection with this Lease and the Premises (collectively, the "*Costs*").⁶ Landlord shall also return all monies previously deposited by Tenant upon execution of this Lease, if any.

4 Delete this sentence if no liquidated damages.

5 Delete bracketed clause if no liquidated damages.

6 Landlord will push back on reimbursing Tenant for its Costs (throughout this Rider) and that's why this provision should be highlighted and outlined in the negotiation of the Letter of Intent (*LOI*). Resist capping the Costs- Landlord is making representations that it can deliver the Premises by a certain date and Tenant is expending huge amounts of money to get the Premises built on time.

4. **Permitted Use.** The “*Permitted Use*” means use of the Premises for these uses: _____.⁷ Tenant may not use the Premises for any other purpose except the Permitted Use.
5. **Exclusivity.** Tenant shall have the exclusive right to operate a _____ in the Project⁸ as the Site Plan delineates the Project (the “*Exclusive*”). Landlord shall cause every future lease and every existing lease that is later amended in any way (including pursuant to Landlord’s discretionary consent to an assignment or subletting) in the Project to prohibit the tenant under that lease from violating the Exclusive. If any other tenant in the Project violates the Exclusive, then without limiting Tenant’s other rights and remedies, so long as that violation continues Tenant shall pay from time to time, in place of Minimum Rent under Landlord’s Lease, an amount equal to [50% of Minimum Rent] [Percentage Rent with a breakpoint of \$0]⁹ (“*Substitute Rent*”). Payment of Substitute Rent shall start as of the first date the Exclusive has been violated and shall continue for a period (the “*Substitute Rent Period*”) that ends on the earlier of: (a) [24] months after it begins; or (b) the date when the violation of Tenant’s Exclusive has been terminated in such a manner that it is not likely to recur (the “*Exclusive Violation Cure Date*”). If the violation continues beyond the Substitute Rent Period, Tenant may terminate the Lease by notice to Landlord (a “*Termination Notice*”). Tenant must give a Termination Notice, if at all, within 90 days after the end of the Substitute Rent Period. If, in that 90-day period, an Exclusive Violation Cure Date occurs, then the Termination Notice shall be ineffective. If Tenant does not elect to terminate the Lease within that 90-day period, then Tenant shall: (a) resume payment of Minimum Rent as Landlord’s Lease requires; and (b) be deemed to have waived its right to terminate the Lease based on that violation of its Exclusive. That does not limit Tenant’s rights or remedies if a later violation of the Exclusive occurs. If Tenant gives a Termination Notice and no timely

7 Be very clear on Tenant’s Permitted Use. Make sure that it is broad enough to cover any future changes in Tenant’s industry (such as “any retail use”) and include incidental uses, such a storage and general office and administrative purposes. Try to avoid any restrictions or requirements on Tenant’s trade name and if there are any requirements, be sure to allow a change in trade name upon assignment or subletting.

8 Adjust all defined terms in this Rider as appropriate. Make sure Lease defines all defined terms not defined in this Rider. Drill down on the meaning of “Project.” Does it include everything we want it to include? If there is a residential portion and office portion of the Project, should the Exclusive apply to those portions of the Project as well?

9 Definition of Percentage Rent will vary with circumstances and definitions in Landlord’s Lease. Adjust as appropriate.

Exclusive Violation Cure Date occurs, then: (a) a Lease Termination shall occur; and (b) Landlord shall within 10 business days reimburse Tenant for the unamortized cost of Tenant's Work based on a 20-year straight line amortization schedule (the "**Unamortized Costs**").

6. **Co-Tenancy Provisions.**

A. **Required Co-Tenants.** The "**Required Co-Tenants**" means (excluding Tenant and the Premises): (a) tenants that (would) occupy at least ___% of the Project's gross leasable area (the "**GLA**"); and (b) [all Anchor Tenants of the Project] [at least 2/3 of Anchor Tenants, rounded up to a whole number].¹⁰ "**Anchor Tenant**" means [_____ and _____, their successors or assigns, or their substantial equivalents reasonably approved by Tenant] [any tenant that occupies or would occupy at least [20,000] square feet of GLA].

B. **Lease-up Contingency.**¹¹

1. Notwithstanding anything to the contrary in the Lease, if, as of _____¹² (the "**Lease-Up Deadline**"), signed leases do not yet exist between Landlord and the Required Co-Tenants (the "**Lease-Up Contingency**"), then Tenant may terminate the Lease by giving notice (the "**Lease-Up Termination Notice**") to Landlord within 30 days after the Lease-Up Deadline (that 30-day period, the "**Lease-Up Termination Option Period**") (but if Landlord satisfies the Lease-up Contingency in the Lease-Up Termination Option Period, then the Lease-Up Termination Notice shall be null and void and of no further force or effect); or (b) if Landlord's Work has been Substantially Completed and Premises are ready to be delivered to Tenant, reject Landlord's tender of possession of the Premises and delay starting Tenant's Work until Landlord has satisfied the Lease-Up Contingency. If Tenant fails to deliver a Lease-Up Termination Notice, then the Lease-Up Termination Notice shall be null and void and of no further force or effect.

10 If the Project has three or more Anchor Tenants use this test. Landlords may want either (a) or (b) but not both. This will be negotiated during the LOI period.

11 Lease-up Contingencies typically apply to new developments only.

12 The Lease-Up Deadline should occur shortly after lease execution so that Tenant doesn't expend too much money on initial development costs.

nation Notice in the Lease-Up Termination Option Period, or if Tenant takes possession of the Premises and starts Tenant's Work at the Premises, then Tenant shall be deemed to have waived its right to reject Landlord's tender of possession and/or give a Lease-Up Termination Notice. If Tenant gives a timely Lease-Up Termination Notice, then: (a) a Lease Termination shall occur; and (b) Landlord shall within 10 business days reimburse Tenant for its Costs, as evidenced by paid receipts therefor.

2. If Tenant accepts Landlord's tender of possession of the Premises on or before the Lease-Up Deadline and thereafter promptly starts Tenant's Work at the Premises, then if the Lease-Up Contingency remains unsatisfied as of the Commencement Date, and Tenant is open and operating its business in the Premises for the Permitted Use, then Tenant shall pay Substitute Rent after the Commencement Date until Landlord satisfies the Lease-Up Contingency. Notwithstanding the previous sentence, in no event shall Tenant be required to open the Premises for the conduct of its business until Landlord satisfies the Lease-Up Contingency.

C. **Opening Condition.**¹³ Notwithstanding anything in the Lease to the contrary and so long as Tenant has not committed an uncured default beyond notice and grace period, Tenant shall not be required to open for business unless and until the Required Co-Tenants are open for business and operating at the Project [the construction of all Common Areas, including (without limitation) all parking areas are substantially complete, all construction equipment and debris have been removed and Landlord has obtained a Certificate of Occupancy for the entire **[Building/Shopping Center]**¹⁴ (the "**Opening Condition**"). If Landlord has not satisfied the

13 Some landlords will try to carve out certain reasons for the failure to satisfy the Opening Condition, like force majeure, casualty, condemnation or the making of repairs or restorations following any casualty or condemnation event. These are usually not acceptable, especially for the initial Opening Condition, and Landlord should bear that risk.

14 If this is new construction, Tenant may want to include this bracketed language as well as part of the "Opening Condition."

Opening Condition as of the Commencement Date,¹⁵ Tenant may: (a) delay opening until Landlord satisfies the Opening Condition; or (b) open for business at the Premises. If Tenant opens for business before Landlord satisfies the Opening Condition, Tenant shall pay Substitute Rent until Landlord satisfies the Opening Condition. If the Opening Condition is not met within __ months after [the date that would have been the Commencement Date had there been no Opening Condition] (the “**Opening Co-Tenancy Election Date**”), then Tenant shall have the option to either: (x) terminate the Lease by giving Landlord notice (the “**Opening Co-Tenancy Termination Notice**”) within 30 days after the Opening Co-Tenancy Election Date (such termination being Tenant’s sole remedy);¹⁶ or (y) if Tenant has not opened for business, Tenant shall immediately open for business. If Tenant elects to give an Opening Co-Tenancy Termination Notice, then: (i) the parties shall have the same rights and obligations as if Tenant had given a valid Lease-Up Termination Notice; and (ii) Landlord shall, without duplication, reimburse Tenant’s Unamortized Costs.

- D. **Post-Opening Condition.** After the Opening Condition has been satisfied, if at any later time (and only for so long as) the Opening Condition is no longer satisfied, Tenant may: (a) pay Substitute Rent;¹⁷ and (b) notify Landlord that Tenant may terminate the Lease if the Opening Condition remains unsatisfied for one year after Tenant’s notice (a “**Termination Warning Notice**”). If Tenant gives a Termination Warning Notice and the Opening Condition is not satisfied within one year thereafter, then Tenant may give a “**Post-Opening Termination Notice.**” A Post-Opening Termination Notice shall have the same consequences as an Opening Co-Tenancy Termination Notice. Notwithstanding anything to the contrary in this Section, if after Tenant issues a Termination Warning Notice, Landlord satisfies the Opening Condition within one year, then the Termination Warning Notice shall be null and void and of no further force or effect.

15 This defined term will vary depending on the terms of LOI, but the Opening Condition should be tied to the date when Tenant is ready to open for business (and/or start paying rent).

16 Tenants may sometimes agree to give a one-year termination warning notice instead of terminating. Landlord would then have one year to satisfy the Opening Condition. In those cases, edit accordingly.

17 Some landlords may require that tenant show a reduction in sales from the previous year as a result of the Opening Condition no longer being satisfied.

- E. **No Other Co-Tenancy Terminations.** If Tenant does not (when entitled to do so) timely give a Lease-Up Termination Notice, an Opening Co-Tenancy Termination Notice, or a Post-Opening Termination Notice, Tenant shall have no other right to terminate the Lease based on absence of any Required Co-Tenants.
7. **Initial Improvements.** Subject to compliance with Laws, Tenant, at Tenant's cost, may install such fixtures and finishes and other initial tenant improvements in the Premises as Tenant deems necessary or desirable for the conduct of Tenant's business in the Premises (the "**Initial Improvements**"). Tenant shall submit the plans and specifications (the "**Plans**") for the Initial Improvements to Landlord for Landlord's review and approval of the structural elements, such approval not to be unreasonably withheld or delayed. Landlord shall have a period of 14 days (the "**Review Period**") to review the Plans. Landlord shall not unreasonably withhold, condition or delay its approval of the Plans.¹⁸ If Landlord shall not respond to such request for its approval within such 14-day period, then Landlord shall be deemed to have approved the Plans as presented unless, on or before the last day of the Review Period, Landlord has delivered to Tenant a written description of the specific structural items in the Plans that are not acceptable and a description of the specific changes that must be made to the Plans to secure Landlord's approval. Tenant shall either (a) submit modified plans for approval; or (b) terminate this Lease if Landlord's requested revisions are not acceptable to Tenant in its sole discretion, in which event a Lease Termination shall have occurred and Landlord shall reimburse Tenant for its Costs. The review and approval process described above shall continue until such time as Landlord has approved the Plans in writing or until this Lease is terminated. Notwithstanding any other provision of this lease, in no event shall Tenant be liable for construction or utility charges or other chargebacks, including (without limitation) charges related to review of Tenant's Plans, architectural fees or similar items.
8. **Subsequent Improvements.** After the installation of the Initial Improvements, Tenant may make such interior non-structural alterations, improvements and additions to the Premises including, without limitation, changing color schemes, installing new countertops, flooring, wall-covering and modifying the layout of the tenant fix-

18 Tenant may also want to add that Landlord's consent is not required for Tenant's contractors or subcontractors. Confirm whether Tenant is obligated to use union contractors in the Building/ Shopping Center- this may substantially increase Tenant's build out costs.

tures, as Tenant deems necessary or desirable without obtaining Landlord's consent. Notwithstanding the foregoing, Tenant shall not make any alterations, improvements, additions or repairs in, on, or about the Premises which affect the structure or the mechanical systems of the **[Building/Shopping Center]** without Landlord's prior written consent, which consent shall not be unreasonably withheld, conditioned or delayed.¹⁹ Landlord shall be deemed to have approved any subsequent improvement proposed by Tenant unless Landlord disapproves of Tenant's proposal in writing within 14 days of receiving Tenant's proposal and request for consent.

9. **Signage.**

- A. **Permitted Signage.** Tenant may install Signage in accordance with all Laws on: (a) all exterior walls abutting the Premises; and (b) all Project monument, pylon, or common signs, as indicated on the site plan attached to the Lease as **Exhibit __**. "**Signage**" includes all signs, designs, monuments, logos, banners, projected images, pennants, decals, advertisements, pictures, notices, lettering, numerals, graphics or decoration that Tenant determines to install or display, including Tenant's or its affiliates' standard national or regional signage requirements as in effect from time to time (the "**Signage Program**"). Landlord expressly approves Tenant's Signage shown on **Exhibit __**.²⁰ Provided that Tenant's Signage Program complies with Law and with Landlord's signage criteria for the Project ("**Signage Criteria**"), notwithstanding anything to the contrary in the Lease, neither (x) Tenant's Signage Program on Tenant's storefront, façade and exterior, nor (y) the graphic content, color or graphic design of any signs on Tenant's storefront that show Tenant's trade name or logo, will require Landlord's approval. Landlord shall obtain approval from the [Village of _____] for Tenant's Signage shown on **Exhibit __** and all building elevations within 12 months after the Effective Date. Landlord's failure to do so shall give Tenant the right to terminate this Lease as provided under the Section of this Lease entitled "Permit Contingency". Tenant may from time to time, without Landlord's consent, replace any Signage. Landlord shall not vary or change the location, size or position of Tenant's signage, including but not limited to the position of Tenant's signage on any pylon

¹⁹ Landlord will want sole consent over structural alterations.

²⁰ Recommend to Tenant to provide the drawings of its Signage while negotiating the Lease and have them approved prior to Lease execution.

or monument signs. [OPTIONAL DEPENDING ON LOI: To the extent Landlord's consent is required, Tenant shall submit plans and specifications for its exterior Signage to Landlord for approval, not to be unreasonably withheld or delayed, prior to submitting the plans and specifications to the local authorities for permitting. Landlord shall be deemed to have consented to such proposed exterior Signage unless Landlord notifies Tenant in writing of its specific objections within 14 days of receiving such proposal.] Landlord shall not allow any signage other than Tenant's to be erected on the exterior walls of the Premises or on the face of the Project or on the roof above the Premises.

- B. *Pylon/Monument Signage.* To the extent that any other tenant installs or has installed any signage on any pylon or monument sign structure, Tenant shall have the right to install equally prominent signage of equal size.
- C. *Coming Soon.* At any time after the parties sign the Lease, Tenant may install "Coming Soon" banners and signage in accordance with Law. If they conform to Tenant's Signage Program, then they do not require Landlord's approval.
- D. *Directories.* All Project directories and way-finding or directional signage within the Project shall identify Tenant and the Premises at least as prominently as any other tenant.
- E. *Interior Signage.* Tenant may, without Landlord's consent, affix window appliques and signs, interior signs and other interior treatments consistent with Tenant's and its affiliates' other stores, provided they are professionally made²¹ and comply with Law. In no event shall any other signage in the Project advertise any _____²² (other than Tenant's).
- F. **OPTIONAL: IF TENANT IS REQUIRED TO COMPLY WITH LANDLORD'S SIGNAGE CRITERIA:** If Landlord changes Landlord's Signage Criteria after Tenant executes this Lease (whether or not the changes are being required by a govern-

21 Some Tenant's may not want to professionally make interior signs unless they are visible from the exterior.

22 Here Tenant's counsel should insert Tenant's specific permitted use. If Tenant operates a movie theater, then no other movie theatre should be advertised in the Project.

ing authority), then Landlord shall submit Landlord's new sign criteria ("**New Sign Criteria**") for Tenant's review and approval (in Tenant's sole and absolute discretion). Tenant shall approve or disapprove Landlord's New Sign Criteria or request modifications to Landlord's New Sign Criteria. Landlord shall reimburse Tenant for the actual cost for Tenant to remove the old signage and manufacture and install its new signage ("**New Sign Costs**") to correspond with Landlord's New Sign Criteria. If Tenant does not approve Landlord's New Sign Criteria or if Landlord and Tenant fail to agree on acceptable revisions to Landlord's New Sign Criteria, Tenant may terminate this Lease by giving written Notice to Landlord. If Tenant does not terminate the Lease and Landlord has not paid Tenant its New Sign Costs within thirty (30) days after Tenant installs its new signage, then in addition to any other remedies Tenant has, Tenant may offset the unpaid amount against Minimum Rent and all other charges (at Tenant's discretion) until the New Sign Costs are fully offset.

10. **Repair and Maintenance.** Landlord, at Landlord's sole cost and expense, [with no direct or indirect contribution from Tenant],²³ shall maintain, repair and make replacements to all elements of the Building²⁴ and the Center (including the Common Areas but excluding the Premises), in a clean, safe and first class manner and in compliance with all Laws, including, without limitation, to the structure, roof, roof membrane, foundation, interior and exterior of windows, mullions and electrical, mechanical systems (to points of connection within the Premises), egress stairs, sewer and water mains outside the Premises (to points of connection within the Premises), fire sprinklers, and fire alarm and exterior. Such repairs, replacements and maintenance shall include (without limitation) (a) the upkeep of all structural components of the Premises, the [**Building/Shopping Center**] and the Common Areas; (b) the maintenance and repair of all parking areas, sidewalks, landscaping and drainage systems on the Property and all utility systems (including mechanical, electrical, and HVAC systems) and plumbing systems which serve the [**Building/Shopping Center**] as a whole and not a particular tenant's premises; (c) removing all snow and ice from the Common Areas, including all parking areas, roads and sidewalks, and provide security service to the [**Building/Shopping Center**]; and (d) daily removal of trash and

23 Insert this language if Tenant is not paying any common area maintenance contribution.

24 Note that if this is ground lease, this would be Tenant's responsibility.

rubbish located in the Common Areas, as well as washing of containers at intervals to maintain them in a reasonably clean condition.. Landlord may allocate the cost of such maintenance and repairs equitably among all tenants, if and to the extent provided in this Lease. **[Delete previous sentence if premises is in a single tenant building]**. Tenant shall have no liability for structural or capital repairs as described above to the Premises or the Building except to the extent caused by Tenant's gross negligence or willful misconduct and not covered by insurance. Landlord shall not be required to maintain the interior surface of exterior walls, windows, doors or plate glass and store fronts within the Premises (except where maintenance of the same is caused by Landlord's negligence or failure to perform its obligations under this Section). Landlord shall make all repairs under this Section promptly after Landlord learns of the need for such repairs but in any event within 30 days after Tenant notifies Landlord of the need for such repairs. If Landlord fails to make such repairs within 30 days after Tenant's written notice to Landlord (except when the repairs require more than 30 days for performance and Landlord commences the repair within 30 days and diligently pursues the repair to completion), Tenant may, at its option, undertake such repairs and deduct the cost thereof from the installments of Minimum Rent next falling due. Notwithstanding the foregoing, in the event of an emergency, Tenant may give Landlord such shorter notice as is practicable under the circumstances, and if Landlord fails to make such repairs immediately after being notified by Tenant, Tenant may immediately undertake such repairs and deduct the cost thereof from the installments of Minimum Rent and all other charges next falling due. Notwithstanding any provision of this Lease to the contrary, any leaks or damage to any water or sanitary drain line located in the plenum of the Premises shall be deemed an emergency which Tenant shall have the right to repair without notifying Landlord, and Tenant shall be reimbursed by Landlord in accordance with the provisions of this Section. In addition, Landlord shall be responsible for the following: (i) any repair or improvement to the Premises necessitated by the negligence or willful misconduct of Landlord, its agents, employees or servants or caused by Landlord's failure to perform its obligations hereunder; or (ii) any seismic or structural upgrades, repairs, improvements or alterations to the Premises or the **[Building/Shopping Center]** (collectively, "*Structural Repairs*"); provided that Tenant, at its cost and expense, shall be responsible for the making of Structural Repairs relating to or resulting from alterations or additions made by Tenant.

11. *Compliance with Laws.*

- A. During the Term, except with respect to Landlord's Work, Tenant, at its expense, shall comply promptly with all Laws pertaining to (a) the physical condition of any improvements constructed by Tenant in the Premises; and/or (b) Tenant's specific business operations in the Premises; provided, however, that, Tenant shall not be required to make any Structural Repairs in order to comply with the Laws unless the necessity for the making of such compliance is attributable to (i) the specific manner in which Tenant uses and occupies the Premises;²⁵ (ii) the negligence or wrongful acts of Tenant, its employees, agents, contractors, customers or other occupants of the Premises, or (iii) if such required Structural Repairs relate to or are attributable to any installations or alterations made by Tenant. Unless same are the responsibility of Tenant pursuant to the preceding sentence, Landlord, at its sole cost and expense, shall comply with all other Laws affecting the Premises, areas adjacent to the Premises, the Common Areas, the **[Building/Shopping Center]** and/or the Property including, without limitation, all ADA requirements. The foregoing or anything else in this Lease to the contrary notwithstanding, Tenant may, at its sole cost and expense, contest the validity or applicability of any present or future Laws. So long as Tenant diligently pursues the contest, compliance with such Laws may be deferred, during the pendency of such contest, provided that (i) Landlord shall not be subject to any criminal proceeding, or any fine, penalty, loss or damage (unless Tenant agrees to indemnify and defend Landlord from and against any such fine, penalty, loss or damage) and (ii) the certificate of occupancy for the **[Building/Shopping Center]** shall not be suspended or threatened to be suspended, by reason of non-compliance or by reason of such contest. Landlord will, at the request of Tenant, cooperate in such contest, provided that Landlord is not required to incur any expense in connection with any such contest.
- B. If the existence of any violation of any Legal Requirement affecting the Premises, the Building, or the Property for which Landlord is responsible pursuant to this Lease prevents or delays Tenant in obtaining a building permit or any required certificates, approval

²⁵ If the lease is for a stand-alone building, Tenant may be responsible for additional legal compliance and may not make the "use" vs. "manner of use" argument. If that is the case, attempt to limit any repair or replacement costs in the last 2 years of the term to no more than \$20,000.

or sign-offs from any governmental authorities that are required to be obtained by Tenant pursuant to applicable Laws, in connection with the Initial Improvements and any other alterations, installations or improvements, Tenant shall be entitled to an additional abatement of all Rent on a per diem basis, equal to the number of days of such delay.

12. **Minimize Interference.** Landlord shall minimize interference with: (i) access to or visibility of the Premises from the Common Areas, (ii) Tenant's conducting of its business in the Premises, and (iii) visibility of Tenant's signage or storefront. If Landlord's activities in the Common Areas interfere with Tenant's business or access to the Premises to the extent Tenant reasonably determines that it cannot feasibly operate its business in the Premises for three consecutive days,²⁶ then Tenant's sole and exclusive remedy shall be an abatement of all monthly Rent during the period commencing on the expiration of such three day period and ending on the date Tenant reasonably determines it can feasibly resume conducting its business in the Premises. If such interference continues for 3 months, Tenant shall have the right to elect that a Lease Termination has occurred by written notice at any time thereafter and Landlord shall reimburse Tenants for the Unamortized Costs. If Tenant is prevented or materially and adversely restricted from using Common Areas, Tenant shall notify Landlord. Landlord will promptly begin (to the extent reasonably practicable) and diligently continue to endeavor to restore Tenant's ability to use the Common Areas.
13. **Protected Areas.** Exhibit __ identifies certain "**Protected Areas**" outside the Premises. Any change to or reconfiguration of a Protected Area shall require Tenant's prior written consent, which may be withheld in Tenant's sole²⁷ discretion. Notwithstanding anything to the contrary in the Lease, at all times in the Term, Landlord shall not cause or permit: (i) any change to any Protected Area that impairs access to or visibility of the Premises or Tenant's Signage, or ability of Tenant's customers to queue or congregate while waiting for film showings; (ii) place anything in any Protected Area that would in any way diminish or interfere with access to the Premises, unless caused

26 Most Landlords will require that Tenant actually stop working in the Premises in order to get the rent abatement, but Tenant should push back to get some rent abatement if its signage or visibility is blocked or if 50% of more of the Premises is unusable.

27 Landlords will want Tenant to be reasonable here. But the whole point of a "Protected Area" is that it is to be protected and not changed, unless a change is required by law.

by casualty, condemnation or Laws; (iii) construct or place, or allow others to construct or place, any kiosk, pushcart or retail merchandise cart (RMU), planting, seating, sculpture, artwork, easel, directory, escalator or other amenity or object of any kind, whether temporary or permanent, in the Protected Area; (iv) place any signage or advertising in the Protected Area, except Tenant's; or (v) sell or distribute, or permit sale or distribution, of any _____²⁸ within ___ feet from the main entrance of the Premises. If Landlord violates this paragraph in any manner and does not remedy that violation within three days after notice from Tenant (except that no such notice shall apply if Tenant previously gave such a notice for substantially the same violation in the preceding 90 days), then so long as Landlord has not cured its violation: (a) Tenant shall be entitled to remove any violating items at Landlord's sole cost and expense; or (b) Tenant shall be entitled an abatement of all Rent until the violation is cured.

14. **Operating Hours/Access.** Tenant shall have access to the Premises, and related Common Areas, through all retail entrance(s) and the right to operate its business 24 hours a day, seven days a week, at no additional cost, to the extent Law allows. Tenant may operate beyond Project standard hours at no additional cost to Tenant . Landlord shall keep the Common Areas or portions thereof, as reasonably necessary, open, lighted, heated and/or cooled for as long after such standard hours as Tenant requests at no additional cost to Tenant.²⁹ Subject to Permitted Closures (as hereinafter defined), Tenant shall continuously use, occupy the whole of the Premises for the Permitted Use for a minimum of ___ hours per week in the aggregate; provided that at provided, that at least ninety percent (90%) of the retail tenants in the [Building/Shopping Center] are open and operating during Tenant's normal operating hours. For purposes hereof, Tenant shall have the right to close the Premises (each, a "**Permitted Closure**") as follows: (i) for not more than five (5) days on two (2) occasions a year for purposes of taking inventory; (ii) for purposes of performing repairs, cleaning or decorating of the Premises; (iii) for purposes of remodeling or refurbishment, not more frequently than one (1) occasion

28 Tenant will want to prevent the sale of any items that are Tenant's primary business within a certain number of feet from the entrance of the Premises.

29 Anchor tenants should not be obligated to comply with an operating covenant, or a "required hours of operation" clause or an obligation to continuously operate. In fact, many anchor tenants will agree that it only has to open for one day at the commencement of the lease term. However, if the tenant agrees to an operating covenant, it should be conditioned on 90% of the remaining gross leasable area being open for business and should allow tenant the right to certain permitted closures.

during any Lease Year, with each closure, not to exceed ninety days and only after not less than ten (10) days' prior written notice to Landlord; (iv) following a casualty which results in damage to or destruction of the Premises; (v) after an event of condemnation; (vi) because of Force Majeure; (vii) as a result of any acts or omissions of Landlord, its employees, agents or contractors; (viii) as a result of any environmental condition, or (ix) any other permitted cessation due to any other express provision of this Lease.]³⁰

15. **Parking:** Landlord shall provide, at no additional cost to Tenant,³¹ areas as designated on **Exhibit** __ (“**Tenant Parking Area**”) where Tenant and its concessionaires, officers, employees,³² contractors, agents, customers and invitees may park their vehicles. The Tenant Parking Area shall comply with applicable Law [and Landlord shall apply for and obtain all variances in connection therewith]. Landlord shall not vary or permit to be varied the existing means of ingress and egress to the [**Building/Shopping Center**] and the Property. [Landlord shall not modify, change or move Tenant Parking Area.] [No modifications made to Tenant Parking Area shall reduce the number of parking spaces below the number of parking spaces Law requires or realign the parking spaces in the Tenant Parking Area in a manner that makes them substantially less accessible to the Premises. If Landlord eliminates more than __% of the Tenant Parking Area, Landlord shall add a number of parking spaces equal to the amount of eliminated parking spaces in an area comparable to the Tenant Parking Area to serve as a reasonable replacement.]³³

16. **Roof Equipment and Generator.** Tenant may, at no additional cost to Tenant, plan, design, construct, install, repair, replace, upgrade, supervise and maintain upon the roof and/or exterior of the Building or elsewhere at the Project (and connect to the Premises): (a) any air-conditioning and electrical equipment, alarm bells and equipment, antennas, satellite dishes, other communications devices and similar facilities (including connections, cables, wiring and conduits,

30 Note that some Landlords will try to have a separate default and maybe even a penalty for Tenant's failure to continuously operate. The answer is that Landlord has its remedies for a non-monetary default and there does not need to be a separate one inserted here.

31 If a parking fee exists, require Tenant to receive the lowest rate offered to any other tenant's patrons. Define the current fee and try to limit increases.

32 Some leases will provide for off-site parking for tenant employees. This depends on the shopping center.

33 Use if Landlord insists on right to change/eliminate parking spaces.

“*Tenant’s Equipment*”), in areas shown on **Exhibit** __; and (b) Tenant’s own dedicated emergency generator (“*Tenant’s Generator*”) (including so-called “automatic transfer switch (ATS) or multiple ATS’s” and all other associated emergency power elements), and fuel tank (“*Tenant’s Fuel Tank*”) in areas shown on **Exhibit** __. Tenant shall have all necessary keys and access codes so that Tenant may access Tenant’s Equipment, Tenant’s Generator and Tenant’s Fuel Tank (the “*Off-Premises Installations*”) at all times without needing to notify, obtain access through or be accompanied by Landlord or Landlord’s agents or employees. Off-Premises Installations shall: (i) comply with applicable Laws; (ii) comply with insurance requirements under the Lease; and (iii) once installed, unless removed by Tenant, be maintained by Tenant at Tenant’s cost and expense. If Tenant removes any Off-Premises Installation, then notwithstanding anything to the contrary in the Lease, Tenant shall repair any resulting damage to the Building.

17. **Utilities.** Landlord shall provide, at Landlord’s expense, connection points within the Premises to all utilities and separate meters for utilities serving the Premises, if not already installed.³⁴ Landlord shall pay all utility connection fees (including without limitation all water and sewer connection fees), traffic impact fees and any other extraordinary fees that are associated with the construction of Tenant’s Initial Improvements or use of the Premises or Landlord’s Work as set forth in **Exhibit** __. Tenant shall pay for: (a) connection of utilities to connection points provided by Landlord; and (b) Tenant’s usage of utilities, directly to each Utility Company,³⁵ with no administrative fee, premium, add-on, meter reading fee, or surcharge of any kind to Landlord. Tenant shall have the right to sufficient utilities and ventilation to support its intended use of the Premises. Without limiting the foregoing, Landlord either (a) represents and warrants that the [**Building/Shopping Center**] has sufficient electrical capacity to allow Tenant to draw ___ amps of service to the Premises without adverse impact on other occupants or the need for an upgrade in utility service; or (b) covenants to upgrade the electrical capacity of the

34 The Lease requirements on Landlord’s Work should also address utilities. Their installation should be a condition to occurrence of the Commencement Date.

35 If utilities are submetered, Tenant may require Landlord to change to direct metering, if possible. If not, any access by Landlord to read the submeter should be subject to the other “Access” provisions in the Rider, and Landlord may not charge Tenant a rate for any utility in excess of the lesser of the rate Landlord pays the supplier of the service or the rate at which Tenant could purchase the services directly through an available supplier, nor may Landlord charge Tenant any administrative fee or charge for reading the meters.

Building prior to the Commencement Date, at Landlord's sole cost and expense, to allow Tenant to draw ___ amps of service to the Premises without adverse impact on other occupants.

18. **Cleaning.** Tenant may, at Tenant's cost, arrange and pay for janitorial service to clean the Premises, using a janitorial service contractor of Tenant's choice.
19. **Trash Removal.** **[IF TENANT IS TO PROVIDE THEIR OWN CONTAINERS, USE THE FOLLOWING:]** Tenant shall arrange for its trash and recycling services and shall pay any costs directly to the company providing such service. Landlord shall provide Tenant with a lawful location on the Property (as shown on **Exhibit**___) to store a trash container and a recycling container adequate for Tenant's needs. Such storage location shall be (a) exclusively for Tenant's use, (b) at least _____ feet long and _____ feet wide, (c) enclosed if required by code or by the terms of **Exhibit** __³⁶ and (d) convenient to the Premises.

[IF THE LANDLORD WILL BE PROVIDING CONTAINERS, USE THE FOLLOWING:] Landlord shall arrange with a waste management company to provide adequate trash and recycling services to the tenants of the **[Building/Shopping Center]**. If Tenant is required to share trash removal or recycling containers with other tenants, such shared containers shall be adequately sized and serviced to handle Tenant's trash and recycling requirements. Landlord shall pay the costs of such trash removal and recycling services (including usage of such containers) directly to the company providing such service.³⁷

20. **Assignment and Subletting.**

- A. **Assignment and Subletting.** Tenant shall not assign this Lease sublet the whole or any portion of the Premises, or permit any third party to use, or occupy any portion thereof without the written consent of Landlord, which consent shall not be unreasonably withheld, conditioned, or delayed. If Landlord's consent is required for an assignment or sublease, then Landlord's consent shall be

36 This refers to the Landlords Work exhibit. Tenant may require that Landlord enclose the storage location.

37 If Tenant is required to pay its pro rata share of trash removal, then it should be at a commercially competitive rate and no administrative charges added on.

deemed to have been given unless Landlord notifies Tenant in writing of the reasons for Landlord's disapproval within fourteen (14) days of receipt of the request. For the purpose of this Lease, any sale or transfer of Tenant's capital stock, redemption or issuance of additional stock of any class shall not be deemed an assignment, subletting or any other transfer of this Lease or the Premises.³⁸ Notwithstanding anything to the contrary contained in the Lease, Landlord shall not have any right to recapture the premises.

- B. ***Permitted Transfers.*** Tenant may, without Landlord's consent and without sharing profits with Landlord, assign the Lease or sublease all or part of the Premises (a "***Permitted Transfer***") to [if there is any restriction on tradename elsewhere in this Lease, add here: "**without restriction as to tradename**"]: (i) an entity directly or indirectly controlled by or under common control with Tenant (a "***Tenant Affiliate***") (the term "***control***" means (a) ownership of 50% or more of all voting stock of a corporation or 50% or more of all legal and equitable interest in any other business entity; or (b) the ability to direct the major business decisions of such entity without prior approval of Tenant's shareholders, partners or other equity holders); (ii)) a successor entity related to Tenant by merger, consolidation, reorganization or government action; or (iii) a transferee having operating experience and reputation at least similar to Tenant's in _____, [with a net worth equal to or greater than Tenant's at the time of the transfer (an "***Equivalent Operator***"). Transferees under clause (i), (ii) or (iii) are "***Permitted Transferees***." If Tenant assigns the Lease to a Permitted Transferee that, with its guarantor, has a net worth of at least [\$10,000,000], Landlord shall release the former Tenant [and Guarantor] from all obligations and liability under the Lease.
- C. ***Assignment or Sublease Profit.*** [Landlord shall not be entitled to any consideration in connection with any assignment or sublet.]³⁹ OR [If Tenant assigns, sublets or transfers (a "***Transfer***") the Lease and that Transfer is not a Permitted Transfer, then Tenant shall pay Landlord, as Additional Rent, 50% of any Assignment Profit or Sublease Profit:

38 In no event should Tenant agree to any increase in rent or security upon transfer.

39 Most anchor or major tenants will not agree to split profits. In any event, there should be no profit splitting in connection with a Permitted Transfer nor if the lease is a ground lease.

1. ***Sublease Profit.*** “***Sublease Profit***” means in any year of the term of the Lease (“***Lease Year***”): (a) any rents, additional charges or other consideration payable under the sublease to Tenant by the subtenant that exceeds all Minimum Rent, Percentage Rent and Additional Rent, accruing in that Lease Year for the subleased space (at the rate per square foot payable by Tenant under the Lease) under the Lease; and (b) all sums paid for the sale or rental of Tenant’s fixtures, leasehold improvements, equipment, furniture or other personal property, less, in the case of a sale, the then net unamortized or undepreciated portion (based on Tenant’s federal income tax returns)⁴⁰ of the amount, if any, by which the original cost thereof exceeded any amounts paid for or contributed by Landlord that the Lease required Tenant to apply against that cost), which net unamortized amount shall be deducted from the sums paid in connection with such sale in equal monthly installments over the balance of the term of the sublease (each such monthly deduction to equal the quotient of the net unamortized amount, divided by the number of months remaining in the term of the Lease); after deducting Tenant’s Costs.

2. ***Assignment Profit.*** “***Assignment Profit***” means an amount equal to all sums and other consideration paid to Tenant by the assignee for or by reason of the assignment (including sums paid for sale or rental of Tenant’s fixtures, leasehold improvements, equipment, furniture, furnishings or other personal property, less, in the case of a sale, the then net unamortized or undepreciated portion (based on Tenant’s federal income tax returns) of the amount, if any, by which original cost exceeded any amounts paid for or contributed by Landlord that the Lease required Tenant to apply against that cost), after deducting Tenant’s Costs.

40 Consider whether to use some other measure as opposed to Tenant’s tax returns. If Tenant uses accelerated depreciation, unamortized cost may be quite low. The same issue arises in Assignment Profit.

3. **Tenant's Costs.** Tenant's Costs shall be deducted from the first available amounts paid to Landlord under this Section, until fully recovered, before Tenant shall be deemed to have recovered any Assignment Profit or Sublease Profit. "**Tenant's Costs**" means reasonable expenses Tenant actually incurred for the assignment or subletting in question for transfer taxes, brokerage commissions, advertising and marketing expenses, attorneys' fees, any commercially reasonable rent credit or concession or work allowance and any alterations Tenant performs, based on bills, receipts or other evidence of such costs reasonably satisfactory to Landlord.]

- D. **Other Transactions.** Notwithstanding anything to the contrary in the Lease, Tenant may, at any time, grant licenses or subleases of departments or concessions for sale of merchandise and services, without Landlord's consent or profit participation.

21. Leasehold Mortgages.

- A. Notwithstanding anything in the Lease to the contrary, Tenant may, without Landlord's consent, mortgage Tenant's interest in the Lease, Tenant's interest in the Building and improvements on the Premises, or any part thereof or property therein, and any sublease, under one or more leasehold mortgage(s) and to assign the Lease and any sublease as collateral security for such mortgages, upon the condition that all rights acquired under such mortgages shall be subject to each and all of the covenants, conditions and restrictions in the Lease, and to all rights and interests of Landlord, none of which covenants, conditions or restrictions is or shall be waived by Landlord by reason of the right given to so mortgage such interest in the Lease, except as this Rider expressly states.
- B. If Tenant mortgages its leasehold, and if the holder(s) of any such mortgage(s) give Landlord a true copy thereof, with written notice specifying the name and address of the mortgagee(s) and (if available at the time) the pertinent recording data for such mortgage(s), Landlord agrees that so long as any such leasehold mortgage(s) shall remain unsatisfied, these provisions shall apply:
 1. There shall be no cancellation, surrender or modification of the Lease by joint action of Landlord and

Tenant without prior written consent of all leasehold mortgagee(s).

2. Landlord shall, upon serving Tenant with any notice of default, simultaneously serve a copy of that notice upon the leasehold mortgagee(s). The leasehold mortgagee(s) shall thereupon have the same period, after service of such notice upon it, as is allowed to Tenant, plus 30 days (plus such further or additional time as the leasehold mortgagee(s) reasonably require for a nonmonetary default), to remedy or cause to be remedied the defaults complained of, and Landlord shall accept such performance by or at the instigation of the leasehold mortgagee(s) in response to any such notice of default as if the same had been performed by Tenant.
3. Notwithstanding anything in the Lease to the contrary, while such leasehold mortgage(s) remains unsatisfied, or until written notice of satisfaction is given by the holder(s) thereof to Landlord or such leasehold mortgage is terminated of record, if any default shall occur, that, pursuant to any provision of the Lease, entitles Landlord to terminate the Lease, and if before the expiration of 30 days from the date of service of notice of termination upon such leasehold mortgagee(s), such leasehold mortgagee(s) notify Landlord of its desire to nullify such notice and pay Landlord all Rent and other payments herein provided for and then in default, and comply or commence the work of complying with all other requirements of the Lease, if any are then in default, and prosecute the same to completion with reasonable diligence, then in such event Landlord shall not be entitled to terminate the Lease as a result of such default and any notice of termination theretofore given as a result of such default shall be void and of no effect.
4. Landlord agrees that the name of the leasehold mortgagee(s) may be added to the "Loss Payable Endorsement" of any and all insurance policies the Lease requires Tenant to carry, on condition that the

insurance proceeds are applied as the Lease specifies, and the leasehold mortgage(s) or collateral documents shall so provide.

5. Landlord agrees that in the event of termination of the Lease by reason of any default by Tenant or any other cause, or if Tenant rejects the Lease in bankruptcy or similar proceedings, Landlord shall enter into a new Lease of the Premises with the leasehold mortgagee(s) or its nominee(s) or assignee(s) for the remainder of the term of the Lease effective as of the date of such termination, at the Rent and upon the same terms, provisions, covenants and agreements as contained in the Lease and subject only to the same conditions of title as the Lease is subject to on the date of its execution and any exceptions to title created by or at the behest or with the consent of Tenant, and to the rights, if any, of the parties then in possession of any part of the Premises, provided:
 - a. said leasehold mortgagee(s) or its nominee(s) or assignee(s) makes written request upon Landlord for such new lease within 30 days after the date of such termination and such written request is accompanied by payment to Landlord of all sums due to Landlord under the Lease;
 - b. said leasehold mortgagee(s) or its nominee(s) or assignee(s) pays to Landlord at the time of the execution and delivery of such new lease, any and all sums that would at the time of the execution and delivery thereof be due pursuant to the Lease but for such termination, and in addition thereto, any expenses, including reasonable attorneys' fees, Landlord incurred by reason of that default;
 - c. said mortgagee(s) or its nominee(s) or assignee(s) shall perform and observe all covenants herein contained on Tenant's part to be performed and shall further remedy any other condition which Tenant under the terminated Lease was obligated to perform under the terms of the Lease; and upon execution and delivery of such new lease, any subleases which may have

theretofore been assigned and transferred by Tenant to Landlord, as security under the Lease, shall thereupon be deemed to be held by Landlord as security for the performance of all of the obligations of the tenant under the new lease;

- d. Landlord shall not warrant possession of the Premises to the tenant under the new lease;
 - e. such new lease shall be expressly made subject to the rights, if any, of Tenant under the terminated lease;
 - f. the tenant under such new lease shall have the right, title and interest in and to the buildings and improvements on the Premises as Tenant had under the terminated lease; and
 - g. said leasehold mortgagee(s) or its nominee(s) or assignee(s) shall bear the cost of recording such new lease or short form thereof if it or Landlord desires recordation thereof.
6. Nothing in the Lease requires any leasehold mortgagee(s) or its nominee(s) or assignee(s) to cure any default of Tenant under the Lease unless such leasehold mortgagee chooses to do so under subparagraph (2) above or chooses to nullify any notice of termination from Landlord under subparagraph (3), or if such leasehold mortgagee(s) elects that Landlord enter into a new lease for the Premises under subparagraph (5) above.
 7. The proceeds from any insurance policies relating to the Premises or arising from a condemnation of the Premises are to be held by any leasehold mortgagee(s) and distributed in accordance with the Lease.
 8. Landlord shall, on request, execute, acknowledge and deliver to each leasehold mortgagee, an agreement prepared at the sole cost and expense of Tenant, in form reasonably satisfactory to such leasehold mortgagee(s) and Landlord, among Landlord, Tenant

and leasehold mortgagee(s), confirming all provisions of the Lease on leasehold mortgagees. The term “mortgage,” when used in this Section, includes whatever security instruments are used in the locale of the Premises, such as, without limitation, mortgages, deeds of trust, security deeds and conditional deeds, as well as financing statements, security agreements and other Uniform Commercial Code documents, and also any documents for a sale and leaseback (or an assignment of lease and sublease) transaction.

22. ***Subordination and Nondisturbance.*** It shall be a condition to subordination of the Lease to any mortgage or lease affecting the [**Building/Shopping Center**] that Landlord obtain on behalf of Tenant (subject to the qualifications in this Section) from any mortgagee or lessor, a subordination, nondisturbance and attornment agreement (an “**SNDA**”); provided that, in the case of any SNDA, it is reasonably acceptable to Tenant and states that Tenant’s use or possession of the Premises shall not be disturbed, nor shall its obligations be enlarged or its rights be abridged hereunder by reason of any mortgage or lease affecting the [**Building/Shopping Center**]. Landlord shall pay the fees associated with obtaining an SNDA for Tenant, except that Tenant shall pay to Landlord all reasonable costs of the mortgagee’s or lessor’s counsel to negotiate the SNDA if Tenant desires changes from such party’s standard form. Those fees, to the extent not paid directly by Tenant to the mortgagee or lessor before issuance of the SNDA, shall be paid by Tenant to Landlord, as Additional Rent under the Lease, within 30 days after Tenant’s receipt of an invoice therefor, in which case Landlord shall, at its election, either prepay (subject to reimbursement by Tenant if not previously paid to Landlord by Tenant) or forward the amount so paid to the party to whom it is due and owing (with Landlord’s contribution thereto, as provided herein if not previously paid by Landlord). The Lease shall be conditioned upon receipt of an SNDA from Landlord’s existing mortgagee and ground lessor, if any.⁴¹
23. ***Furniture, Fixtures & Equipment (FF&E) Liens.*** If at any time or from time to time Tenant desires to enter into or grant any security

41 Sometimes Landlords will need a period of time after lease signing to obtain the SNDA, which is acceptable, provided that, Tenant has the right to terminate if the SNDA is not obtained within x days after lease signing and get reimbursed for its Costs.

interest, financing lease, personal property lien, conditional sales agreement, chattel mortgage, security agreement, title retention arrangement or similar arrangement (including any related financing statement) for Tenant's acquisition or leasing of any FF&E (hereinafter defined) used in the Premises that is leased, purchased under conditional sale or installment sale arrangements, encumbered by a security interest, or used under a license (a "**FF&E Lien**") that otherwise complies with this Lease, then on Tenant's request Landlord shall enter into a Lien Subordination Agreement in a form reasonably acceptable to Landlord and the holder of any FF&E Lien for that FF&E that is subject to an FF&E Lien (such FF&E, "**Financed FF&E**"). If Tenant enters into any FF&E Lien, then Tenant shall: (i) not file (or cause or permit to be filed) that FF&E Lien as a lien against the Premises or any part of the Premises (except the Financed FF&E). "**FF&E**" means all movable furniture, furnishings, equipment, and Tenant's personal property that may be removed without material damage to the Premises and includes items such as factory equipment, furniture, movable equipment, movable telephone and telecommunications equipment, point of sale equipment, televisions, radios, network racks, and computer systems and peripherals.

24. *Environmental Liability.*

- A. *Environmental Law.* The term "*Environmental Law*" means all present and future federal, state and local laws, statutes, rules, ordinances and regulations relating to pollution or protecting human health or the environment including, without limitation, laws, statutes, rules, ordinances and regulations relating to emissions, discharges, releases of hazardous substances, or otherwise relating to the manufacture, processing, distribution, use, treatment, storage, disposal, transport or handling of Hazardous Substances including, without limitation, the Comprehensive Environmental Response, Compensation and Liability Act of 1980, 42 U.S.C. §§ 9601 *et seq.* (CERCLA or "Superfund"); the Resource Conservation and Recovery Act of 1976, 42 U.S.C. §§ 6901 *et seq.* (RCRA); the Toxic Substances Control Act, 15 U.S.C. §§ 2601 *et seq.* (TSCA); the Clean Water Act, 33 U.S.C. § 1251 *et seq.* (CWA); the Clean Air Act, 42 U.S.C. § 7401 *et seq.* (CAA); the Hazardous Materials Transportation Act, 49 U.S.C. § 5101 *et seq.* (HMTA); the Safe Drinking Water Act, 42 U.S.C. § 300f *et seq.* (SDWA); the National Environmental Policy Act of 1969, 42 U.S.C. § 4321 *et seq.* (NEPA); the Superfund Amendments and

Reauthorization Act of 1986, codified in scattered Sections of 10 U.S.C., 29 U.S.C., 33 U.S.C. and 42 U.S.C.; and Title III of the Superfund Amendment and Reauthorization Act, 42 U.S.C. § 11001 *et seq.* (SARA), as the same may be hereafter amended or modified.

- B. ***Hazardous Materials.*** The term “***Hazardous Material***” means any substance which is (a) included within the definition of “hazardous substances”, “hazardous materials”, “toxic substances”, or “solid waste” in or pursuant to any Environmental Law or subject to regulation under any Environmental Law; (b) listed in the United States Department of Transportation Optional Hazardous Materials Table, 49 C.F.R. Section 172.101 enacted as of the date hereof or hereafter amended, or the United States Environmental Protection Agency List of Hazardous Substances and Reportable Quantities, 40 C.F.R. Part 302 *et seq.* enacted as of the date hereof or as hereinafter amended; or (c) a flammable substance, explosive, radioactive, asbestos, asbestos-containing material, polychlorinated biphenyl, chemical known to cause cancer or reproductive toxicity, pollutant, contaminant, hazardous waste, medical waste, toxic substance or related material, explosive, oil or petroleum product.
- C. ***Landlord’s Environmental Covenants.*** Landlord represents and covenants to Tenant that: (a) the Premises and the **[Building/Shopping Center]** comply with Environmental Law; (b) to Landlord’s actual knowledge, the Premises and the Project contain no Hazardous Materials no Hazardous Materials have been released, discharged or disposed of on, under or about the Premises, the **[Building/Shopping Center]** or the Property (or off-site of the Property which might affect the Premises, the **[Building/Shopping Center]** or the Property) by any entity or person, or from any source whatsoever; (c) Landlord’s Work: (i) does not and shall not contain Hazardous Materials; and (ii) shall comply with Environmental Law; (d) there are no underground storage tanks on the Premises, the **[Building/Shopping Center]** or the Property; and (e) no underground storage tanks have been removed from the Premises, the **[Building/Shopping Center]** or the Property. Without limiting the foregoing, Landlord represents that the following constitutes all information in Landlord’s possession or control concerning any release of Hazardous Substances on, under or about the Premises, the **[Building/Shopping Center]** or the Property (or

off-site of the Premises that might affect the Premises, or off-site of the Property that might affect the Premises or the [**Building/ Shopping Center**]) including, without limitation, sampling data, environmental studies or reports, environmental site assessments, building surveys, and historical use reviews (collectively, “*Environmental Reports*.”), all of which have been provided to Tenant: **[PLEASE PROVIDE ENVIRONMENTAL REPORTS FOR THE PROPERTY AS SOON AS POSSIBLE]**

- D. **Removal.** Landlord, at Landlord’s sole cost and expense, shall remove, abate, encapsulate or remediate any Hazardous Materials or threatened Release or disposal of a Hazardous Material existing on the Premises or the Project as of the Commencement Date. If any Hazardous Materials are discovered in the Premises during Tenant’s inspection of the Premises, construction of its Initial Improvements or any subsequent tenant improvements or at any other time during the Term, then Landlord shall promptly remove or encapsulate the same, at Landlord’s sole cost and expense, and if the foregoing delays the construction or installation of Tenant’s Initial Improvements then the Rent Commencement Date shall be extended for one (1) day for each day of delay. Landlord indemnifies and saves Tenant harmless from all claims, liens, losses, damages and expenses, including without limitation reasonable attorneys’ fees and expenses, arising out of: (x) Landlord’s breach of this paragraph; or (y) any Hazardous Materials existing now or discovered later in or on the Premises or the Project, unless Tenant brought them to the Premises or the Project. If it is determined that there are Hazardous Materials on, upon or within the Premises and/or the Project that violate any Environmental Laws or result in action by either local, state or federal environmental agencies, then, Landlord, at Landlord’s expense, shall promptly and diligently, to the extent required by any Laws, including (without limitation) any Environmental Laws, and in compliance with such Laws, remove, abate, encapsulate or remediate such Hazardous Materials. Landlord shall use its best efforts to minimize direct and indirect impact on Tenant, including its operations in the Premises and effective use of the Common Areas, if any, during all activities related to remediation. If in Tenant’s reasonable opinion such violation and/or action materially impairs Tenant’s ability to conduct business upon the Premises and Tenant ceases to operate from the Premises as a direct result, all Rent and charges payable by Tenant under the Lease shall abate during such period as long as Tenant’s

ability to so operate is materially impaired and Tenant is not so operating. If such condition continues for in excess of 6 months, Tenant shall have the right to elect that a Lease Termination shall occur by notice at any time when that condition continues to materially impair Tenant's ability to conduct business upon the Premises and Tenant in fact ceases operations from the Premises as a direct result.

E. ***Tenant's Use Of Any Hazardous Substance.*** Notwithstanding the foregoing, Tenant may use cleaning solutions and other substances that are customarily used in Tenant's business. Tenant will manage such use in accordance with the Environmental Laws.

F. ***Notices.*** Landlord and Tenant shall give prompt written Notice to the other of: (a) any proceeding or inquiry by any governmental authority with respect to the presence of any Hazardous Material on the Premises or the **[Building/Shopping Center]** (or off-site of the Premises that might affect the Premises) or related to any loss or injury that might result from any Hazardous Material; (b) all claims made or threatened by any third party against Landlord or the Premises, the **[Building/Shopping Center]** or the Property relating to any loss or injury resulting from any Hazardous Material; and (c) the discovery of any occurrence or condition on the Premises, the **[Building/Shopping Center]** or the Property (or off-site of the Premises that might affect the Premises) that could cause the Premises or the Common Areas, if any, or any part of either, to be subject to any restriction on occupancy or use of the Premises under any Environmental Law.

G. ***Survival.*** The provisions under this Section shall survive the expiration or earlier termination of the Lease.

25. ***End of Term.*** On expiration or earlier termination of the Lease, Tenant shall: (a) have the right, but not the obligation, to remove any of its alterations, improvements, fixtures, floor coverings, personal property or equipment installed during the term of the Lease; (b) have no obligation to repair any damage caused by that removal; and (c) have no obligation to restore or repair the Premises or the Building in any way.

26. ***Holding Over.*** This Lease and the tenancy created by this Lease shall expire and terminate at the expiration of the Term, without the necessity of any additional notice from Landlord to Tenant or from Tenant

to Landlord. If Tenant remains in possession of the Premises after the expiration of the Term without the written consent of Landlord, the Term will not be extended and Tenant will be occupying the Premises under a tenancy at will, under all the terms, covenants and conditions of this Lease, except that Rent for the holdover period will be calculated on a per diem basis, at a rate equal to (x) for the first two months of holdover, one hundred twenty-five percent (125%),⁴² and (y) thereafter, one hundred fifty percent (150%); and (z) thereafter, two hundred percent (200%), of the Minimum Rent due for the last month of the Term, and shall be due and payable to Landlord on the first (1st) of each month, as during the Term. All other charges shall be at the rate payable during the last month of the Term. This holdover arrangement shall continue until such tenancy is terminated by Landlord or Tenant giving the other at least thirty (30) days' prior written notice of its intention to do so. This provision shall not be interpreted to give Tenant any right to continue occupancy following the expiration or earlier termination of this Lease, except with the prior written consent of Landlord.

27. **Permit Contingency.** Tenant's obligations under this Lease are conditioned on Tenant's obtaining,⁴³ within the later of _____ (____) days of the mutual execution and delivery of this Lease [or one hundred twenty (120) days after the date Landlord delivers to Tenant final plans for the **[Building/Shopping Center]** in an industry standard electronic or digital format that have been approved by all applicable governmental entities],⁴⁴ any permits and/or licenses (including but not limited to conditional use permits, building permits, variances and other governmental approvals) (collectively, "**Government Approvals**") that are required by applicable laws to enable Tenant legally (a) to construct Tenant's improvements to the Premises in accordance with the Plans; (b) to install Tenant's signage on the Premises; and (c) to conduct its business from the Premises. Each Government Approval shall not be subject to any ban, bar, memorandum or unexpired appeal period. Tenant shall, at Tenant's expense, initiate and diligently pursue each Government Approval. Landlord shall execute any applications and shall provide Tenant with

42 Holdover rates should be negotiated down as much as possible. Also try not to agree to indemnify Landlord for any consequential damages for at least the first month of holdover.

43 The Lease may also be conditioned on Landlord obtaining certain permits to construct the Shopping Center if it is a new development. Landlord should use best efforts to obtain those permits.

44 Depends on whether Project is a new development or not.

such further assistance and cooperation as Tenant may require in connection with applications for such Government Approvals. If Tenant does not obtain such Government Approvals on terms satisfactory to Tenant within such period or if any Government Approvals are not renewed or are revoked during the Term of this Lease due to Landlord's conduct, Tenant shall have the right to terminate this Lease.⁴⁵ If Tenant gives a timely termination Notice, then a Lease Termination shall occur and Landlord shall reimburse Tenant for all its Costs within 30 days thereafter. If the Lease Termination is based on Landlord conduct, Tenant shall be entitled to pursue such other rights and remedies as may be available at law or in equity.

28. **Measurement of Building.**⁴⁶ At any time during the first 6 months of the Term, Tenant may engage an independent certified architect or surveyor to measure the GLA of the Premises. If the architect's or surveyor's measurement of the GLA of the Premises is more than the GLA of the Premises set forth in Section __ above, Minimum Rent and Tenant's Proportionate Share (as defined below) shall be proportionally reduced; provided, however, that in no event shall the Minimum Rent and Tenant's Proportionate Share increase by more than three percent. For purposes of this Lease, "**GLA**" means the number of gross square feet of leasable floor area (regardless of whether such area is occupied or enclosed) intended primarily for the exclusive use by an occupant for any length of time, including without limitation garden centers used for the sale and display of merchandise and storage space within or immediately adjacent to an occupant's premises, but excluding any **[Building/Shopping Center]** management office, Common Area maintenance storage areas, and Common Area community room. The GLA of any premises (including the Premises) shall be measured from the exterior face of exterior walls and the exterior face of service corridor walls, the line along the front of the such premises where it abuts the sidewalk or other Common Area (which line is commonly known as the "lease line"), and the center line of any wall that such premises shares with other leasable areas of the **[Building/Shopping Center.]**

45 Sometimes, Landlord will want the right to pursue the permits on Tenant's behalf after Tenant has tried and failed. This is acceptable as long as the period of time is limited to no more than 60 days after Tenant's notice of termination. Then, if Landlord cannot obtain the permits within such time, a Lease Termination shall occur.

46 If Tenant is paying rent on a \$/Sq.Ft. basis or its pro rata share of any expenses or taxes, Tenant will want the right to remeasure the Building and confirm the calculations. If so, insert this section.

29. **Landlord Defaults And Remedies.** The occurrence of any one or more of the following events shall constitute a default and breach of this Lease by Landlord: (a) Landlord's failure to do, observe, keep and perform any of the terms, covenants, conditions, agreements or provisions of this Lease required to be done, observed, kept or performed by Landlord, within 30 days after written notice by Tenant to Landlord of said failure (except when the nature of Landlord's obligation is such that more than 30 days are required for its performance, then Landlord shall not be deemed in default if it commences performance within the 30 day period and thereafter diligently pursues the cure to completion) or with no notice (other than oral) in the event of an emergency; or (b) the failure of any representation or warranty to be true when deemed given hereunder. In the event of a default by Landlord, Tenant, at its option, without further notice or demand, shall have the right to any one or more of the following remedies in addition to all other rights and remedies provided at law or in equity or elsewhere herein: (w) to remedy such default or breach and invoice Landlord the reasonable out-of-pocket costs thereof (including attorneys' fees), including a 5% administrative fee, plus interest thereon at the Default Rate, or deduct such sum from the installments of Rent if not paid within 30 days after sending Landlord an invoice therefor and such failure continues following Landlord's receipt of a second invoice from Tenant for such costs which are not paid within 10 days following Landlord's receipt of the same; (x) to pursue the remedy of specific performance; or (y) to seek money damages for loss arising from Landlord's failure to discharge its obligations under this Lease. Nothing herein contained shall relieve Landlord from its obligations hereunder, nor shall this Section be construed to obligate Tenant to perform Landlord's repair obligations.
30. **Force Majeure.**⁴⁷ In the event that either party shall be delayed or hindered in or prevented from the performance of any covenant, agreement, work, service, or other act required under this Lease to be performed by such party (a "**Required Act**"), and such delay or hindrance is due to causes entirely beyond its control such as riots, insurrections, martial law, civil commotion, war, fire, flood, earthquake, or other casualty or acts of God (a "**Force Majeure Event**"), then the performance of such Required Act shall be excused for the period of delay, and the time period for performance of the Required Act shall be extended by the same number of days in the period of delay. For

⁴⁷ Force Majeure clauses must be mutual and notice should be required.

purposes of this Lease, the financial inability of Landlord or Tenant to perform any Required Act, including (without limitation) failure to pay Rent and/or to obtain adequate or other financing, shall not be deemed to constitute a Force Majeure Event. A Force Majeure Event shall not be deemed to commence until the party who asserts some right, defense or remedy arising from or based upon such Force Majeure Event gives written notice thereof to the other party hereto. If abnormal adverse weather conditions are the basis for a claim for an extension of time due to a Force Majeure Event, the written notice shall be accompanied by data substantiating (i) that the weather conditions were abnormal for the time and could not have been reasonably anticipated and (ii) that the weather conditions complained of had a significant adverse effect on the performance of a Required Act. To establish the extent of any delay to the performance of a Required Act due to abnormal adverse weather, a comparison will be made of the weather for the time of performance of the Required Act with the average of the preceding 10 years climatic range based on the National Weather Service statistics for the nearest weather reporting station to the Premises. No extension of time for or excuse for a delay in the performance of a Required Act will be granted for rain, snow, wind, cold temperatures, flood or other natural phenomena of normal intensity for the locality where the Premises are located.

31. ***Confidentiality Of Lease.***⁴⁸ From and after the date lease negotiations were entered into and throughout the Term of this Lease, the parties shall not disclose any of the terms, covenants, conditions or agreements set forth in the letters of intent or in this Lease or any amendments hereto, nor provide such correspondence, this Lease, any amendments hereto or any copies of the same, nor any other information (oral, written or electronic) which is communicated by or on behalf of Tenant or on behalf of Landlord relating to Tenant's proposed development of the Premises (including, without limitation, architectural plans, specifications, site plans and drawings) or Tenant's business, to any person including, without limitation, any brokers, any other tenants in the **[Building/Shopping Center]** or any affiliates, agents or employees of such tenants or brokers except as set forth herein, without Tenant's written consent or except as ordered by a court with appropriate authority provided Landlord seeks available protective orders. Landlord hereby acknowledges that the disclosure of the foregoing to any third party would cause material damage to

⁴⁸ This Section is very important to most anchor or major tenants and is lacking from most leases.

Tenant, and Landlord agrees to indemnify, save and hold Tenant harmless from and against any and all damages suffered by Tenant which are attributable to any disclosure by Landlord in violation of the terms of this provision. Notwithstanding the foregoing, Landlord may disclose the terms of this Lease to those of its partners, employees, consultants, attorneys, accountants, current or potential mortgagees, lenders or purchasers of the Property who agree to be bound by the terms of this Section and Tenant may disclose the terms of this Lease to those of its partners, employees, consultants, attorneys, accountants and current or potential lenders, assigns or subtenants who agree to be so bound.

32. *Miscellaneous*.⁴⁹

- (a) If any Superior Mortgagee or Master Landlord shall require any modifications(s) of this Lease, Tenant shall, at Landlord's request, promptly execute and deliver to Landlord such instruments effecting such modification(s) as Landlord shall require, provided that such modification(s) do not, in any respect, adversely affect any of Tenant's rights under this Lease or increase Tenant's obligations.. Landlord shall reimburse Tenant, on demand, for any out-of-pocket costs incurred by Tenant in connection with any such modifications.
- (b) Anything in this Lease to the contrary notwithstanding, in no event shall either party have any liability to the other for consequential or punitive damages for breach of any provision of this Lease.
- (c) In the event that Landlord or Tenant shall bring an action to recover any sum due hereunder or for any breach hereunder and shall obtain a judgment in its favor, or in the event that Landlord or Tenant retains an attorney for the purpose of collecting any sum due hereunder or construing or enforcing any of the terms or conditions hereof or protecting their interest in any bankruptcy, receivership, or insolvency proceeding or otherwise against the other, the prevailing party shall be entitled to recover all reasonable costs and expenses incurred, including reasonable attorneys' and legal assistants' fees prior to trial, at trial, and on appeal and for post-judgment proceedings. Further, either party shall be entitled to its reasonable attorneys' fees and costs incurred in connection with

⁴⁹ There are many miscellaneous provisions that can be added to this Rider. This Rider just lists a few that would be "non-standard" for a typical lease, but very appropriate for an anchor tenant.

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pursuing and/or collecting any past due sums due from the other party hereunder regardless of whether or not a lawsuit is filed.

- (d) Notwithstanding the foregoing, with respect to any remedy exercised by Landlord, Landlord shall have an affirmative obligation to obtain another tenant for the Premises promptly, at a fair market rental, and to otherwise mitigate its damages.⁵⁰

50 Some Landlords may limit this only if required by applicable laws. Strike that limitation for any anchor tenant-applicable law is subject to change and tenant wants the certainty of an contractual covenant for mitigation. That being said, Landlord should not be required to accept a tenant for the Premises that does fit the “mix” of the Shopping Center. Changing the affirmative obligation to “commercially reasonable efforts” is also acceptable.

CHAPTER TWENTY-SIX

**TELECOMMUNICATIONS
LEASES AND LICENSE
AGREEMENTS**

Jeffrey A. Moerdler, Esq.

[26.0] I. FOUND MONEY: NEW OPPORTUNITIES IN TELECOMMUNICATIONS AGREEMENTS¹

Editor's Note: Telecommunications firms invest an enormous amount of capital in their technology and equipment. That investment will not pay off until this equipment (such as antennas, wiring and related transmission facilities) is installed and functioning. Equipment placement is critical, and many existing but unused commercial spaces present prime locations. Practitioners involved with such leasing transactions need to be aware of the issues that accompany these situations.

The title of the first article that I wrote on telecommunications leasing in 1998, from which this chapter is adapted, was “Found Money,” and it is still very true. If someone came to you and offered you anywhere from \$10,000 to \$200,000 to add to your property’s bottom line every year, with zero investment expected on your part, you might be skeptical. The truth is, that exact opportunity exists as a result of new and evolving telecommunications technology—it is possible to rent out previously unusable rooftop, building setback, and other interior space, and receive income for allowing telecommunications companies access to your building and your tenants. To appreciate the value these spaces can bring to your business, it is important to understand the types of new telecommunications technologies that are out there, their uses, their space needs, and the legal and business issues they raise.

[26.1] A. Background

The Information and Technology Age created a new type of real estate lease—the telecommunications lease or license agreement. Previously, cellular phones, smart phones, portable laptop computers, tablets and other electronic devices essentially did not exist in the workplace. Today they are commonplace and vital tools that have become both personal and business necessities. Similarly, wireless and mobile technologies allow for wireless use of laptops and other portable electronic devices not only at the office and at home, but also at hotspots including hotels, pools, retail stores and eateries, and even in a car, train or airplane. The transmission facilities required by these technologies can be placed in existing otherwise unusable space in all types of properties and thereby create a new source of income for the property. For example, a typical office

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building in an urban area may be able to add one to 10 small rooftop or in-building antennas. At an average monthly rental rate in Manhattan of \$2,000 to \$2,500 for a typical set of three cellular antenna arrays facing in different directions on the roof or side of a building and related equipment (or \$500 and up per month in other urban markets), and with other levels of market-rate prices for other types of antennas such as Wi-Fi, Wi-MAX, pagers and fixed wireless antennas in a well-situated building, with knowledgeable and proactive leasing and management or appropriate consultants, these facilities could generate income of \$25,000 to \$300,000 per year.

If it is a cell site, the telecommunications tenant pays all the installation expenses for its facilities, plus the cost of the utilities it uses, and the only costs to the property owner are the transaction costs of the lease. For most other telecom tenants, such as fiber optic carriers and microwave antennas, the tenant generally pays the majority or all of the installation expenses plus utilities. Accordingly, the income from most of these leases translates almost directly into increased net operating income and, hence, into increased sale or financing proceeds. The biggest exception to this is Distributed Antenna or In Building Wireless Systems as discussed below.

Most important, these technologies have become ubiquitous; buildings without both wired and wireless high-speed data service and good cellular telephone reception can be at a distinct disadvantage when marketing to potential tenants or occupants. While location, rent space, layout and similar factors remain the principal determinative factors for tenants, it has now become common for the telecommunication infrastructure of a property to be a major distinguishing factor among the short list of locations that receive final consideration, particularly for financial service firms, law firms and other larger space users. Many owners of larger properties are at a disadvantage because they are not proactively bringing multiple redundant high speed data providers, wireless data providers, cellular carriers and other new technologies into their properties to maintain a competitive edge. As part of the WiredNYC initiative, New York City, through the Wired Score program, certifies the level of connectivity of commercial office buildings in an effort to encourage increasing levels of connectivity and give tenants a way to compare the connectivity of different properties.²

2 See <https://wiredscore.com>.

[26.2] B. Types of Telecommunications Facilities

Cellular and Other Small Rooftop Antennas. In urban areas, the transmission systems for cellular telephones and many developing new technologies are small rooftop antennas, usually 5 to 10 feet or less in height and diameter. These small rooftop antennas service various types of technologies, including PCS (personal communications services) equipment, Wi-Fi, and Wi-MAX services (wireless high speed data services), specialized mobile radio, fixed wireless services, and paging services.

Larger Rooftop Antennas. Satellite and microwave reception and transmission antenna dishes, which can be as small as twelve inches in diameter but are more commonly 3 to 6 feet or more in diameter, can also be installed on rooftops. These networks are generally installed for tenants on the roof of the building where they occupy space. Their uses range from data transmission for financial services to video conferencing.

Broadcast Antenna Towers. Tall antenna towers broadcast radio and television signals throughout the country and cellular and PCS signals in non-urban areas. These towers are located on top of the tallest buildings in urban areas or on a 50- to 150-foot-tall tower outside urban areas. Co-location allows multiple antennas for different technologies to be located on a single tower so that one tower could include one or more TV or radio station transmitters, serve as both a cellular and a PCS antenna location, and also have several satellite and microwave repeater antennas pointed in different directions.

Distributed Antenna or In-Building Wireless Systems. Cellular telephone networks were originally designed to provide cell phone service to people at street level, either driving in cars or walking on the streets. As technology has evolved over the last ten years, cell phones and cellular data networks are also heavily used inside buildings for iPhones, iPads, other tablets and laptops. This increased indoor traffic, plus the difficulty in providing service inside buildings constructed with lots of concrete and steel, results in poor or no reception in buildings, particularly in or near the elevator lobbies in the core on each floor, in stairwells and inside the elevators. The need for better reception inside buildings and the strain that these added high volume data users put on the network have led to the development of Distributed Antenna Systems also known as In Building Wireless Systems or DAS Systems. These are small cellular antennas installed throughout the building with one or more on every floor and a single master transmitter which combines the signals of multiple carriers such as Verizon Wireless, AT&T Wireless, Sprint/Nextel and T-Mobile

and transmits all of those signals out over this network of small antennas throughout the building. We will discuss these systems in more detail later in this Chapter.

Communications Closets. Many telecommunications companies—wireless, Internet-access providers or competitive local exchange companies (CLECs)—need a small amount of space, either in a stand-alone equipment cabinet or a communications closet in buildings which they serve or as connection or retransmission points along their networks. Like rooftops, this is space that is not ordinarily rentable except possibly as storage space at a much lower rental rate.

Wiring Smart Buildings. New technologies require the ability to transmit more and more information at faster and faster speeds. Ordinary copper telephone lines are no longer sufficient for many businesses and even for individuals who don't want to wait for Internet Web pages, documents or videos to be downloaded to their computers. For higher-speed service, several types of technologies are available, such as numerous levels of fiber optic and copper wiring, WiFi and Wi-MAX service, point to multi-point data transmission service, DSL or Integrated Services Digital Network service (ISDN) (which are all-digital, high-speed phone lines), or even faster T-1 or T-3 phone lines. In order for property owners to retain existing tenants with increasing technology and information transmission needs and to attract new high-tech or technology-conscious tenants to their properties, they must have these capabilities along with greater electrical capacity (eight to twelve watts or more per square foot, instead of three to five watts per square foot), air-conditioning capacity to cool all of this equipment, and risers and equipment rooms available for tomorrow's new technology.

Wiring an existing office or residential building, particularly an occupied building, is very expensive. Although costs depend on the specific configuration of the building, the type of cabling or wireless infrastructure and the number of "drops" to separate tenants, wiring a typical office building with fiber or wireless infrastructure and equipment for Internet access can cost several hundred thousand dollars or more. As an alternative, during the past few years private companies would often wire a building at little or no cost to the owner, lease access to the infrastructure to the tenants and share the income or profits with the owner or pay a flat rental-type fee; however, with the economic upheaval and price competition in the telecommunications industry during the past ten years and with carriers viewing their services as a required building service rather than an option amenity, the opportunity to wire a building at no cost to the owner

varies depending on the telecommunications infrastructure existing in the building, the size of the building and the number, types and sizes of the occupants of the building.

[26.3] C. Making the Most of This Opportunity

With proper planning, telecommunications “tenants” of an office building can generate anywhere from \$300 to \$2,500 per month per deal—income that really adds up—particularly because it is almost always triple net income direct to the bottom line without any additional expenses.

Along with opportunity comes the need to take a cautious approach to choosing which telecommunications service providers to “invite” into your building. The onus is on the building owner or property manager to carefully manage the procedures and standards for access to their real estate and to be certain that they utilize the best service providers available and have the right types and diversity of providers in the building.

The first step in the process is generally educational—new clients, both property owners and tenants, want to hear how this type of agreement affects their rental space, which service providers have the most to offer their property, what the business and legal issues are, and what type of deal should be negotiated. Many landlords and property managers don’t realize the potential income telecommunications agreements can generate and marketing benefits they provide. Because they are unfamiliar with this type of deal, they often think the lease is like a revocable license for removing their garbage—rather than understanding that, like a long-term lease, it requires greater protection for the owner and, if properly handled, creates a quantifiable asset upon sale or financing.

The average real estate owner initially doesn’t fully understand the impact that telecommunications tenants will have on his or her business, as well as the legal issues that are ever-present. Issues like rental rates, alteration rights, maximizing the use of riser space, interference, lease term and renewal options, the tenant’s creditworthiness, scope of installation, permits and approvals needed and status of assignment and subletting rights must all be taken into consideration.

Real estate is a highly competitive business—any landlord can tell you that. Any edge you have on the competition can make a difference. Using telecommunication agreements to your advantage is an edge that a smart landlord just can’t afford to ignore.

[26.4] II. THE LEGAL INS AND OUTS OF TELECOMMUNICATION LEASES³

True or false: All real estate leases are created equal.

If you guessed true, you might want to think again. Although most real estate leases are cut from the same cloth, telecommunication agreements are another matter altogether. Telecommunications agreements—which dictate the terms for leasing or licensing space to accommodate rooftop antennas, antenna towers, inside-building wiring and communication closet leases—demand a different perspective than that applied to the run-of-the-mill real estate lease. This equipment is vital to today’s technology services including cellular, wireless and paging services and high-speed data transmission. Although a landlord might be anxious to mine this windfall of financial potential—telecommunication agreements often utilize previously unused and unprofitable space—it is wise to proceed with caution. Here are some key legal issues that must be considered before a long-term commitment is made.

Lease vs. License Agreement: With the exception of broadcast antenna towers and large antenna tower leases, most landlords prefer to call the agreement permitting the installation of a rooftop antenna, communications closet or the wiring of a smart building, a license agreement rather than a lease. Generally, a license agreement vests less rights in the licensee than a lease vests in the tenant, making it faster and easier for the building owner to terminate the agreement and remove the occupant from the property in the event of a default. While such a general legal difference exists, the fact is, telecommunications license agreements fail many, if not all, of the tests that differentiate leases from license agreements. Therefore, the building owner should be aware that, while utilizing the term “licensing agreement” may offer psychological comfort, legally, it will be treated much like a lease.⁴

Scope of Installation: The document should clearly detail the scope of the equipment to be installed. This very specific reference should include an itemization of all equipment and/or a plan showing not only the space leased but also the specific equipment to be installed, and its location.

3 Reprinted with permission (and with updates, substantial revisions and format changes) from February 15, 1999, issue of *Mortgage & Real Estate Executives Report*, published by West Group.

4 The only reported case on this topic held a cell site license agreement to be a lease. *Nextel of N.Y. v. Time Mgmt. Corp.*, 297 A.D.2d 282, 746 N.Y.S.2d 169 (2d Dep’t 2002).

Such a definitive listing can avoid any disputes and maximize the remaining space available to the property owner for other telecommunications agreements or other uses. The agreement should also spell out the proposed physical improvements to be made by the telecommunications provider.

Permits and Approvals: The Telecommunications Act of 1996 preempted local regulations, particularly zoning regulations, which prohibit small telecommunications antennas of one meter or less in diameter, subject to exceptions where reasonable health or safety regulations are involved. Nonetheless, in many cases, special zoning variances, building permits, FCC licenses or other governmental approvals are required for the installation and operation of a telecommunications antenna⁵ and specific requirements apply to properties containing telecommunications antennas.⁶ The tenant will want to have its obligations, particularly the obligation to pay rent under the lease or licensee agreement, conditional and effective only upon the tenant obtaining the necessary approvals. While a reasonable period of time must be allowed for this process, the property owner must be protected by setting a definite deadline by which (1) the tenant can exercise its right to terminate, or (2) the tenant must begin to pay rent, approvals or no approvals. While setting a deadline might not result in rent actually being paid on time, at the very least the existence of the date can institute a dialogue between the landlord and the tenant about the status of the approval process and the project in general.

Assignment and Subletting: Unlike a traditional real estate lease, it is appropriate to restrict the assignment and subletting rights under a telecommunication lease, particularly one that does not involve a large antenna tower. It is usually advisable to require the owner's approval for any transfer of the lease, except in the case of the transfer of the tenant's FCC license to operate its PCS, cellular or other communications system,

5 See N.Y.C., N.Y., Technical Policy and Procedure Notice #5/98 (July 1, 1998), <https://www1.nyc.gov/assets/buildings/ppn/tppn598.pdf>, which indicates that an alteration permit is not required to install an antenna if the building has a use independent of the antenna, if the antenna does not extend more than 6 above the height of the roof or parapet on the roof, or 6' above any penthouse or bulkhead (if mounted on such), if the antenna does not have a footprint greater than 8.45 square feet (or 1 meter in diameter), and if the equipment does not occupy more than 5% of the floor area of the lot (or 400 square feet, whichever is smaller).

6 See N.Y.C., N.Y., ADMIN. CODE, tit. 29, ch. 2 § 504.4 (2008), http://www.nyc.gov/html/fdny/pdf/firecode/2009/fire_code_ll26_2008_amended_ll37_41_64_2009_final_complete.pdf, and N.Y.C., N.Y., Technology Management Bulletin 02/2011 (Feb. 20, 2013), http://www.nyc.gov/html/fdny/pdf/fire_prevention/otmb_02_2011.pdf (hereinafter TMB 02/2011), requiring (1) unobstructed rooftop access locations and landings, (2) clear path clearances, (3) rooftop door opening clearances, and (4) fire escape clearances.

the transfer of all of its assets in the market in which the antenna site is located, a merger or an affiliate transfer. The telecom tenant will of course push back and seek little or no approval rights or an agreement that the landlord will be reasonable in granting all approvals.

Representations: Because of the detailed technical requirements associated with telecommunications agreements, an extensive investigation of the state of the physical property, its suitability and the availability of utility services may be necessary on the part of the tenant. The owner is customarily not involved in this procedure, and should require the tenant to acknowledge that any necessary investigations were carried out solely by the tenant to its full satisfaction.

Alterations: In a typical real estate lease, alterations are greatly restricted. These same alterations are vital to a telecommunications agreement, especially as they relate to electrical power and ability to upgrade their equipment. A property owner should expect to allow a tenant to make necessary alterations without regard to the usual distinction between structural and non-structural alterations, although subject to a reasonable plan approval right. Restrictions can also be placed on alterations, repairs and replacements which augment tenants' facilities and uses more space than the original equipment. It is fairly standard for the tenant to have the right to install (and pay for) additional utility lines, provided they do not in any way hamper service to existing tenants.

Access: In most cases, building owners restrict access to the roof, mechanical floors and some areas of the basement. Obviously, the telecom tenant needs around-the-clock access to its equipment, but the owner should require appropriate advance notice except in the event of an emergency. The owner may want a representative to accompany the tenant to assure that no other equipment is adversely impacted by any actions taken. Also, if a building does not have 24-hour staff, the owner may be able to restrict the telecom tenant's access to the building's business hours as long as emergency access can be provided after hours.

Relocation Rights: With respect to rooftop antennas, it is critically important for the property owner to have the right to relocate the antenna, wires, cabling or other equipment. It is impossible to plan in advance for every potential use for a property, so flexibility is important. These provisions are generally critical points of negotiation—issues like paying for the cost of relocation, how much notice should be given, whether the relocation will only be permitted on a temporary basis or may also be a per-

manent relocation, when the relocation will occur and how the relocation will affect existing service must be worked out in advance.

Subordination and Other Financing Provisions: Telecommunications tenants often insist on using their very simple standard form of lease that may not have provisions standard to a real estate lease—provisions that may affect that lease’s financeability. In particular, the tenant’s form is likely to omit any subordination provision, leaving the lease superior to all future mortgages and ground leases. If a subordination provision is added, as it should be, the tenant may request nondisturbance protection, something that would be very unusual for the owner to request for a small telecommunications agreement and very difficult for the owner to obtain. Similarly, an attornment provision should be added, providing that the tenant will attorn to any new owner of the property after a foreclosure, and that the tenant will provide estoppel certificates and minor lease amendments where necessary to satisfy a lender.

Hazardous Materials and Environmental Concerns: In addition to the standard environment and hazardous material provisions, a telecommunications agreement should also contain a provision allowing the landlord to terminate the lease if it can be reasonably shown that the equipment poses a health hazard. This is wise in the face of ongoing controversy over the impact of electrical and magnetic radiation fields upon the human body.

Termination Options: It is rare that a telecom tenant will agree to give a property owner a termination option such as a demolition clause allowing the lease to be terminated if the building is going to be demolished because of the cost and effort required to relocate a telecom antenna, particularly a cell site or a broadcast antenna tower.

In light of these issues, it is clear that not only are all leases not created equal, but telecommunication leases demand extra attention before signing on the dotted line.

[26.5] III. HOW TO MANAGE THE BUSINESS OF TELECOMMUNICATIONS AGREEMENTS⁷

It sounds too good to be true: previously unused interior and rooftop space can generate a sizable rental income. But as any savvy business person knows, if something seems too good to be true, there is need to exercise caution. When it comes to negotiating and managing telecommunications agreements, the property owner should beware. Here are a few key business issues to take into consideration before signing on the dotted line. As in every other area of business, the more information you have at your disposal, the better your position.

Rental Issues: Although rental rates can vary greatly, even within the same market, standardization has occurred, particularly with respect to small rooftop antennas. For example, the going rate for cell sites in Manhattan is about \$2,000 to \$2,500 per month per property with the installation, including a set of three arrays of antennas (each array containing 3-4 antennas facing in one direction), an equipment room or space to install an equipment shed on the roof of the building or in a yard and related equipment and wiring. A carrier bringing fiber optic connectivity into a building will pay anywhere from several hundred to several thousand dollars per month depending on the size and tenant demographics of the building. The rental rates for other types of small rooftop antennas such as pager and fixed wireless antennas, larger rooftop antennas and building wiring tend to be very negotiable, depending upon the bargaining power of the tenant, the location of the property and the volume of available space in other nearby buildings suitable for the specific use. Negotiating points would include the right to add future antennas or other equipment, which would in turn affect the rate the property owner could charge.

In the case of wiring to create smart buildings, there are three basic solutions, depending upon the needs of the building. The owners can either arrange at their own expense to install the necessary wiring, hire a single preferred building service provider to perform the installation at no charge and then lease usage of that communications equipment to existing tenants with profits shared between both parties, or bring multiple separate service providers in to wire the building. Types of DAS System solutions are discussed below.

⁷ Reprinted with permission (and with updates, substantial revisions and format changes) from March 1, 1999, issue of *Mortgage & Real Estate Executives Report*, published by West Group.

Data centers, telecom carrier switch facilities and large broadcast antennas rent for a substantially higher rate than rooftop space, depending on where they are located. Understanding the market rate for the particular use is important in negotiating the best deal.

Lease Term and Options: When deciding on the term of an agreement, it may be in the owner's best interest to give the tenant the shortest possible term, so that the property will not be tied up for an extended length of time. Renewal options are always in the service provider's favor, so the property owner will generally want to avoid giving options altogether. You will most likely be looking at a five-year lease for a small rooftop antenna, with the service provider seeking several five-year renewal options or a total potential term of 15–20 years or more, with longer terms frequently in effect for broadcast antenna towers, data centers and switch facilities because they require a substantial capital investment to build and maintain.

Creditworthiness of the Tenant: Although some large telecommunications companies interested in leasing space are well-known and well-capitalized, there are new players emerging every day and mergers as well as bankruptcies of existing players abound. It behooves the landlord or property manager and also the lender to carefully analyze and investigate the creditworthiness of the tenant, its track record, and chances of future stability before making a commitment.

Desirability of Use: Early on in the process of leasing space to telecommunications tenants, the landlord must seriously consider the big picture. The average office building owner is used to dealing with tenants that have little, if any, effect on the building outside of their particular space. In this case, you must think about the effect a rooftop tenant will have on your building and your core business of renting space in the building. Look beyond the dollars and cents, as tempting as the bottom line might be. For example, adding rooftop antennas that are visible from the street to a shopping center may have a negative impact on the marketability of the property to future image-conscious tenants.

Environmental Concerns: Objections from existing space tenants, particularly in residential buildings, are common when the issue of telecommunication antennas is raised. With the exception of large antenna towers, all of the technologies operate at very low power, generally 10 to 100 watts. This is not believed to have any significant adverse health or environmental impact, although the psychological impact can occasionally have a negative effect on your building's marketability. Larger

antenna towers, such as those used by radio and television stations, however, can pose serious health and environmental risks at close range if not properly operated, which is why their placement, operation and proximity to people is subject to substantial regulation by the Federal Communications Commission, the Occupational Health and Safety Administration and other governmental agencies and any telecom tenant should be required to comply with all of those governmental regulations.

Electricity and Other Utilities: Be sure there is sufficient access to electricity and other utilities to cover present and future telecommunications usage. Generally, telecommunications companies hire their own experts to evaluate a property under consideration early in the site selection process. A landlord must be sure that the incoming telecom tenant doesn't impede or detract from existing utilities available to present or future tenants, and is prepared to pay for all costs associated with its own usage. A telecom tenant will generally install any additional electrical capacity that it requires at its own expense.

Physical Constraints: The property owner must be aware of the building's physical constraints—can the roof bear additional weight or will structural supports be required? Other issues that require investigation include how the new equipment will affect the roof warranty, how much space is already taken up by existing equipment, if the new equipment will cause interference with the old, and if sufficient riser space is available for the wiring that connects the roof to utility and other building systems.

Exclusivity: When the world of telecommunication leases first opened up, it was common for tenants to try to get exclusive control of an entire rooftop, without telling the landlord that they, in turn, were going to sublet space. The landlord would end up giving away the entire roof for the price of one antenna. Similarly, some carriers providing services to tenants in a building would ask for exclusive or preferred marketing rights although as discussed below some of these exclusives have been prohibited by the Federal Communications Commission.

Rooftop Managers: Specialized companies now act as rooftop managers for the landlord. These companies typically provide three types of services: (1) they act as the leasing agent or landlord's broker locating and negotiating with telecommunications providers based upon the extensive specialized relationships that they have with, or data bases of available locations that they provide to, the telecom providers and, more importantly, the engineers at the providers who usually determine the location

of these facilities; (2) they serve as the property manager for these facilities, billing and collecting rent or access fees, obtaining and reviewing insurance evidence and providing customary property management services; and (3) they provided specialized engineering services in reviewing the plans for these facilities and in supervising the installation of wiring, equipment and antennas. As long as the landlord is aware of his or her options, each situation can be fairly evaluated.

Attracting Cell Sites—The Need for a Rooftop Manger: It should be noted that a landlord cannot call up a cellular company and get them to look at a particular property as a potential cell site location. Cell site location decisions are engineering decisions made not based on an available location but based on gaps in existing cellular networks. Remember back to Venn Diagrams from High School (overlapping concentric circles) or a beehive layout, a new cell site goes in the gaps between the circles or between the transmission patterns of existing nearby cell sites resulting from changes in usage patterns, such as the construction of a new building blocking service to an area or similar facts. Carriers first decide where they need to add a cell site and then look for available locations in that area. This is done by the carrier establishing a “search ring” or small area where they need an additional location by latitude and longitude, and then they typically hire a site selection company which acts as a specialized brokerage firm that locates and generally then also gets all the necessary permits and approvals for a new cell site. That site selection company then usually first checks the data bases provided by rooftop managers for available locations and then goes to the site and looks at nearby properties listed on those data bases that fit the necessary specifications and that they know are interested in having cell sites because they are listed on the data bases. Those are typically the first properties that they will look at and they will typically only look at other properties if none of those properties are in the right location or otherwise don’t fit the search ring specifications.

Looking to the Future: It is impossible to predict where technology will go. Be cautious as to whom you take on as a tenant, since many technology companies won’t survive. Even an experienced building owner used to dealing with all kinds of tenants can be blindsided by this industry, which measures time in milliseconds.

One Fact is a Certainty: The telecommunications industry is here to stay. It’s up to you to proceed boldly, but with caution and with appropriate expert assistance, in order to effectively make this industry work for you and your property.

[26.6] IV. TELECOMMUNICATIONS: THE FCC ACTS ON BUILDING ACCESS⁸

In November 2000, the Federal Communications Commission (FCC) issued regulations implementing measures to ensure that building owners do not unreasonably deny competing telecommunications service providers access to customers in commercial buildings or other multiple-tenant environments (MTEs).⁹ The FCC took the following actions:

1. The FCC forbade telecommunications carriers from entering into exclusive contracts, preferred provider agreements and similar arrangements that effectively prohibit property owners of commercial buildings from permitting other providers to access their property. This did not invalidate agreements previously executed.
2. The FCC established procedures to facilitate moving the demarcation point (the end of the network and wiring operated by the incumbent local exchange carrier, the local Bell company—also known as the ILEC) to the minimum point of entry (MPOE) just inside the building at the building owner's request in order to reduce the competitive carriers' dependence on the ILEC to gain access to wiring inside the building. Under current law, the demarcation point may be located at either the MPOE just inside the building or further inside the building. If the demarcation point is moved to the MPOE, then the property owner or the tenant must maintain the wiring from the MPOE to the tenant's space.
3. The FCC determined that the Telecom Act of 1996 required that ILECs must afford telecommunications carriers and cable service providers reasonable and nondiscriminatory access to conduits and rights-of-way located in MTEs, to the extent such conduits and rights-of-way are owned or controlled by the ILEC.
4. The FCC prohibited restrictions that impair the installation, maintenance or use of certain video antennas on property within the exclusive use or control of the antenna user.

8 Reprinted with permission (and with updates, substantial revisions and format changes) from November 15, 2000, issue of *Mortgage & Real Estate Executives Report*, published by West Group.

9 15 F.C.C.R. 22983.

The FCC continues to monitor this area, and in March 2008, the FCC issued a Report and Order which was incorporated in a final order in 2010 prohibiting future exclusivity contracts between telecommunication providers and customers in multiple-tenant residential and commercial environments and invalidated any existing exclusivity agreements in multiple-tenant residential environments. This extension reflected the FCC recognition of the burgeoning market for bundled services, which include telecommunication, video and broadband under one bill for customers.¹⁰ Several states have also established legislation or regulations regarding telecommunication providers' access to buildings (e.g., Texas, Massachusetts and Connecticut), however, the impact of their efforts have been minimal.

[26.7] V. DATA CENTERS, SWITCH HOTELS, AND TECHNOLOGY BUILDINGS: DEVELOPMENT, FINANCING AND BUSINESS ISSUES¹¹

The continuing growth of technology and telecommunications has spawned a new set of companies with a specialized set of physical space requirements. Real estate owners and developers looking to serve this growing category of telecommunications tenants have focused on their specific needs in designing, constructing and renovating properties for their use. Traditional real estate leases have by necessity been modified to meet these requirements. In addition, telecom tenants and the brokers and consultants representing them, together with those representing their landlords, have by necessity redefined their approaches and strategies for leasing space for these uses. Also, developers and owners seeking financing for properties designed for telecommunications tenants have learned to deal with a changing set of lenders' requirements, and in some locales are learning how to take advantage of incentives and special financing programs offered to builders, owners, developers and users of telecommunications facilities.

There is no single name for the facilities occupied by telecommunications tenants—they can be called data centers, switch hotels, telecom

10 FCC Prohibition on Exclusive Telecommunications Contracts, 47 C.F.R. § 64.25 (2010), <https://www.gpo.gov/fdsys/pkg/CFR-2010-title47-vol3/pdf/CFR-2010-title47-vol3-sec64-2500.pdf>.

11 Reprinted with permission (and with updates, substantial revisions and format changes) from the Spring 2001 issue of *The Real Estate Finance Journal*, published by West Group.

buildings, carrier hotels, co-location facilities, intelligent buildings, high-tech buildings, technology centers or new media buildings.

[26.8] A. Types of Facilities

Regardless of the name used, these facilities fall into one or more of three basic categories:

[26.9] 1. Switch Facilities

A true telecommunications switch facility holds switching equipment used to operate a telecommunications network or to allow interconnection of multiple networks. Originally, these buildings were the local, regional and main central offices of AT&T Corp. and its subsidiaries prior to the breakup of the Bell System and the advent of deregulation. Now such facilities may be operated by the ILEC (one of the descendants of the Baby Bells, such as Verizon), a cellular phone operator such as T-Mobile, fiber-based data carriers such as Level 3 or a CLEC providing competitive telecom services switching facility. These facilities may also serve as a co-location facility, as discussed below, where equipment and wiring of other telecom providers is located, allowing interconnection of the networks between the party operating the switching equipment and the other party.

[26.10] 2. Data Centers

A data center or web-hosting facility generally has the same special needs as a switching facility, but instead of containing switching equipment operating a telecom network, it is used by parties operating computer network servers and transmitting high volumes of data requiring specialized and highly controlled computer equipment environments and efficient and cost-effective connections to telecom networks. Multiple redundant telecom providers will have interconnection points in these facilities allowing such data transmission on the highest available transmission speeds. Users of these facilities include web-hosting companies, banks and financial service firms, Internet information and digital service providers such as Google and eBay, and Internet retailers such as Amazon.com and Alibaba.com, Internet service providers such as Time Warner Cable, Cablevision and Comcast, as well as data center and co-location facility operators such as Digital Realty, Level 3 and iO. In addition, a myriad of other users will find the special facilities of these buildings, particularly the redundant systems allowing uninterrupted operations, enticing—such as telephone call centers, credit card operators,

check-clearing facilities and disaster recovery facilities. Data center space is now commonly rented based upon the quantity of electricity made available to the space, rather than on a per square foot basis.

[26.11] 3. Co-location Companies

A co-location company may operate an entire data center building or lease a portion of such a building and provide services on a retail rather than a wholesale basis to smaller users. Fully built-out data center space with raised flooring, fire suppression, power distribution equipment, specialized cooling and temperature control systems, etc. installed by the operator or the facility owner and with space typically provided on a per cabinet basis. Typically, co-location companies also provide other services, known as managed services, to a customer, such as providing data network connectivity and specialized engineering labor known as “remote hands.”

[26.12] 4. New Media or Wired Buildings

New media or wired buildings and technology centers generally have some of the attributes of a true data center or switch facility but have evolved into what is known as smart office buildings with more sophisticated technology and more telecommunications providers providing service in the building and with more bandwidth (fatter pipes for transmitting data) available in the building than in traditional office buildings. Having these amenities available in the building makes these buildings more attractive to new-media and other tech savvy companies (which today is almost every large company) and allows specialized marketing campaigns focusing on these industries.

Typical office space leases or leases in new-media buildings are gross leases subject to traditional office lease escalations including services such as air conditioning, electricity and cleaning. In these leases, extensive documentation is devoted to the description and allocation of financial responsibility for “tenant improvements,” including the extent and quality of tenant finishes such as wall coverings, carpeting and millwork. The scope of a tenant’s installation cost is \$50 to \$200 per square foot; and the alterations performed by or for the tenant are within the tenant’s demised premises and generally are non-structural in nature.

Data center or switch facility leases can be gross leases including all operating expenses and real estate taxes or net leases with the tenants paying their pro-rata share of all expenses of operating the property. The

property owner arranges for special services to be available, often incurring the expense of bringing services such as additional electrical capacity and fiber optic connections to the property. In a wholesale data center lease the space is raw with the services brought to the space and the tenants' installations includes their own HVAC and electrical systems, as well as other work such as the installation of generators and antennas requiring structural alterations and including significant work outside the tenant's own demised premises. In a turnkey data center lease the space is generally fully built out by the owner or operator so that the tenant or customer just installs its server racks and servers. The aggregate investment of the party building out the space (be it the property owner or the tenant), including equipment, costs between \$500 and \$1,000 per square foot. These costs may be passed onto the tenant as a factor built into annual rent or as tenant's initial alterations or configuration work or may be paid by the tenant.

[26.13] B. Property Criteria

The following are the most common criteria for a data center or switch facility and each of these areas should be carefully examined when acquiring a facility or underwriting a loan on such a facility:

- **Ceiling Height:** The height of switching and computer control equipment, together with the need for 18- to 36-inch-high raised flooring below the equipment and ladder systems to hang wiring above the equipment, as well as ducts for supplemental high-capacity air conditioning to cool the equipment, necessitates high ceiling height. Clear ceiling heights, free of pipes, beams and other obstructions, of a minimum of 12 to 14 feet are generally required, while 14 to 16 feet of clear ceiling height is strongly preferable.
- **Floor Load:** The weight of the computer servers and switching equipment requires sturdy floors with a minimum load capacity of 150 pounds per square foot and preferably 200 to 300 pounds per square foot. Portions of these facilities, generally those containing backup battery power units, will require floor loads of 300 pounds or more per square foot and may, therefore, require reinforcing or will need to be located on slab or at grade level.
- **Electrical Power:** The intensive use of computer servers and switching and computer equipment in these facilities requires very extensive electrical power capacity, with multiple levels of redundancy at all critical failure points throughout the network. While a typical office utilizes 4

to 6 watts per square foot, these facilities require 100-200 or more watts per square foot. Telecom switch facilities principally utilize direct current (DC) power, whereas data centers principally utilize alternating current (AC) power. Today, availability of power is more critical than availability of space because of the difficulties in obtaining more power in most areas. Diverse sources of power from separate power plants or substations are desirable, although not generally an absolute requirement.

- **Fiber Optic Access:** Having multiple—or at least initially 2–4,—fiber optic service providers at the property with diverse routes to the property and diverse entry points into the property (or at least two separate services utilizing diverse routes and entry points) makes a property more desirable. Alternatively, fiber optic cables should be near the property; however, bringing fiber optics to the property may create a delay and an expense for the property owner or the tenant if excess conduit space is not available in the streets, since tearing up streets to install new cables can be time-consuming and expensive.
- **Freight Elevators:** Availability of at least one—and preferably several—oversized, heavy-duty freight elevators capable of holding equipment the size of small trucks facilitates the installation of large, heavy equipment, without having to install the equipment in pieces or remove windows and use exterior hoists or cranes.
- **Roof Space:** Rooftop space for antennas and supplemental air conditioning equipment is required. Particular locations on a roof may be necessary for line-of-sight microwave and similar antennas.
- **Riser Space:** Telecommunications tenants require significant riser space connecting the demised premises to the basement, fiber optic access points, electrical transformers, rooftop antennas, air conditioning equipment and other points at the property in multiple, diverse locations to bring additional and redundant electrical capacity, telecommunications wiring and supplemental air conditioning to the premises. Depending upon the size and type of tenant, the riser space can be several square inches, several square feet or more. Property owners may need to be creative to find additional riser space, such as by decommissioning extra elevators that are no longer required because these tenants have much lower occupancy levels (machines don't require as many elevators as people).

- **Column Spacing:** Column-free spaces are preferable; however, the combination of free spaces with the desired floor loads and ceiling heights is not common in multi-floor buildings. Minimum spacing between columns should be 20 feet (preferably 25 to 30 feet) to maximize equipment layout efficiency and allow for oversized equipment.
- **Backup Electrical Power:** Data center and switch-hotel tenants generally install their own sources of backup electrical power, battery backup for instantaneous protection against power outages and coverage until a generator starts up, diesel generators for longer outages, and an outside plug for a mobile generator for redundant backup if the generator fails. In facilities serving smaller tenants, the owner may install these backup electrical facilities and charge the tenants for the shared or allocated capacity thereof.
- **Generator and Equipment Space:** Additional space outside the demised premises is generally also necessary for the installation of backup generators, diesel fuel tanks (unless they are located in the base of a modular generator unit), electrical transformers and similar equipment. Since these tenants use many fewer parking spaces, excess parking spaces, subject to zoning requirements, can often be used for generators, tanks, and equipment rooms. Alternatively, equipment can be placed in excess loading docks, on rooftops or roof setbacks (subject to weight limitations), in garages, or in basements.
- **Access and Security:** Telecommunications tenants require 24/7 access to these spaces. High-level security systems, including key card entry systems, or even better, biometric (fingerprint, retina or hand measurement) systems, covering not only tenant spaces, but the entire property, are desirable.
- **Reliability and Experience of Ownership:** In light of the specialized nature of these properties and the requirement to move at “Internet speed,” telecommunications tenants strongly prefer to deal with well-established, financially solvent ownership having established track records with similar spaces, uses and tenants. Many of these tenants have had bad experiences with inexperienced ownership, and the need to meet or exceed timetables requires dealing with experienced owners.

[26.14] C. Data Center and Switch-Hotel Leasing Issues

The special needs of telecommunications tenants and the requirements of data center and switch-hotel landlords impact the negotiation and struc-

ture of a number of lease provisions. Outlined below are some of the key leasing issues that distinguish data center and switch-hotel leases from more traditional space leases.

[26.15] 1. Installation

In a data center or a switch hotel the tenant provides substantially all of its own equipment and depending on whether it is a “turnkey” lease or a “wholesale” lease, will determine if the landlord or the tenant does the installation of raised floors, supplemental air-conditioning, generators, and fiber optic cable installation requiring major structural alterations within and outside the demised premises. If the tenant is doing this work then the landlord will require covenants from the tenant that the tenant will perform its work in accordance with typical alteration requirements. Since these alterations are critical to the tenant’s ability to operate its space, these tenants will ask for, and are entitled to receive, greater alteration rights than typical office tenants.

[26.16] 2. Co-Location

The business models for many tenants of these facilities include providing space for their customers’ telecommunications and/or computer equipment in the tenants’ space. It is therefore essential for data center and switch-hotel tenants to be able to enter into “co-location agreements,” similar to license agreements but with the tenant/licensor providing services to the licensee/co-location customer. Consequently typical subletting restrictions must be modified to accommodate this need and provide co-location rights to the tenants, subject to appropriate restrictions, without eliminating the landlord’s typical rights to approve all subleases and control the use and occupancy of its space.

[26.17] 3. Nondisturbance Agreements

Due to the extent and expense of their installations, data center and switch-hotel tenants generally insist on nondisturbance agreements from any lenders and superior lessors. Typically, lenders restrict the provision of nondisturbance agreements to tenants of a minimum size. Consequently tenants will want to ascertain upfront if the landlord has enough flexibility with its lender to provide the required nondisturbance protection.

[26.18] 4. Security Deposit

Despite a tenant expending large sums on its installation, it may not have a traditional credit or earnings track record to support its rent obligation and its net worth may be an illiquid investment in equipment and facilities, or it may currently have cash from investors, but in a short time that cash will be invested in equipment and facilities, rendering it illiquid. It is not unusual for a landlord to insist on a large security deposit, sometimes as much as one or two years' rent. On the other hand, if an old building is being converted to a data center or switch facility then the tenant may be making a valuable investment in electrical, HVAC and other facilities, which add value to the building.

[26.19] 5. Financial Credibility of Landlord

Likewise, given the investment in their space, tenants will look for credible and creditworthy landlords who can meet both their space delivery time requirements and also ongoing operational requirements of their tenants as well.

[26.20] D. Data Center and Switch-Hotel Financing Issues

When the bubble burst for dot-coms in the spring of 2000, telecom companies and other users of data center and switch facilities were also severely affected. Developers seeking debt financing for new, to-be-developed data center and switch facilities need to provide greater equity or guaranties from financially strong entities. In addition, lenders are more likely to require executed leases in hand for at least part of the property and, obviously, the scope of the pre-leasing requirement will be tied to the scope of equity the developer is investing. A major problem was the "chicken or egg" issue: tenants looking at these facilities needed immediately available space to achieve their goals of speed to market and therefore would not pre-lease space, and without pre-leasing, many developers could not close acquisition or construction loans.

With regard to equity financing, private sources such as the real-estate arms of money management and asset management firms have partnered with owners and development groups in the funding of telecom facility development. Because timing is a critical issue with respect to the development and leasing of telecommunications facilities, a developer may need an equity partner to fund the early phases of construction prior to the developer securing leases that can then be used to secure more traditional debt financing. One option in this regard is for the equity partner to pro-

vide financial guarantees to the lender with the understanding that once a certain percentage of approved signed leases are in place, the guarantee requirement will be lifted.

As a result of the continuing shakeout in the start-up world and in the telecommunications industry, lenders will look carefully at the financials of the tenants. Lender due diligence will include a review of the companies' key investors and strategic partners, as well as a review of each company's financials and trade record, particularly where nondisturbance protection is required. At the same time, as mentioned above, developers will need to pay careful attention to subordination and nondisturbance provisions of loan documents in order to preserve the necessary flexibility for dealing with their tenants and accommodating their needs with respect to critical and costly installations.

Bottom line—because of the competitive and volatile nature of the telecommunications industry, lenders and investors need to proceed cautiously with regard to the financing of telecommunications facilities. They will look for developers and owners with strong track records and with strong tenants, or, at a minimum, tenants with strong financial backing and a good business plan, before committing to these projects. Even economic development agencies and local governments providing incentives will look to financially strong, experienced developers to qualify for the benefits and programs offered.

[26.21] E. Conclusion

As the growth of wireless communications continues and new telecommunications applications are developed, the demand for data center and switch hotels to accommodate carriers and related telecommunications equipment users will continue to expand. Because of the evolving nature of the telecommunications business, as in any evolving industry, some companies will succeed while others will fail. Only time will determine the Darwinian survivors—and therefore owners, developers and lenders need to structure and document leases, loans and other financial documents to take into account, and provide protections and solutions for, potential issues arising as a result of the evolving nature of the telecommunications industry.

[26.22] VI. DISTRIBUTED ANTENNA OR IN BUILDING WIRELESS SYSTEMS

Cellular telephone systems were originally designed primarily to provide service to customers walking on the sidewalks or driving in cars on the streets not at their desks or homes. Since the “traffic” on those networks was at street level—in consumers’ hands or cars—the original antennas were principally designed to cover as much geography as possible and were pointed down towards the streets or nearby highways or transportation centers where there was substantial pedestrian or vehicular traffic to utilize the cellular network.

The use of cell phones together with smart phones, iPads, laptop computers and other connected devices has grown exponentially in recent years and has moved from street level into buildings. Cell phones have become just another device for transmitting voice and data services. Now, the traffic for cellular networks is not only at street level but also inside buildings.

However, the quality of a cellular signal can deteriorate when inside a building, particularly in the core or in elevators or stairwells. The degree of that deterioration varies dramatically based on numerous factors including the size of the building, the distance to the nearest cellular antennas, the number of obstructions such as other buildings, the amount of interference from other telecom and cellular transmitters, and the amount of steel or concrete used in the construction of the building. As one gets closer to the center of a building, the quality of the cellular signal can deteriorate from multiple bars on the cell phone, tablet or other device, to one or even zero bars as a result of those obstructions. As a result, both the device and the cellular network need to work harder to keep a signal connected. The battery on the device is also used up much more quickly and the amount of data traffic and the number of calls that may be transmitted simultaneously from an individual cell site goes down because both sides of the network have to work harder to keep that signal connected.

Therefore, locations with high data and cellular phone traffic such as transportation centers, casinos, sports venues, hotels, airports, hospitals, convention centers and hotels have, over the last ten years, begun to install small cellular systems within the buildings. These systems are known as distributed antenna systems (DAS) or in-building wireless systems. These systems can be built separately for each carrier within the building or can operate as a single consolidated neutral host system and support multiple

carriers over one set of equipment. A well engineered and operated combined neutral host network is much more efficient, less costly for the carriers and simpler for the property owner to manage.

A neutral host or combined multi-carrier system typically consists of two or more fiber optic connections to the street, an equipment room where base station signals are combined, converted to fiber optics, and transmitted throughout the building to remote antennas installed by the system operator. Each of the separate carriers desiring to utilize the system then install their own base station transmitters within that room and connect to the combiner system, thereby connecting to the wiring and infrastructure covering the entire building and the many separate small cellular antennas which distribute and transmit the signal. These systems can also support communications systems for building maintenance and other employees and for building and equipment management systems. Having a single system for all carriers minimizes the space and construction headaches for a property owner.

Depending on, among other things, local building codes, a DAS system may also be capable of supporting an emergency communication system or first responder system (FRS) for police, fire and other first responders and public safety workers, allowing them to communicate effectively inside a building during an emergency. In fact, where permitted by law, combining a well engineered and constructed DAS with an FRS may produce a better result with less interference for all users. In some areas, however, that system needs to be separate from a commercial system. Also, a first responder communication system requires a higher level of redundancy and resilience (e.g., waterproof installation, redundant pathways for fiber and battery or generator backup) and typically covers the entire building; including non-public service areas, whereas a DAS may only cover public areas of a building. Nonetheless, there can be economies of scale installing both systems at the same time.

In an office building, a DAS system may use one or two or as many as eight or ten separate antennas. These antennas can be the size of a smoke detector or a dinner plate and can be located on each floor of the building or only one or two antennas may be installed to cover two floors depending on the construction and the volume of traffic in that building. These antennas may be able to be located in common areas or above hung ceilings or can be mounted on the hung ceilings. In a transportation facility or sports arena there may 50, 100 or even more antennas throughout the facility to provide good coverage in the arena and in all of the restaurants,

hallways, lobbies and ancillary spaces as well as much higher capacity at peak utilization.

DAS transactions can generally be structured in three different ways, each with its own separate issues: (1) the property owner can (usually with assistance from a specialized consultant) design, purchase, install and operate the system and then contract directly with carriers for the carriers to connect to the system—however, such a system requires technical expertise that a property owner generally does not have and may not want to obtain and requires large capital expenditures; (2) the property owner can hire a third party company (not a carrier) to design, purchase, install and operate the system at the third party's expense allowing that third party to contract with carriers to connect to the system—however, this option is not necessarily favored by the carriers; or (3) a carrier can design, purchase, install and operate the system at its expense both for its own use and for other carriers to connect to the system—although concerns exist about whether one carrier installing a system will truly build a neutral host system and allow other competing carriers equal access to that system. The major distinguishing factors between these models are the party who pays for the DAS, who profits from the DAS and who controls the operations of the DAS.

While today, these systems are generally limited to locations with high volumes of users such as transportation or sports facilities or large office buildings, typically one million square feet or larger, the need of the carriers to manage the transmission spectrum available to them favors installing more small cell systems within various types of properties. Consequently, DAS systems will increasingly become part of carrier networks and more prevalent in facilities of all sizes in the future.

The legal issues in DAS agreements are similar to those that arise in cellular antenna leases, building wiring agreements and data center agreements.

GLOSSARY OF COMMON TELECOMMUNICATIONS TERMS

Bandwidth—A term used to describe the capacity of wiring to carry communications. Voice transmission requires 3,000 cycles per second. Video transmission requires 4.5 million cycles per second. A typical data transmission would involve many thousands or millions of bits per second.

Broadband—A communications channel having a bandwidth greater than a voice-grade channel, characterized by data transmission speed of 10 to 500 kilobytes per second or faster.

Bundled Services—The combination of several services, such as local telephone, long distance, Internet access and video, with a single bill to the customer.

Cable System—A multichannel video programming distribution facility consisting of a set of closed transmission paths and associated signal generation, reception and control equipment, designed to provide cable service (including video programming) to multiple subscribers within a community unless such system does not use any public rights-of-way.

Cell Site—The location of a cellular radio antenna typically consisting of three arrays of three antennas each pointed in different directions and covering all 360 degrees, together with a base station or equipment space where the transmission equipment is housed, one or two GPS antennas and wiring leading from the antennas to the base station and on to the street.

Central Office—Telephone company facility where customers' lines are joined to switching equipment for connecting other customers to each other, locally and for long distance.

CLEC (Competitive Local Exchange Carrier)—Usually refers to a facilities-based carrier as opposed to a reseller. A CLEC competes with the local exchange carrier and may provide services such as local telephone, long distance, Internet access and other services.

Coaxial Cable—A cable consisting of an outer conductor concentric to an inner conductor, separated from each other by insulating material. It can carry a much higher bandwidth than a copper twisted pair.

Copper (shorthand for copper wire)—Two insulated copper wires twisted around each other are called a twisted pair, which is the predominant type of telephone wire. Typical copper wiring is category 3, and that with a tighter twist is category 5. Category 5 copper has greater bandwidth and may be preferable for data transmission.

Demarcation Point (Demarc)—The point at which the service provider's network ends, which is usually, but not always, near the edge of the customer's premises.

Direct Broadcast Satellite (DBS)—A satellite transmitting TV programs which can be received by small and somewhat inexpensive dish antennas often installed in backyards or on the roofs of houses.

Fiber Optic Cable (Fiber)—The filaments of glass or other transparent materials sheathed in an insulator through which a light beam may be transmitted for long distances. Fiber is used to transmit digital information.

House and Riser—The wiring distribution system that leads from the basement to the upper floors of a building.

Inside Wiring—That wiring located within a subscriber's premises or building. Inside wiring starts at the service provider's demarcation point and extends to the individual phone extensions.

Internet Service Provider (ISP)—A company which provides an interface between the customer and the World Wide Web. By deploying special electronic equipment in a building, an ISP can offer tenants high-speed Internet access.

Kbps—Kilobytes per second.

LEC (Local Exchange Company)—The local phone company—which can be either a regional bell operating company (e.g., NYNEX, later Bell Atlantic and now merged with GTE to form Verizon) or an independent (e.g., GTE)—which provides local transmission services. Prior to divestiture, the LECs were called telephone companies or telcos.

Local Area Network (LAN)—A data communications network over a limited area, such as a building or corporate campus.

Mbps—Megabytes per second.

Personal Communications Services (PCS)—A digital wireless technology similar to cellular telephone services. Allows for personal phone numbers that can directly access phones, fax machines, beepers and computers. Requires many microcell sites, or radio relay stations with antennas.

Regional Bell Operating Company (RBOC)—The acronym used for local telephone companies created in 1984 as part of the breakup of AT&T. The three remaining RBOCs are Qwest, AT&T and Verizon.

Reseller—A company that buys services from a carrier at bulk rates and resells and bills customers under its own brand name.

Riser—The path between floors of a building through which telephone, cable and other utility cables run.

Satellite Master Antennas Television (SMATV)—SMATV systems are primarily rooftop satellite reception facilities that serve multi-dwelling establishments, such as apartment complexes, hotels and similar multi-unit buildings. SMATV service uses wire or cable to deliver signals received on the satellite antenna through the building.

Wi-Fi—Wireless data transmission for mobile devices at 1 to 100 mbps through wireless local area networks (WLAN) based on the IEEE 802.11 transmission standard.

Wi-MAX—Method of wireless data transmission for mobile devices similar to Wi-Fi but operating over longer distances (miles rather than feet) and with less interruption based on the IEEE 802.16 standard.

Wireless Cable System—A multichannel video distributor using microwave television transmission technology.

CHAPTER TWENTY-SEVEN

ASSIGNMENT AND SUBLETTING RESTRICTIONS IN LEASES AND WHAT THEY MEAN IN THE REAL WORLD

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[27.0] I. INTRODUCTION

This chapter surveys the law on assignment and subletting restrictions in leases. The author notes that for good reason, these clauses often require significant attention during lease negotiation. This chapter discusses some issues that practitioners should consider in drafting or negotiating these clauses for their clients. It also addresses issues of interpretation for tenants trying to understand how to escape from a lease they no longer want.

When landlords and tenants negotiate space leases,¹ those space leases will often prohibit² assignment, subletting, and potentially other similar transactions. Typically a landlord's first draft will allow almost no transactions of these types. A well-advised tenant will try to allow as much as possible without any need to go back to the landlord for consent. These negotiations often become a major focus of discussions.

Later, if a tenant finds its space lease no longer makes business sense, the tenant often will wish it had negotiated harder on these issues. A restriction that seemed to make sense when the parties negotiated their lease may no longer make sense, may give the landlord a revenue opportunity, and may create a corresponding burden for the tenant.

When an operating company enters into many leases for many locations, it may not want to devote the effort to negotiate each lease carefully, or it may focus more on operational issues than on unlikely future transactions.

Eventually, that operating company may become a target company in a corporate merger, acquisition, or other change in ownership. When that

1 A "space lease" usually means a lease of space the tenant uses for actual business operations, when the tenant is not in the development or real estate investment business. Space leases typically include office leases, with an original term of five to fifteen years, and retail leases, which can go much longer (at least for large spaces) after taking into account multiple extension options. The longer the lease term and the more limited the landlord's responsibilities, the closer the transaction comes to a "ground lease," in which the tenant regards its leasehold as a real estate investment. A ground lease typically will allow the tenant much more flexibility than a space lease, with few of the burdensome restrictions analyzed in this chapter at least after the tenant finishes any required initial construction.

2 This chapter treats a requirement to obtain the landlord's consent as equivalent to a prohibition because one should assume both roads will usually lead to the same place: the tenant's checkbook. In some states, however, a consent requirement may imply a "reasonableness" qualification, whereas an outright prohibition will not. These distinctions are, however, quite subtle, fact-specific, unpredictable, and unreliable. This chapter discusses all these issues below.

happens, the Assignment and Subletting Restrictions³ in the target company's leases may create issues for, and impede, a corporate transaction. In extreme cases, the leases may prevent a transaction from closing or increase the transaction's cost. Whether any of these problems arise will depend primarily on the exact words of the leases and what those words mean.

Therefore, if a target company holds important leases,⁴ the Assignment Restrictions in those leases may require substantial and very focused early attention in due diligence and contract negotiations. And any participant in a corporate transaction of this type, or any tenant under a major space lease that it no longer wants, will care very much about the answers to the following questions:⁵

- What should counsel look for when reviewing Assignment Restrictions in space leases?
- What do the more common Assignment Restrictions mean?
- How do Assignment Restrictions interact with mergers, equity transfers, or other particular types of corporate transactions?
- Do similar principles apply to restrictions on subletting?⁶
- Does a proposed transaction require the landlord's consent?

3 Part II.B, *infra*, defines the terms "Assignment," "Transfer," and "Subletting Restrictions."

4 If the company has only a few leases, has generic space requirements (so it could easily replace any lost leases), or has mostly at- or above-market rent under its leases, the parties may make a business decision not to worry about leases at all. As a practical matter, the likelihood of trouble under these circumstances seems fairly low, especially if the company has good relations with its landlords and those landlords are widely dispersed. On the other hand, if the company's value lies in its leases and their below-market rents (as a traditional example, a typical supermarket chain, although this may be less true now than it was in 2007), or if a single landlord owns many of the tenant's locations, the risk of claims by opportunistic landlords may turn these legal issues into the most important business issues in the deal. Exactly how to approach all these issues represents a strategic decision to be discussed with the client early in the transaction and confirmed in writing.

5 Similar issues arise for valuable contracts. No reason exists to think the answers would be dramatically different.

6 When faced with strict prohibitions on assignment, the parties, depending on the larger deal structure, instead sometimes can create a sublease to give the subtenant nearly the functional equivalent of an assignment. The question then becomes whether the lease prohibits, or requires the landlord's consent to, subleasing of this type. And when does a sublease amount to an assignment? This chapter does not consider that last question.

- If a transaction does require consent of the landlord, must the landlord be “reasonable” about granting or withholding consent?
- If so, what does “reasonable” mean?

This chapter tries to answer these questions to help landlords, tenants, and their counsel understand the issues in this area, both in drafting and negotiating leases and in structuring transfers of individual leases as well as corporate transactions that involve multiple leases.

Exit strategy issues like these have taken on particular urgency given the level of stress and uncertainty in American business since the financial crisis of 2007. These pressures have forced many institutions and companies—often on an urgent basis—to rethink their space requirements and how their restructuring, merger, sale, downsizing, or bankruptcy⁷ will affect their lease obligations. Thus, the issues this chapter addresses have become more timely and important than ever.

After summarizing the basic legal principles that govern Transfer Restrictions in leases, this chapter identifies some important categories of transfers, then analyzes how courts treat certain Transfer Restrictions that commonly appear in space leases.

This chapter also examines whether a tenant must obtain landlord consent to an assignment or subletting if the lease says nothing, and if so, whether a landlord must be reasonable regarding that consent. Also, when the lease or governing law requires a landlord to be “reasonable,” what does that mean?

This chapter considers both New York law and general American common law principles. It ultimately reconfirms the importance of precision in drafting and the need to thoughtfully consider, in the drafting stage, the parties’ intentions and expectations, along with how a court will respond to Transfer Restrictions, or the lack thereof, in a lease. This chapter concludes with lessons and practical advice for both landlords and tenants.

⁷ The federal bankruptcy law allows a debtor or its trustee to assume or reject unexpired leases. *See* 11 U.S.C. § 365. These provisions often override whatever the lease says, as well as some state law. Bankruptcy treatment of lease assignments lies outside the scope of this chapter. As in so many other areas of transactional law, however, bankruptcy provides the ultimate test (and the ultimate escape hatch) for any business document or transaction. Thus, every transactional lawyer must to some degree be a bankruptcy lawyer, or at least bankruptcy literate.

Understanding what Transfer Restrictions in leases mean and how the law treats these provisions represents the first step toward avoiding future roadblocks and headaches in this area for all parties involved.

[27.1] II. OVERVIEW AND SOME DEFINITIONS

[27.2] A. General Common Law Definitions

These general common law principles form the basic foundation and starting point for the present discussion:

- “Restrains on Alienation.” Restrictions against assignment and subletting are regarded as restraints on alienation, which the courts generally disfavor. The courts therefore construe these restrictions strictly, in favor of free alienability.⁸
- “Forms of Alienation.” A covenant against one form of alienation does not prohibit another form.⁹ For example, a covenant against assigning does not preclude subletting, pledging, or mortgaging.¹⁰

[27.3] B. Terms Used in This Chapter

Starting from those general principles, these defined terms will apply throughout the discussion:

- “Basic Assignment Restriction” refers to an ordinary, generic provision in a lease that generally prohibits a lease assignment or requires landlord consent for such an assignment. Any such restriction does not single out particular types of assignments or specify other types of transfers that are prohibited; it merely says the tenant may not assign the lease.

⁸ See *Riggs v. Pursell*, 66 N.Y. 193, 201 (1876) (“Such covenants are restraints which courts do not favor. They are construed with the utmost jealousy, and very easy modes have always been countenanced for defeating them.”).

⁹ See 1 Milton R. Friedman, *Friedman on Leases* § 7:3.3 (Patrick A. Randolph, ed., 5th ed. 2008).

¹⁰ See *id.* If, however, the mortgagee or pledgee exercises its rights and remedies to bring about an absolute transfer, then the transaction usually will, and should, be deemed an assignment or transfer. In most cases, therefore, the safe harbor for a mortgage or pledge usually will not give a lender much comfort, because the lender usually will want to know it can safely realize on its collateral. On the other hand, if the lender merely wanted to achieve secured status for bankruptcy purposes, the lender might not care about this problem. In that case, counsel should consider the risks of imperfect memory on the part of clients.

- “Advanced Assignment Restriction” refers to a provision in a lease that prohibits particular types of assignments. For example, a restriction on the transfer of control of a corporation or assignment by “operation of law”¹¹ would constitute an Advanced Assignment Restriction.
- “Assignment Restriction” refers to Basic Assignment Restrictions and Advanced Assignment Restrictions together.
- “Subletting Restriction” refers to an ordinary, generic provision that generally prohibits any subletting of all or part of the leased property without landlord consent.
- “Transfer Restriction” refers to Assignment Restrictions and Subletting Restrictions together.

[27.4] C. Overview of Issues Addressed in This Chapter

This chapter addresses the following five issues of law and reaches the conclusions summarized below.¹² For any individual transaction, of course, the conclusions in this chapter will need to be confirmed, taking into account the specific facts, circumstances, leasing documents, and governing law at issue.

1. Stock Transfers

Q: Do Basic Assignment Restrictions prohibit stock transfers of a corporate tenant?

A: No, unless the lease contains an Advanced Assignment Restriction that specifically prohibits such transfers.¹³

2. Assignments by Operation of Law

Q: Do Basic Assignment Restrictions prohibit assignments by “operation of law”?

11 This chapter examines what operation of law means. *See infra* Part IV.

12 The discussion generally refers only to corporate tenants. Limited liability company (LLC) tenants and partnership tenants likely would be treated the same as corporations for this purpose, but this likelihood has not been tested or researched for the present discussion. For reasons this chapter will make amply clear, landlords should address these points in their leases expressly if the tenant is, or could become, some type of entity.

13 *See infra* Part III.

A: No. An assignment by operation of law will not violate the lease unless the lease contains an Advanced Assignment Restriction that specifically prohibits an assignment by operation of law.¹⁴

3. Mergers

Q: Do Basic Assignment Restrictions prohibit mergers of a corporate tenant?

A: No. A corporate merger will not violate the lease unless the lease contains an Advanced Assignment Restriction specifically prohibiting mergers—either explicitly or as assignments or transfers by operation of law.¹⁵

4. Requirement for Consent If Lease Is Silent

Q: If a lease contains no Transfer Restriction, must the tenant obtain the landlord's consent before assigning or subletting?

A: Most jurisdictions favor free transferability and do not require a tenant to obtain a landlord's consent if the lease does not require it. A minority of jurisdictions require landlord consent before a tenant can assign or sublet even if the lease says nothing.¹⁶

5. Reasonableness in Denying Consent

Q: If a Transfer Restriction sets no standard for the landlord's consent, must the landlord act reasonably in refusing consent? If so, what standard of "reasonableness" must the landlord meet?

A: Only a minority of jurisdictions require landlords to be reasonable. Even where the courts require it, no single standard defines "reasonableness." Numerous cases offer some clues, which this chapter will discuss.¹⁷

Although the above answers represent majority views on these issues, plenty of exceptions and minority views—some of which amount to emerging trends—exist for some of these issues. Moreover, any individual

¹⁴ See *infra* Part IV.

¹⁵ See *infra* Part V.

¹⁶ See *infra* Part VI.

¹⁷ See *infra* Part VII.B.

judge usually can find some basis to decide any particular case in whatever way the judge sees fit. Any potential participant in a transaction therefore should consult current case law in each applicable jurisdiction. Finally, in negotiating leases and corporate transactional documents, the parties should not leave these issues for a court to decide. They should carefully consider, negotiate, and address all these issues in their documents, and very likely even at the term sheet stage before they start to draft or negotiate documents.

[27.5] III. STOCK TRANSFERS

Under general legal principles, the sale or transfer of a corporate tenant's stock does not violate a Basic Assignment Restriction¹⁸ because a corporation exists separately from its stockholders, and courts generally have found a landlord who enters into a lease with a corporate tenant should be deemed to know about such separate existence.¹⁹ A corporation's separate legal existence is hardly a deep, dark secret that tenants conceal from innocent and naïve landlords. Thus, while owners of a corporation may transfer the company's stock, this transaction does not

18 See *In re Ames Dep't Stores, Inc.*, 127 B.R. 744, 748 (Bankr. S.D.N.Y. 1991) ("In Illinois, it is settled that the transfer of all of the stock issued by a tenant corporation does not effect an assignment of the tenant's lease unless the lease so provides."); *Ser-Bye Corp. v. C. P. & G. Markets, Inc.*, 179 P.2d 342, 345 (Cal. Dist. Ct. App. 1947) ("The inhibitions against assignment run as to the lease itself and not to the stock in the lessee corporation by one or more stockholders. When, therefore, it was covenanted that the lessee should not 'assign the leasehold estate' the lease as an entirety was meant, and not merely shares of stock in the lessee corporation.") (internal citation omitted); *Nat'l Bank of Albany Park v. S.N.H., Inc.*, 336 N.E.2d 115, 122 (Ill. App. Ct. 1975) ("When a [shareholder] transfers all of [a corporation's] stock, the control of the corporation is also transferred, but the legal entity of the corporate lessee remains the same."); see also *U.S. Cellular Inv. Co. v. GTE Mobilnet, Inc.*, 281 F.3d 929, 934–36 (9th Cir. 2002) (limited partnership agreement restriction on a corporation's sale of its general partnership interest does not restrict sale of stock by stockholders of that corporate partner); *Richardson v. La Rancherita La Jolla, Inc.*, 159 Cal. Rptr. 285, 289 (Ct. App. 1979) (sale of all shares of stock in lessee corporation does not violate antiassignment clause); *Burrows Motor Co. v. Davis*, 76 A.2d 163, 165 (D.C. 1950) (transfer of majority of stock in lessee corporation producing change in control does not violate antiassignment clause); *Posner v. Air Brakes & Equip. Corp.*, 62 A.2d 711, 713 (N.J. Super. Ct. Ch. Div. 1948) (a tenant corporation's becoming wholly owned by or a subsidiary of another corporation "does not under the circumstances of this case constitute an assignment of the lease or an underletting of the premises by the lessee").

19 See, e.g., *Rubinstein Bros. v. Ole of 34th St., Inc.*, 101 Misc. 2d 563, 421 N.Y.S.2d 534 (Civ. Ct., N.Y. Co. 1979).

change the actual tenant under the lease, which was, is, and remains exactly the same corporation.²⁰

Courts apply this rule even when a landlord previously disapproves a proposed lease assignment, and the rejected assignee then proceeds to purchase the stock of the corporate tenant²¹—a transparent and brazen attempt to get around the assignment prohibition.²² In the few New York cases on point, the courts have generally followed the precedent of other jurisdictions.²³

A landlord, if it wants, may try to prohibit a de facto assignment of the lease through a stock transfer. To do this, the landlord must draft an Advanced Assignment Restriction specifically forbidding transfer of control of the tenant corporation.²⁴ Although such provisions have been

20 See *Branmar Theatre Co. v. Branmar, Inc.*, 264 A.2d 526, 529 (Del. Ch. 1970) (“[T]he rule that precludes a person from doing indirectly what he cannot do directly has no application to the present case. The attempted assignment was . . . by plaintiff corporation, the sale of stock by its stockholders.”). Although courts refuse to treat a stock sale as an implied lease assignment, the New York State and New York City tax rules take a different approach. By statute, New York treats the transfer of a “controlling interest” in an entity that owns real estate as an implied transfer of the real estate. N.Y. Tax Law § 1401(b), (e); New York City Admin. Code §§ 11-2101(6)–(9), 11-2102(a). A 2008 New York decision extends the transfer of a controlling interest to include a change of voting control even if ownership percentages do not change. See *CBS Corp. v. Tax Appeals Trib. of State of N.Y.*, 56 A.D.3d 908, 867 N.Y.S.2d 270 (3d Dep’t 2008). The New York tax collectors will look all the way up the chain of entities, even if (for example) a great-great-grandparent entity is an offshore entity that does not operate in New York. They may then assess any unpaid transfer tax against the entity that owns New York real estate.

21 See *In re Ames Dep’t Stores*, 127 B.R. at 749; see also *Burrows Motor Co.*, 76 A.2d at 164.

22 The court in *Alabama Vermiculite Corp. v. Patterson*, 124 F. Supp. 441 (D.S.C. 1954), responded to the argument that tenants should not be able to use corporate stock transfers to “get around” assignment restrictions. The court saw no reason to deny stockholders the right to transfer stock solely because the result was an indirect transfer of the lease, which the lease would have prohibited if the tenant were an individual. See *id.* at 445.

23 See *Rubinstein Bros.*, 101 Misc. 2d at 568 (“[T]he rule [of the cases previously cited] makes sense. A landlord entering a lease with a corporate tenant should be presumed to know that it is an artificial entity with a life distinct from the individuals who may from time to time be its owners.”); see also *Gasparre v. 88-36 Elmhurst Ave. Realty Corp.*, 464 N.Y.S.2d 106 (Sup. Ct., Queens Co. 1983) (extending *Rubinstein* to hold that transfer of stock of corporate property owner does not constitute sale of property under due-on-sale clause).

24 See *U.S. Cellular*, 281 F.3d at 936 (“Had the partners intended that the sale of stock of a corporate partner be restricted, such intent could easily have been stated.”). For an example of such a lease provision, see *Brentsun Realty Corp. v. D’Urso Supermarkets*, 182 A.D.2d 604, 582 N.Y.S.2d 216 (2d Dep’t 1992) (lease drafted by landlord stated that transfer or sale of 50% or more of corporate tenant’s stock would constitute an assignment and require landlord’s consent).

enforced,²⁵ they restrict alienation of property; therefore, courts will construe them strictly against the landlord.²⁶

For example, a clause that prohibits the transfer of existing stock in a corporation may be held to allow the creation and sale of new stock, even though the issuance of that new stock will change control of the corporation.²⁷

Although New York courts have not considered Advanced Assignment Restrictions specifically prohibiting the transfer of a corporate tenant's stock, cases suggest such clauses would be enforceable under New York law.²⁸ That proposition may not apply, though, for a corporation with many shareholders. For example, a court disregarded such restrictions in a case where, when the parties signed their lease, more than a dozen shareholders owned 40% or more of the corporation's stock.²⁹ Rather than rely on the next court to reach a similar result, well-represented tenants will often ask landlords to carve out from Advanced Assignment Restrictions any limit on initial public offerings or transfers of publicly held stock.

25 See *Associated Cotton Shops, Inc. v. Evergreen Park Shopping Plaza of Del., Inc.*, 27 Ill. App.2d 467, 170 N.E.2d 35 (Ill. App. Ct. 1960).

26 See *Lipsker v. Billings Boot Shop*, 288 P.2d 660 (Mont. 1955); see also, e.g., N.Y. Gen. Oblig. Law § 13-101 ("Any claim or demand can be transferred" with very limited exceptions).

27 See *Friedman*, *supra* note 9, § 7:3.3[C][1]. To avoid ambiguity when trying to prevent changes in corporate control, Friedman recommends landlords draft nonassignment clauses in the following form (which may require updating or modification in particular cases or for "Plain English" comprehensibility):

An assignment, forbidden within the meaning of this [section], shall be deemed to include one or more sales or transfers, by operation of law or otherwise, or creation of new stock, by which an aggregate of more than 50% of Tenant's stock shall be vested in a party or parties who are nonstockholders as of the date hereof. This paragraph shall not apply if Tenant's stock is listed on a recognized security exchange. For the purpose of this paragraph, stock ownership shall be determined in accordance with the principles set forth in Section 544 of the Internal Revenue Code of 1954 as the same existed on August 16, 1954.

Id.

28 See *Ninety-Five Madison Co. v. Active Health Mgmt.*, 16 Misc. 3d 1140(A), 851 N.Y.S.2d 59 (Civ. Ct., N.Y. Co. 2007) (unpublished table) (upholding lease prohibition on transfer of more than 25% of a partnership's equity without landlord's consent); *Rubinstein Bros. v. Ole of 34th St., Inc.*, 101 Misc. 2d 563, 568-69, 421 N.Y.S.2d 534 (Civ. Ct., N.Y. Co. 1979) ("If a landlord wished to protect itself against such vicissitude [of corporate ownership], it could easily write into the lease a condition subsequent. One can certainly not be implied, however."); see also *Dennis' Natural Mini-Meals, Inc. v. 91 Fifth Ave. Corp.*, 172 A.D.2d 331, 568 N.Y.S.2d 740 (1st Dep't 1991) (citing *Rubinstein* to hold stock transfer does not violate no-assignment clause in lease).

29 See *Friedman*, *supra* note 9, § 7:3.3(C)(1).

If the tenant is an LLC, and the lease prohibits stock transfers or partnership transfers but says nothing about transfers of LLC membership interests, the courts might allow a transfer of the LLC interests. Courts dislike Assignment Restrictions and will construe them strictly. Therefore, courts probably would hold that if the landlord wanted to prohibit transfer of LLC interests, the landlord should have said so in the lease. If that is true, it places quite a burden on any landlord whose lease was drafted before Wyoming introduced America to the LLC.

[27.6] IV. ASSIGNMENTS BY OPERATION OF LAW

Many commercial leases prohibit assignments by “operation of law.” To understand these restrictions, one first must define an assignment by operation of law. The Sixth Edition of *Black’s Law Dictionary* defines operation of law as “the manner in which rights, and sometimes liabilities, devolve upon a person by the mere application to the particular transaction of the established rules of law, without the act or cooperation of the party himself.”³⁰ The Eighth Edition of *Black’s Law Dictionary* defines operation of law as “the means by which a right or a liability is created for a party regardless of the party’s actual intent.”³¹

“Operation of law” thus refers to the transfer of rights or liabilities by court order, statute, or the like—as opposed to a voluntary and express transfer made by a party. Assignments by operation of law would include the transition of a tenant’s lease rights to the executor of the estate of a deceased tenant,³² to a legatee,³³ to a tenant’s trustee in bankruptcy³⁴ or receiver,³⁵ or through a judicial sale.³⁶ The passage of a corporate tenant’s

30 Black’s Law Dictionary 1092 (6th ed. 1990).

31 Black’s Law Dictionary 1124 (8th ed. 2004).

32 See *Francis v. Ferguson*, 246 N.Y. 516, 517 (1927); see also *Second Realty Corp. v. Fiore*, 65 A.2d 926, 927 (D.C. 1949); *Swan v. Bill*, 59 A.2d 346, 348 (N.H. 1948).

33 See *Burns v. McGraw*, 171 P.2d 148, 152 (Cal. Dist. Ct. App. 1946); see also *Squire v. Learned*, 81 N.E. 880, 881 (Mass. 1907); *Buddon Realty Co. v. Wallace*, 189 S.W.2d 1002, 1008 (Mo. Ct. App. 1945); *Charcowsky v. Stahl*, 19 Misc. 2d 1096, 189 N.Y.S.2d 384 (App. Term 1959).

34 See *Gazlay v. Williams*, 210 U.S. 41, 47 (1908); see also *Standard Operations, Inc. v. Montague*, 758 S.W.2d 442, 444 (Mo. 1988); *Miller v. Fredeking*, 133 S.E. 375, 377 (W. Va. 1926).

35 See *In re Prudential Lithograph Co.*, 265 F. 869, 871 (S.D.N.Y. 1920), *aff’d*, 270 F. 469 (2d Cir. 1920); see also *Standard Operations*, 758 S.W.2d at 444.

36 See *Friedman*, *supra* note 9, § 7:3.3(D).

lease to a successor tenant through a merger of the corporate tenant also is regarded as being by operation of law.³⁷

Like transfers of all the stock of a corporate tenant, assignments by operation of law do not violate Basic Assignment Restrictions.³⁸ Basic Assignment Restrictions are said to bar only affirmative voluntary acts by the tenant.³⁹ Because assignments by operation of law are not the assignors' voluntary acts, Basic Assignment Restrictions do not prohibit them.⁴⁰ As one possible exception to this rule, courts might not allow assignments by operation of law that were demonstrably arranged specifically to circumvent a Basic Assignment Restriction.⁴¹ Even then, courts would not necessarily interfere, because courts often are quite willing to endorse transactions that brazenly seek to "get around" Basic Assignment Restrictions, as discussed above.⁴²

As with other types of assignments, a landlord can prohibit assignments by operation of law by using Advanced Assignment Restrictions.⁴³ Again, such restrictions must be drafted with extreme specificity and clarity because most courts disfavor them and will construe them strictly against the landlord.⁴⁴

37 Part V *infra* covers mergers in some depth.

38 See *Friedman*, *supra* note 9, § 7:3.3(D).

39 See *id.*

40 See *In re Childs Co.*, 64 F. Supp. 282, 284 (S.D.N.Y. 1944) ("It is well settled under the cases that an involuntary assignment by operation of law, as we have here, does not constitute a breach of a covenant in a lease against an assignment thereof by the tenant without the consent of the landlord."); see also *Burrows Motor Co. v. Davis*, 76 A.2d 163, 165 (D.C. 1950); *Francis v. Ferguson*, 246 N.Y. 516 (1972); *Milmoe v. Sapienza*, 142 A. 360 (N.J. Ch. 1928).

41 See *Swan v. Bill*, 59 A.2d 346, 347 (N.H. 1948) ("A transfer by operation of law is not, in the absence of an express stipulation in that regard, within a provision against assignment, unless it is procured by the tenant merely for the purpose of avoiding the restriction.") (citation omitted); see also *Francis*, 246 N.Y. at 517–18.

42 See *supra* notes 21–22 and accompanying text.

43 See *In re Georgalas Bros.*, 245 F. 129, 131 (N.D. Ohio 1917); *Pacific First Bank v. New Morgan Park Corp.*, 876 P.2d 761, 765 (Or. 1994) ("If a covenant not to assign a lease expressly prohibits transfers by operation of law, then transfers by operation of law breach the covenant not to assign.") (citation omitted); see also *Clifford v. Androscoggin & K. R. Co.*, 115 A. 511, 513 (Me. 1921).

44 See *Morris v. Canadian Four State Holdings, Ltd.*, 254 A.D.2d 705, 706, 678 N.Y.S.2d 214 (4th Dep't 1998) (holding that general language prohibiting assignment "whether by operation of law or otherwise" did not contain "very special" language needed to treat devolution to executors as being a prohibited assignment); see also *Francis*, 246 N.Y. at 517–18.

Absent an Advanced Assignment Restriction that specifically refers to transfers by operation of law, tenants generally can take comfort that such transfers should not run afoul of Basic Assignment Restrictions in their lease.

[27.7] V. MERGERS

Few courts have considered whether the merger of a corporate tenant violates a Basic Assignment Restriction.⁴⁵ The courts that have considered the question typically have treated these transactions as constituting transfers by operation of law, not voluntary assignments.⁴⁶ As a result, such transfers do not violate Basic Assignment Restrictions.⁴⁷ One New York court reasoned:

[T]he merger of the subsidiary corporation into its parent corporation did not constitute an assignment for purposes of violating the nonassignment covenant in the lease. The merger did not change the beneficial ownership, possession, or control of [the subsidiary's] property or leasehold estate. Only [the subsidiary's] corporate form was affected, not the corporate property. Therefore, no assignment or similar transfer of the lease occurred.⁴⁸

Although most jurisdictions agree that Basic Assignment Restrictions do not prohibit mergers of corporate tenants, courts disagree over whether to classify the change of ownership of a leasehold estate through a merger as an actual assignment of the lease, or as a mere transfer by operation of law. The wording of the restriction in any particular lease (in the context

45 See *Friedman*, *supra* note 9, § 7:3.3(E)(2).

46 See *Middendorf v. Fuqua Indus., Inc.*, 623 F.2d 13, 16 (6th Cir. 1980) (“[T]he effect under Ohio law of the merger of [two corporations] was to transfer the leasehold by operation of law and not by assignment.”).

47 See *Dodier Realty & Inv. Co. v. St. Louis Nat'l Baseball Club*, 238 S.W.2d 321, 325 (Mo. 1951) (“The merged corporation having succeeded to the rights of the original lessee by operation of law, it follows that there was no assignment within the prohibition of the covenant in question”); *Segal v. Greater Valley Terminal Corp.*, 199 A.2d 48, 50 (N.J. Super. Ct. App. Div. 1964) (“In authorizing a corporate merger, the Legislature provided that the rights, privileges, powers, franchises ‘and all and every other interest’ of each component corporation shall vest in the successor corporation. R.S. 14:12-5, N.J.S.A. The passage of such interests under the statute, whether labeled an assignment, sublease, or transfer, is by operation of law, and it will not operate as a breach of a covenant barring assignment.”).

48 *Brentsun Realty Corp. v. D'Urso Supermarkets, Inc.*, 182 A.D.2d 604, 605, 582 N.Y.S.2d 216 (2d Dep't 1992).

of a particular state's law) can become quite important. The wording of the merger closing documents also may play a role.

Under a strict construction of Basic Assignment Restrictions, courts would prohibit mergers only if mergers pass rights through assignments rather than through mere transfers by operation of law. This question of construction becomes quite important given that most modern Assignment Restrictions specifically prohibit assignments by operation of law. Most courts that have considered this question of construction answer it by saying that a prohibition on assignments by operation of law does prohibit mergers.⁴⁹ For example, an Oregon court stated:

Although there is “meager authority” addressing the effect on a nonassignment clause of mergers by corporate tenants, where such clauses prohibit transfers “by operation of law,” such mergers are a breach of the nonassignment clause “if the effect is to transfer the lease to an entity other than that of the original tenant” *even though no interest in property is impaired by the merger*.⁵⁰

Other courts, however, have held that mergers, although “transfers” by operation of law, are not “assignments” of any kind and therefore such clauses do not reach them.⁵¹ Given the hostility of most courts toward restraints on alienation, it is unclear whether courts will continue to follow the majority rule or adopt the second, more tenant-friendly view.

Landlords that wish to prohibit mergers of their corporate tenants therefore should do so specifically, prohibiting both mergers in particular and all transfers, subleases, or assignments made by operation of law in general, in order to prohibit mergers under either reading. And a tenant

49 See *Citizens Bank & Trust Co. v. Barlow Corp.*, 456 A.2d 1283, 1289 (Md. 1983) (“The nonassignment clause used . . . in the lease of the subject premises may be characterized as of the strict type. Its inclusion of assignments by operation of law embraces transfers by merger.”).

50 *Pacific First Bank v. New Morgan Park Corp.*, 876 P.2d 761, 765 (Or. 1994).

51 See *Albermarle, Inc. v. Eaton Corp.*, 357 S.E.2d 887, 888 (Ga. Ct. App. 1987) (surviving corporation after merger more accurately described as successor than assignee); *Standard Operations Inc. v. Montague*, 758 S.W.2d 442, 443 (Mo. 1988) (“The present lease makes use of the phrase, ‘operation of law,’ which was used in the Dodier opinion to describe the transaction we found not to be covered, but continues to use the term, ‘assignment,’ which we there found to be an inappropriate description of the effect of a merger.”); *Sante Fe Energy Res., Inc. v. Manners*, 635 A.2d 648, 649 (Pa. Super. Ct. 1993) (characterizing a transfer of rights of action and property pursuant to a merger properly as succession, not assignment). The *Standard Operations* court justifies this conclusion under the theory that forfeitures must be viewed with disfavor and therefore the governing documents must be interpreted as strictly as possible.

should try equally hard to assure that any lease with Assignment Restrictions expressly permits mergers.

Given the cases just discussed, a corporate tenant planning a merger might not want to execute a document entitled “Assignment Agreement” or in any other way suggest in the merger documentation that anyone ever assigned any lease. The tenant later may wish to assert that the transaction merely amounted to a change in the identity of the tenant but in no way an assignment of the lease or a violation of a prohibition against assignments by operation of law. Making this argument might be difficult if the parties executed an Assignment Agreement. Therefore, the parties may want to name the document “Merger Implementation Agreement” or “Succession of Lease,” or to let the merger speak for itself—a reasonable position if, in fact, the parties believe the lease was never transferred and the merger did whatever it did without an assignment of the lease.

A careful purchaser of a corporate tenant should, however, consider the possibility that any merger might be deemed a prohibited assignment by operation of law—even if the closing documents try to portray the transaction as something else—and should proceed accordingly.

[27.8] VI. REQUIREMENT FOR CONSENT IF LEASE IS SILENT

Unless a lease expressly restricts the tenant’s right to assign its leasehold interest, most jurisdictions hold that the tenant may freely assign.⁵² Many state legislatures have codified this result.⁵³ A handful of states adopt the opposite view, providing by statute that a tenant cannot transfer its leasehold estate without the landlord’s consent even if the lease says nothing on the issue.⁵⁴

52 See *Joseph Bros. Co. v. F.W. Woolworth Co.*, 641 F. Supp. 822 (N.D. Ohio 1985), *modified*, 844 F.2d 369, 374 (6th Cir. 1988) (tenant did not need landlord’s consent to sublease absent restriction in lease); *Jenkins v. Eckerd Corp.*, 913 So.2d 43, 50 (Fla. Dist. Ct. App. 2005); *Cole v. Ignatius*, 448 N.E.2d 538, 541 (Ill. App. Ct. 1983); *Dress Shirt Sales, Inc. v. Hotel Martinique Assocs.*, 12 N.Y.2d 339, 239 N.Y.S.2d 660 (1963); *International Chefs Inc. v. Corporate Prop. Investors*, 240 A.D.2d 369, 658 N.Y.S.2d 108 (2d Dep’t 1997); see also Restatement (Second) of Prop: Landlord & Tenant § 15.1 (1977).

53 See, e.g., Del. Code Ann. tit. 25, § 5512(a) (1989 & Supp. 2008); La. Civ. Code Ann. art. 2713 (2005). Other statutes set tenant-friendly rules for residential leases, but those lie beyond this discussion.

54 See, e.g., Alaska Stat. § 34.03.060 (2008); Ga. Code Ann. § 44-7-1 (1991); S.C. Code Ann. § 27-35-60 (2007); Texas Prop. Code Ann. § 91.005 (Vernon 2007) (tenant may not assign without landlord’s consent); Wis. Stat. Ann. § 704.09(1) (West 2001).

Courts generally disfavor restrictions on alienability and typically will refuse to find any implied restrictions.⁵⁵ In practice, therefore, leases are rarely entirely silent on the issue of transferability. Leases almost always seek to restrict the tenant's power to transfer his or her leasehold interest. Few commercial landlords or their counsel will tolerate silence on assignment restrictions in a lease.

[27.9] VII. REASONABLENESS IN DENYING CONSENT

[27.10] A. Whether Required

In most states, including New York, the rule remains that if a lease prohibits assignment or subletting without the landlord's consent, the landlord may refuse consent arbitrarily and for any or no reason at all—and may even extract payment as a condition for consent⁵⁶—unless the lease specifically requires any refusal of consent to be reasonable.⁵⁷ Under the

55 See *Mann Theatres Corp. v. Mid-Island Shopping Plaza Co.*, 94 A.D.2d 466, 464 N.Y.S.2d 793 (2d Dep't 1983). For two rare examples of courts inferring restrictions on transferability, see *Stacy v. Midstates Oil Corp.*, 36 So. 2d 714, 720 (La. 1947) (lease allowed removal of minerals, and court concluded that an increase in the number of persons extracting minerals would impose a burden on landlord's estate); *Nassau Hotel Co. v. Barnett & Barse Corp.*, 162 A.D. 381, 147 N.Y.S. 283 (1st Dep't 1914) (tenant was experienced hotel operator paying percentage rent).

56 See *Alwen v. Tramontin*, 228 P. 851, 852 (Wash. 1924) (enforcing a lease provision requiring tenant to pay a fee for landlord's consent to assignment in a jurisdiction that does not require a landlord to act reasonably in withholding consent). But see *Banc of Am. Secs. LLC v. Solow Bldg. Co. II, L.L.C.*, 47 A.D.3d 239, 847 N.Y.S.2d 49 (1st Dep't 2007) (landlord's demand for a large payment as a condition to consenting to tenant's alterations treated as quasi-tortious monetary harm absent lease provision requiring fee; holding based less on the words of the lease than on a tort-like analysis of landlord's acts).

57 Courts (although not necessarily all courts) in these jurisdictions have adopted this majority rule: Colorado, Connecticut, Delaware, Georgia, Indiana, Kentucky, Louisiana, Maryland, Massachusetts, Michigan, Minnesota, Nebraska, New Hampshire, New Jersey, New York, North Dakota, Ohio, Pennsylvania, South Carolina, Texas, Vermont, and Washington. Because of the frequency with which this issue arises and the likelihood of changes in the law, the preceding list (which was based on limited research) should not be relied upon. For a description of cases in some of these jurisdictions, see James C. McLoughlin, Annotation, *When Lessor May Withhold Consent Under Unqualified Provision in Lease Prohibiting Assignment or Subletting of Leased Premises Without Lessor's Consent*, 21 A.L.R.4th 188, § 3 (2004).

traditional majority rule, a landlord bears no obligation to act “reasonably” or “in good faith” in considering a request for such consent.⁵⁸

A small but growing minority of jurisdictions hold, however, that a landlord must act reasonably in withholding consent even if the lease does not require reasonableness. One commentator suggested the following basis for this trend:

The reasoning behind the rule allowing nearly total landlord control over tenant transfers, in the absence of a lease provision to the contrary, no longer holds sway with many judges, lawmakers, and commentators. Relationships between landlord and tenant have become more impersonal These changes and concerns have had a profound impact on courts and legislatures [M]odern courts have almost universally adopted the view that restrictions on the tenant’s right to transfer are to be strictly construed.⁵⁹

58 In New York, at least, the courts apply similar principles in interpreting and applying any contract that requires the other party’s consent but does not expressly require the other party to act reasonably. See, e.g., *State St. Bank & Trust Co. v Inversiones Errazuriz Limitada*, 374 F.3d 158 (2d Cir. 2004); *Teachers Ins. & Annuity Ass’n of Am. v. Wometco Enters., Inc.*, 833 F. Supp. 344 (S.D.N.Y. 1993). These cases teach that New York courts will not infer a reasonableness requirement from some kind of implied covenant of good faith and fair dealing. In *State Street Bank*, the party withholding consent demanded payment in exchange for consent, and the court specifically allowed that. See 374 F.3d at 169. Texas also has refused to infer a general duty of good faith and fair dealing in real property contracts. See *Trinity Prof’l Plaza Assocs. v. Metrocrest Hosp. Auth.*, 987 S.W.2d 621, 625–26 (Tex. App. 1999).

59 2 Richard R. Powell, *Powell on Real Property* § 17.04[1][c][ii] (Michael Allan Wolf ed., 2008).

Florida and Illinois, among other states,⁶⁰ have adopted this position. California codified a presumption of reasonableness for purposes of ascertaining whether a landlord's consent was reasonable, and placed the burden of proof on the tenant to determine otherwise.⁶¹ The California statute allows the parties to contract around this presumption by setting express standards in the lease.⁶²

A 2005 California federal court case⁶³ restated this rule by holding that when the contract unambiguously grants one party an unqualified right, "in its sole discretion, to terminate the negotiations with any prospective [s]ubtenant or assignee at any time and to refuse to enter into any sublease or with any prospective subtenant,"⁶⁴ that party can not only refuse to

60 Courts, though not necessarily all courts, in these jurisdictions have adopted this minority rule: Alabama, Alaska, Arizona, Arkansas, California, Colorado, Connecticut, District of Columbia, Florida, Georgia, Idaho, Illinois, Louisiana, Maryland, Massachusetts, Nebraska, New Mexico, North Carolina, Ohio, Oregon, and Tennessee. Because of the frequency with which this issue arises and the likelihood of changes in the law, the preceding list (based on limited research) should not be relied upon. For a description of cases in some of these jurisdictions, see James C. McLoughlin, Annotation, *When Lessor May Withhold Consent Under Unqualified Provision in Lease Prohibiting Assignment or Subletting of Leased Premises Without Lessor's Consent*, 21 A.L.R.4th 188, § 3 (2004). See also *Pacific First Bank v. New Morgan Park Corp.*, 876 P.2d 761, 762 (Or. 1994) (applying contractual duty of good faith to lease agreements, which requires adherence to reasonable expectations of parties—a standard that may in practice leave it all up to the judge, potentially many years after the fact); *Cafeteria Operators, L.P. v. AMCAP/ Denver Ltd. P'ship*, 972 P.2d 276, 278 (Colo. Ct. App. 1998) ("[W]ithout a freely negotiated provision in the lease giving the landlord an absolute right to withhold consent, a landlord's decision to withhold must be reasonable."); Restatement (Second) of Prop.: Landlord & Tenant § 15.2(2) (1977) (lease may prohibit lessee's assignment without lessor's consent, but lessor may not withhold consent unreasonably unless a freely negotiated provision confers absolute discretion on lessor).

61 See Cal. Civ. Code §§ 1995.010–1995.340. Other states also have enacted statutes providing that a landlord cannot unreasonably withhold consent to a transfer by the tenant. See Alaska Stat. § 34.03.060 (commercial and residential leases); Del. Code. Ann. tit. 25, § 5508(c) (residential leases). In New York, a landlord cannot unreasonably refuse consent to assignment of a residential lease but may withhold consent arbitrarily for commercial leases. See N.Y. Real Prop. Law § 226-b.

62 Well-represented landlords presumably will do so. Hence, each lease now may contain yet another state-specific paragraph, probably in all capital letters and requiring the parties to add their initials to prove they were awake. And leases will grow a little bit longer yet again.

63 See *Turkus v. Egreetings Network, Inc.*, 2005 WL 2333834 (N.D. Cal. Sept. 19, 2005). The court also restated the rule that "where a discretionary right in a contract i[s] unambiguous, a party may not invoke the implied covenant of good faith and fair dealing." *Id.* at *4 n.3. This case involved a real-estate-related consent right other than the typical landlord's right to consent to a sublease, but the same principles should apply.

64 *Id.* at *4.

enter into any sublease proposals but also can refuse even to consider any and all proposed sublease agreements.⁶⁵

As in so many other areas, New York diverges from California and follows the majority rule, tending to prefer private negotiations over judicial improvement (and often rewriting) of privately negotiated agreements. If a New York lease contains a Transfer Restriction, the landlord need not be reasonable in refusing consent unless the lease language specifically so requires.⁶⁶ Absent an agreement otherwise, a New York landlord may impose conditions, including payment, as a prerequisite to consent.⁶⁷ (One court, however, held such conditions may amount to economic duress,⁶⁸ demonstrating yet again how these outcomes can depend on the particular judge rather than the consistent application of predictable legal principles, even in New York.) Like other restrictions on alienation of property, though, Transfer Restrictions are disfavored. Therefore, courts will construe such clauses strictly against any restrictions on alienation.⁶⁹

65 See *id.*

66 See *Mann Theatres Corp. v. Mid-Island Shopping Plaza Co.*, 94 A.D.2d 466, 470, 464 N.Y.S.2d 793 (2d Dep't 1983) ("[W]here the lease contains an express provision restricting assignment or subletting without the landlord's consent, the landlord may arbitrarily refuse consent for any or for no reason, unless the provision requires that consent not be unreasonably withheld."); *aff'd*, 62 N.Y.2d 930, 479 N.Y.S.2d 213 (1984); see also *Caridi v. Markey*, 148 A.D.2d 653, 539 N.Y.S.2d 404 (2d Dep't 1989) (recognizing the need to protect a landlord's substantial interest in controlling assignability of leases in New York); *Arlu Assocs., Inc. v. Rosner*, 14 A.D.2d 272, 220 N.Y.S.2d 288 (1st Dep't 1961), *aff'd*, 12 N.Y.2d 693, 233 N.Y.S.2d 477 (1962); *Kruger v. Page Mgmt. Co., Inc.*, 105 Misc. 2d 14, 432 N.Y.S.2d 295 (Sup. Ct., N.Y. Co. 1980) (including subletting in the majority rule).

67 See *Durand v. Lipman*, 165 Misc. 615, 621–22, 1 N.Y.S.2d 468 (Mun. Ct., N.Y. Co. 1937) ("The landlord . . . could withhold such consent, even arbitrarily. Hence the landlord was at liberty to impose such conditions as he deemed proper as a prerequisite to his consent to the assignment."); see also *Herlou Card Shop, Inc. v. Prudential Ins. of Am.*, 73 A.D.2d 562, 422 N.Y.S.2d 708 (1st Dep't 1979). Friedman notes, however, that the courts do not view such practices favorably, and this aversion may be driving some jurisdictions to the minority rule. See *Friedman*, *supra* note 9, § 7:3.4(A). ("[T]he minority cases generally involve a demand by landlord from tenant for something in excess of the tenant's lease obligations, usually a rent increase or equivalent, which one court called 'blood money' A few more 'blood money' cases could provoke a change [in other jurisdictions to requiring reasonableness in withholding consent].")

68 See *Equity Funding Corp. v. Carol Mgmt. Corp.*, 66 Misc. 2d 1020, 322 N.Y.S.2d 965 (Sup. Ct., N.Y. Co. 1971), *aff'd* 37 A.D.2d 1047, 326 N.Y.S.2d 384 (1st Dep't 1971).

69 See *Kruger*, 105 Misc. 2d 14; see also *Chanslor-Western Oil & Dev. Co. v. Metro. Sanitary Dist.*, 131 Ill.App.2d 527, 266 N.E.2d 405 (Ill. App. Ct. 1970); *Ring v. Mpath Interactive*, 302 F. Supp. 2d 301, 306 (S.D.N.Y. 2004).

[27.11] B. What Constitutes Reasonableness

Even if a Transfer Restriction or governing law requires a landlord to act “reasonably” or not “unreasonably” in withholding consent, it is not at all clear what “reasonable” means. Although landlords cannot seize on absolutely any creative excuse to withhold consent, no single rule or set of rules for defining reasonableness exists.

The question of “reasonableness” therefore generally remains an issue for the trier of fact to decide,⁷⁰ with the result that consistent legal principles—or predictable results—are quite hard to find in this area. Friedman wrote: “What is ‘reasonable’ at one time may not be at another.”⁷¹ This standard requires the factfinder to consider whether a reasonably prudent person in the landlord’s position would have withheld consent.⁷² Considerations of mere personal taste and convenience—personal idiosyncrasies of the landlord—probably are not reasonable.⁷³ The test of reasonableness is an objective one, based on the standard of a reasonable prudent person

70 See *Worcester-Tatnuck Square CVS, Inc. v. Kaplan*, 601 N.E.2d 485, 488 (Mass. App. Ct. 1992) (“Whether a lessor acts reasonably in withholding his consent to a sublease, therefore, is a question for the finder of fact.”); *Am. Book Co. v. Yeshiva Univ. Dev. Found., Inc.*, 59 Misc.2d 31, 33, 297 N.Y.S.2d 156 (Sup. Ct., N.Y. Co. 1969) (“The standards of ‘reasonableness’ have not heretofore been clearly delineated by any single New York case, but are left to the trial court to determine in accordance with the particular factual patterns before it, and the conceptual boundaries may be only faintly discerned in the few reported cases.”); see also Cal. Civ. Code § 1995.260.

71 *Friedman*, *supra* note 9, § 7:3.4[D][3].

72 See *Ramco-Gershenson Props., L.P. v. Serv. Merch. Co., Inc.*, 293 B.R. 169, 177 (M.D. Tenn. 2003) (applying commercial reasonableness standard to landlord’s withholding of consent); *Ringwood Assocs., Ltd. v. Jack’s of Route 23, Inc.*, 379 A.2d 508, 511 (N.J. Super. Ct. 1977); *Ernst Home Ctr. v. John Y. Sato*, 910 P.2d 486, 492 (Wash. Ct. App. 1996).

73 See *Worcester*, 601 N.E.2d at 488–89; see also *Broad & Branford Place Corp. v. J.J. Hockenjos Co.*, 39 A.2d 80, 82 (N.J. 1944); *John Hogan Enters. v. Kellogg*, 187 Cal. App. 3d 589, 592 (1986); *Chanslor-Western*, 266 N.E.2d at 405; *Maxima Corp. v. Cystic Fibrosis Found.*, 568 A.2d 1170, 1176 (Md. Ct. Spec. App. 1990) (any landlord is “normally expected to act pursuant to reasonable commercial standards, without regard to subjective attitudes personal to the landlord”); *Ontel Corp. v. Helasol Realty Corp.*, 130 A.D.2d 639, 640, 515 N.Y.S.2d 567 (2d Dep’t 1987) (calling a situation in which lessor’s general manager denied consent because he thought assignee’s representative should have contacted him to discuss assignee’s financial status an example of “subjective concerns and personal desires” that “cannot play a role in a landlord’s decision to withhold its consent”).

without considering the particular circumstances or agenda of the landlord.⁷⁴

Despite the nebulous nature of the reasonableness standard, the court in *American Book Co. v. Yeshiva University Development Foundation, Inc.*⁷⁵ set forth a nonexhaustive list of objective standards for determining reasonableness. Other courts have followed them.⁷⁶ These standards:

are readily measurable criteria of a proposed subtenant's or assignee's acceptability, from the point of view of *any* landlord:

- (a) financial responsibility [of the proposed subtenant]⁷⁷
- (b) the “identity” or “business character” of the subtenant—i.e. his suitability for the particular building

74 *Tenet v. Jefferson Parish Med. Ctr.*, 426 F.3d 738, 743 (5th Cir. 2005). In this well-reasoned Fifth Circuit case, a real estate investor leased space to a tenant for a medical use. The lease said the landlord would not unreasonably withhold consent to an assignment. The original landlord sold the property to a hospital. The original tenant proposed to assign to a different type of medical use, one the lease would allow but that would compete with the hospital in ways the previous tenant would not have. The hospital, as the new landlord, withheld consent based on concern about competition. *See id.* at 740. The hospital argued that: (a) reasonableness depends in part on the identity and circumstances of the landlord at the moment the tenant requests the landlord's consent and (b) if the current landlord wants to protect itself from competition, that constitutes a reasonable basis to withhold consent. *See id.* at 742–44. The court disagreed, stating: “In determining whether a landlord's refusal to consent was reasonable in a commercial context, only factors that relate to the landlord's interest in preserving the leased property or in having the terms of [the] prime lease performed should be considered.” *Id.* at 743. The court also reasoned that a future landlord's ability to tighten the scope of permitted assignments based on circumstances peculiar to that landlord would amount to an expansion of the landlord's rights under the lease without the tenant's consent. *See id.* at 744. (Of course, this court also would not have allowed the original landlord to assert its own personal circumstances, *see id.* at 744, so the argument carries little additional weight.) *See also Logan & Logan, Inc. v. Audrey Lane Laufer, LLC*, 34 A.D.3d 539, 539, 824 N.Y.S.2d 650 (2d Dep't 2006) (if a landlord has agreed not to unreasonably withhold consent, the landlord may consider only “objective factors such as the financial responsibility of the [proposed assignee], the [proposed assignee's] suitability for the particular building, the legality of the proposed use and the nature of occupancy”); *Sayed v. Rapp*, 10 A.D.3d 717, 720, 782 N.Y.S.2d 278 (2d Dep't 2004); *Astoria Bedding, Mr. Sleeper Bedding Ctr. v. Northside P'ship*, 239 A.D.2d 775, 657 N.Y.S.2d 796 (3d Dep't 1997).

75 59 Misc. 2d 31, 297 N.Y.S.2d 156 (Sup. Ct., N.Y. Co. 1969).

76 *See Fernandez v. Vazquez*, 397 So. 2d 1171 (Fla. Dist. Ct. App. 1981); *Ernst Home Ctr.*, 910 P.2d at 493 (discussing factors landlord can reasonably consider).

77 This item is perhaps more important than ever in an era when creditworthy financial institutions commonly vanish over a weekend.

- (c) the legality of the proposed use⁷⁸
- (d) the nature of the occupancy—i.e. office, factory, clinic, or whatever.⁷⁹

Starting with the first criterion suggested above, a landlord probably acts reasonably in refusing consent unless the tenant gives the landlord reasonable evidence that the proposed assignee is ready, willing, and able to perform under the lease.⁸⁰ A reasonable belief (supported by reasonable evidence) that a proposed assignee cannot pay the rent should almost always give a landlord reasonable grounds to deny consent.⁸¹ A landlord also almost always should be deemed reasonable in refusing consent if the proposed assignee does not deliver adequate financial information in a timely manner so that the landlord can ascertain whether the proposed assignee is financially responsible.⁸²

Other considerations can, however, sometimes outweigh financial responsibility. For example, a landlord's refusal to allow financially

78 If the proposed assignee or subtenant would or might use the premises in violation of the lease (whether the use clause, an obligation to comply with law, or any other lease terms), why shouldn't the landlord be relegated to its rights and remedies if and when a violation actually occurs? Why should this discussion be a component of reasonableness at all? The answer may be that the courts cannot be relied upon to enforce the landlord's rights and remedies for a nonmonetary breach, and therefore the landlord should be able to point to the likelihood of such a breach as a reason to withhold consent. And an ordinary, objectively motivated landlord would have precisely that concern, so it fits into the template of reasonableness.

79 *Am. Book Co.*, 59 Misc. 2d at 33.

80 *See Golf Mgmt. Co. v. Evening Tides Waterbeds, Inc.*, 572 N.E.2d 1000 (Ill. App. Ct. 1991). One can determine what makes an assignee ready, willing, and able from, for example, *Vranas & Assocs., Inc. v. Family Pride Finer Foods, Inc.*, 498 N.E.2d 333 (Ill. App. Ct. 1986) (a buyer is ready, willing, and able, for purposes of a purchase and sale contract, if the buyer has sufficient resources on hand or can command necessary funds within the required time).

81 *But see Ring v. Mpath Interactive*, 302 F. Supp. 2d 301, 306 (S.D.N.Y. 2004) (landlord's unsubstantiated assertion that some unspecified documents showed subtenant to be a financial risk constitutes an unreasonable refusal of consent); *see also Friedman, supra* note 9, § 7:3.4[D][3]. Friedman points out "[i]nasmuch as neither assignment nor subletting releases the original tenant from his lease obligations, it may be argued that the landlord has all he bargained for regardless of the wealth or skill of the assignee or subtenant." *Id.* Friedman notes, however, that the little relevant authority on the issue has held that the landlord is entitled to a responsible assignee. *See id.* In practice, landlords prefer a financially responsible assignee or subtenant to minimize the likelihood of default and litigation against the tenant, even though the tenant will remain liable on the lease. That preference generally is accepted and taken seriously in the real estate industry.

82 *See 200 Eighth Ave. Rest. Corp. v. Daytona Holding Corp.*, 293 A.D.2d 353, 740 N.Y.S.2d 330 (1st Dep't 2002) (noting financial information later submitted by proposed assignee showed proposed assignee was not financially capable of assuming lease obligations).

responsible parties as multiple subtenants was upheld when subdivision of the leased space would have been undesirable in a “prestige building.”⁸³

Although the second factor listed above, the “identity” or “business character” of the subtenant/assignee, may be used as a reasonable basis for a landlord to reject an assignment, landlords asserting this argument bear a heavy burden of proof.⁸⁴

One New York case involved an Assignment Restriction that required the landlord to be reasonable, but stated that the landlord could consider the “business reputation of the proposed assignee or subtenant,” as well as “the effect that the proposed assignee or subtenant’s occupancy or use of the demised premises would have upon the operation and maintenance of the building and the landlord’s investment therein.”⁸⁵ Although the court in that case began by analyzing the factors listed above, it rejected the landlord’s substantial evidence that assignment to a financially responsible bank with an alleged “bad business reputation” would lower the value of the property.⁸⁶ This case reflects judicial skepticism of landlords who turn down assignments based on allegedly bad characteristics of the assignee.

Courts have, however, held that a landlord reasonably may deny consent under these circumstances:

83 *Time, Inc. v. Tager*, 46 Misc. 2d 658, 260 N.Y.S.2d 413 (Civ. Ct., N.Y. Co. 1965). Here, the tenant sought the landlord’s consent to sublet part of the leased space to a subtenant. The court found the landlord’s decision to withhold consent reasonable, even though after terminating the lease with the tenant, the landlord proceeded to rent the space to the same proposed subtenant. *See id.*

84 *See Ernst Home Ctr. v. John Y. Sato*, 910 P.2d 486, 493 (Wash. Ct. App. 1996) (while tone and image are valid considerations, landlord must be able not only to express (concoct?) appropriate concerns but also to “produce evidence that a trier of fact could examine objectively”). *But see Mowatt v. 1540 Lake Shore Drive Corp.*, 385 F.2d 135, 137–38 (7th Cir. 1967) (landlord was reasonable in withholding consent based on criteria such as insolvency, association with disreputable people, and noisiness, which would be undesirable characteristics of cotenants). The lease in *Mowatt* was residential, but the court’s reasoning does demonstrate criteria to assess a landlord’s reasonableness. *See id.*

85 *Chase Manhattan Bank, N.A. v. Lincoln Plaza Assocs.*, 201(5) N.Y.L.J. 22 col. B (Jan. 9, 1989).

86 *Id.* Chase Manhattan wanted to assign its lease to Bank Leumi. The landlord rejected the assignment, saying Bank Leumi had a “bad business reputation,” was plagued by “image problems,” and was “simply not a Chase Manhattan.” As evidence, the landlord introduced (among other things) news articles on indictments of several of the bank’s low-level officers and economic problems and stock scandals in Israel, Bank Leumi’s home country. The landlord also presented affidavits by real estate attorneys and appraisers that a Bank Leumi tenancy would lower the value of the building. Presumably the tenant offered competing affidavits from other attorneys and appraisers.

- A landlord is unaware of the assignee's proposed use;⁸⁷
- A proposed subtenant would compete with other businesses in the same shopping center, prejudicing the landlord's relationship with other tenants;⁸⁸
- Gross sales, and thus percentage rents, would drop (in the case of a percentage lease);⁸⁹ and

The mix of tenants is critical to the success of the landlord, such as in a shopping center.⁹⁰

Unreasonable grounds for denial, as found by courts, include:

- A proposed subtenant would compete with the landlord's business;⁹¹

87 See *Kroger Co. v. Rossford Indus. Corp.*, 261 N.E.2d 355 (Ohio Ct. Com. Pl. 1969).

88 See *Kenney v. Eddygate Park Assocs.*, 34 A.D.3d 1017, 825 N.Y.S.2d 297 (3d Dep't 2006). In this New York case, a tenant had wanted to assign its lease to a Korean restaurant in 1999. The landlord rejected the assignment because the complex already had a Chinese restaurant, and the landlord had said it did not want to see competition it considered inappropriate. See *id.* at 1018. Several years later, the plaintiff moved out. In 2003, the landlord leased the exact same space to a Korean restaurant. The first tenant sued, claiming the landlord unreasonably had withheld its consent to the proposed 1999 assignment. The court ruled the landlord reasonably had based its first decision on objective factors because in 1999 the first tenant did not offer to indemnify the landlord against claims from the Chinese restaurant, something the new tenant did agree to do. See *id.* at 1018–19. In addition, the marketplace had changed enough from 1999 to 2003 to justify the landlord's later decision that an increasing demand for Asian food would support both a Chinese restaurant and Korean restaurant. See *id.* This case demonstrates how a reasonableness standard, though objective, might change over time depending on both particular facts and overall market conditions. See also *Norville v. Carr-Gottstein Foods Co.*, 84 P.3d 996, 1002 (Alaska 2004) (recognizing that concerns about competition with a primary tenant were plausible).

89 See *Norville*, 84 P.3d at 1002; see also *Worcester-Tamuck Square CVS, Inc. v. Kaplan*, 601 N.E.2d 485, 489 (Mass. App. Ct. 1992) (“[Landlord] could reasonably insist upon a subtenancy that would be likely to generate at least a reasonable amount of percentage rent.”).

90 See *Warmack v. Merchants Nat'l Bank*, 612 S.W.2d 733, 735 (Ark. 1981) (upholding landlord's refusal to consent to assignment from bank to savings and loan, where savings and loan would draw neither the same nor as many customers as bank); see also *Ramco-Gershenson Props. L.P. v. Serv. Merch. Co.*, 293 B.R. 169, 174–75 n.3 (M.D. Tenn. 2003) (“[T]he tenant mix in a shopping center may be as important to the lessor as the actual promised rental payments . . .”) (quoting H.R. REP. NO. 95-595, at 348–49 (1977), as reprinted in 1978 U.S.C.A.N. 5963, 6305).

91 See *Tenet Healthsystem Surgical, LLC v. Jefferson Parish Hosp.*, 426 F.3d 738, 744 (5th Cir. 2005) (landlord's withholding of consent unreasonable when premised on concern that the assignee would compete with the landlord's business; instead, landlord's refusal “must relate to the ownership and operation of the leased property, not lessor's general economic interest.”); see also *Edelman v. F.W. Woolworth Co.*, 252 Ill. App. 142 (1929) (finding a similar denial unreasonable where landlord's business was located a block away from potential competitor's business).

- A tenant would make a profit from the assignment or sublease;⁹²
- A landlord has philosophical objections to the proposed tenant's business;⁹³
- A landlord dislikes a particular business or method of doing business;⁹⁴
- The prospective assignee is already an existing tenant;⁹⁵ and
- A landlord attempts to "extract a financial concession or to improve its financial position."⁹⁶

The above hardly represents a complete list of all factors that courts have considered in determining reasonableness. Potential assignors and assignees should consult case law regarding reasonableness in each applicable jurisdiction and should remember that courts may rule differently on the same grounds for rejection, depending on the facts of the particular case, and, perhaps, on what the judge had for breakfast. Landlords, in turn, should plan carefully and consult counsel before taking any action or

92 *See Stauffer Chem. Co. v. Fisher-Park Lane Co.*, 63 Misc. 2d 511, 312 N.Y.S.2d 243 (Sup. Ct., N.Y. Co. 1970); *see also Kendall v. Ernest Pestana, Inc.*, 709 P.2d 837, 845, 847-48 (Cal. 1985) (stating that a landlord has no claim to financial benefits a tenant may gain by alienating the leasehold during its term); *Carter v. Safeway Stores*, 744 P.2d 458, 461 (Ariz. Ct. App. 1987).

93 *See Am. Book Co. v. Yeshiva Univ. Dev. Found., Inc.*, 59 Misc. 2d 31, 297 N.Y.S.2d 156 (Sup. Ct., N.Y. Co. 1969) (refusal to consent to assignment was unreasonable where landlord, a religious university, objected to tenant's sublease to a Planned Parenthood office). A landlord with special sensitivities of this type may wish to build appropriate restrictions into the lease or insist on an absolutely discretionary right of approval.

94 *See Broad & Branford Place Corp. v. J.J. Hockenjos Co.*, 39 A.2d 80 (N.J. 1944) (holding refusal to consent to assignment was unreasonable where proposed assignee was a dressed poultry store); *see also Roundup Tavern, Inc. v. Pardini*, 413 P.2d 820 (Wash. 1966) (objection to tavern).

95 *See Catalina, Inc. v. Biscayne Ne. Corp. of Fla.*, 296 So. 2d 580, 582-83 (Fla. Dist. Ct. App. 1974) (noting that such a refusal to consent would be reasonable if proposed sublease would have destroyed or adversely affected preexisting lease).

96 *See Worcester-Tatnuck Square CVS, Inc. v. Kaplan*, 601 N.E.2d 485, 489 (Mass. App. Ct. 1992); *see also Kendall v. Ernest Pestana, Inc.*, 709 P.2d 837, 845 (Cal. 1985) ("[T]he lessor's desire for a better bargain than contracted for has nothing to do with the permissible purposes of the restraint on alienation . . ."); *Campbell v. Westdahl*, 715 P.2d 288 (Ariz. Ct. App. 1985); *Giordano v. Miller*, 288 A.D.2d 181, 182, 733 N.Y.S.2d 94 (2d Dep't 2001) (landlord's demand that tenant pay landlord a fee as a condition precedent to landlord's granting of consent was unreasonable). Although New York law allows a landlord to demand payment as a condition to granting consent if the lease is silent, the lease in *Giordano* specified that the landlord could not withhold its consent unreasonably, and the lease did not allow such a fee. Hence, the court regarded the landlord's fee request as unreasonable.

imposing any condition on a tenant that could create an appearance of acting in an idiosyncratic, unreasonable, or indefensible manner. Landlords and their counsel should be careful about creating a paper (or email) trail that suggests anything but pure, objective, and reasonable motivations.

[27.12] C. Withholding Consent Versus Refusing Consent

One Colorado case purported to distinguish between a landlord’s “withholding” and “refusing” consent to a proposed assignment.⁹⁷ In *Parr*, the lease allowed the tenant to assign with the landlord’s prior consent, and also said the landlord could not unreasonably “withhold” that consent.⁹⁸

The tenant told the landlord it wanted to assign the lease, and the landlord asked for certain information. The tenant provided all the information and the landlord did nothing.⁹⁹ The landlord deferred making any decision at all, even though the tenant told the landlord that timing was crucial. The tenant turned out to be right, and “lost the deal.”¹⁰⁰

The court concluded that the provision stating the landlord could not “withhold” consent meant the landlord could not silently let an unreasonable amount of time go by without a response.¹⁰¹ The court suggested that if the lease had said the landlord could not “refuse” consent, then the landlord might violate the lease only if the landlord took some affirmative action to refuse consent, or made some affirmative statement of rejection; mere inaction, however, might be just fine.¹⁰² Because the lease prohibited unreasonable withholding of consent (not “refusal” of consent), the landlord’s failure to respond amounted to a withholding of consent.¹⁰³ In contrast, if the lease had said the landlord could not “unreasonably refuse” consent, then mere silence might have been acceptable.

No court in any other case reviewed for this chapter drew any similar distinction between a landlord’s “withholding” or “refusing” consent. Nevertheless, if this distinction actually exists, then landlords’ counsel

97 See *Parr v. Triple L&J Corp.*, 107 P.3d 1104 (Colo. Ct. App. 2004).

98 *Id.* at 1105–06.

99 *Id.* at 1106.

100 *Id.* at 1107.

101 *Id.*

102 *Id.* at 1108.

103 *Id.*

might want any lease to say the landlord will not “unreasonably refuse” consent. Correspondingly, tenants’ counsel might want to use the words “unreasonably withhold” consent. In any event, the case is hardly persuasive. Most lease provisions on this issue do tend to use the words “unreasonably withhold” rather than “unreasonably refuse” consent.

[27.13] VIII. LESSONS FOR A LANDLORD

A landlord should consider these suggestions when writing or reviewing Transfer Restrictions in leases:

- *Uphill Battle.* Courts dislike restrictions on alienation and will strictly construe them. When landlord’s counsel drafts such a restriction, counsel should draft both broadly and precisely, and think also about every likely or possible future transaction.
- *Prohibit Equity Transfers.* Include specific language that prohibits the transfer of control of a corporate or other entity tenant. This language also should prohibit the creation and sale of new stock or other equity interests. The language should be broad enough to refer to all present and future entity types and equity types, including any not yet created.
- *Change of Control.* Prohibitions against the transfer of control seem appropriate only when dealing with corporations that have a small number of shareholders. If the landlord really cares about these restrictions, the lease or a separate document should memorialize who actually holds the tenant’s stock on the date of lease signing.
- *Operation of Law.* Include language prohibiting transfers, subleases, or assignments by operation of law.
- *Murkiness on Mergers.* A landlord should specifically prohibit mergers or, more generally, prohibit a whole laundry list of possible transactions—“all (a) assignments, subleases, mergers, and consolidations, and (b) transfers of any kind occurring by operation of law.”
- *Consent Standards.* Explicit standards regarding consent tend to prevail over any presumed reasonableness standard, so it is better to state what the parties consider “reasonable.” Without a specific standard, the outcome is unpredictable, which may concern a tenant more than a landlord. If the parties intend to allow the landlord to be unreason-

able, then the drafter should, just to prevent possible issues, state that the landlord can withhold consent in its sole and absolute discretion, can impose a fee for consent, and need not even consider the tenant's request for consent.

- *Idiosyncratic Tastes.* If the landlord wants the right to withhold consent for reasons specific to that particular landlord—religious beliefs, personal tastes, the landlord's own activities—the lease should say so expressly or, better yet, give the landlord an absolute discretionary right to withhold consent.
- *Liability for Unreasonableness.* If a landlord agrees to be reasonable, the landlord should disclaim any liability for failing to be reasonable. The lease should say that the tenant's only remedy in that case would be to obtain equitable relief deeming the landlord's consent granted.

[27.14] IX. LESSONS FOR A TENANT

A tenant should consider these suggestions to mitigate the risks of Transfer Restrictions:

- *Cut Them Back.* Try to limit Transfer Restrictions as much as possible. If feasible, avoid Advanced Assignment Restrictions entirely. If avoiding these restrictions is not possible, at least try to obtain the landlord's preapproval of certain likely corporate transactions that obviously would not constitute devices to evade the Assignment Restrictions (for example, any bona fide corporate transaction, or transactions affecting the tenant's entire business or at least multiple tenant sites, such as at least 50% of the tenant's locations in California). State that the landlord will not unreasonably "withhold" consent as opposed to unreasonably "refuse" consent. Consider adding a statement that any transaction not expressly banned shall be deemed permitted, though the courts typically will reach this conclusion anyway, as noted above.¹⁰⁴
- *Define Reasonableness Favorably.* Consider any issues particularly likely to arise if the tenant ever tries to assign. Does a particular type of alternative use of the space seem particularly likely? If so, perhaps ask the landlord to preapprove that particular use (and charge of permitted uses, if necessary) to prevent arguments that a reasonable landlord would never allow it. Or, if the tenant might want to assign to a range of possible business categories, the lease might list all of them, with a

¹⁰⁴ See *supra* Part VI.

sample brand name for each category to define a standard of operation that will be deemed automatically reasonable; for example, “an office supply store similar to or better than Staples®.”

- *Early Attention.* Particularly for a real-estate-intensive tenant with high-value leases, consider the effect of Assignment Restrictions in the earliest stages of structuring the transaction. Treat them as fundamental business issues.
- *Identify and Use Leverage.* If the landlord ever requests any accommodation or amendment related to an existing lease, try to use it as an opportunity to trim back any Transfer Restrictions in the lease.

[27.15] X. CONCLUSION

Transfer Restrictions can create unpleasant surprises for both landlords and tenants. As the first step toward preventing those surprises, parties to commercial leases initially need to understand what the various Transfer Restrictions mean, and then confirm that those restrictions reflect the parties' expectations. This chapter offers that starting point.

CHAPTER TWENTY-EIGHT

ASSIGNMENT AND ASSUMPTION OF LEASES

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[28.0] I. INTRODUCTION

Assignments of leases of commercial space are a topic of critical interest even outside the real estate profession. In entering into a lease for commercial space, a business creates an asset, and shoulders liability, which can exist for decades. The long life of a lease makes it unusual within the universe of contractual obligations, presenting the landlord and the tenant, at various times during the lease term, with an ebb and flow of risks and opportunities. Crafting a lease document which addresses the uncertainty, and harnesses the opportunity, of events many years in the future can be like peering into a crystal ball. The issues and uncertainties involved are vividly illustrated in the provisions of the lease governing assignment and subletting.

The freedom of a tenant to transfer its rights and obligations under a lease to a new tenant can be a major factor in the success, stagnation or collapse of the tenant's business. If rental rates rise after the commencement of the lease term, the tenant's ability to transfer the lease determines whether, and subject to what conditions, the tenant can capitalize on the increased rental value of the leased space. If a tenant no longer needs leased space due to contraction or expansion of its business requirements, the tenant's ability to have a successor assume its liability under the lease, and in some cases to secure release from the burden of the lease altogether, may be the deciding factor as to whether the tenant's business will continue, grow or close.

Moreover, many leases treat a change in control of the tenant as an assignment of the lease. In fact, some leases even treat any transfer of a direct or indirect interest in the tenant as an assignment of the lease. Such provisions can make "assignment" provisions applicable to ownership transfers even where the tenant entity and the management of the tenant remain the same entity. Such provisions may serve legitimate landlord interests by restricting de facto assignment of a lease through transfer of the ownership of the tenant entity. Often, however, such provisions inadvertently complicate and delay entity-level ownership transactions by introducing potential landlord notice and consent, recapture and profit share rights in the context of mergers, the admission of new investors or providing ownership interests to employees.

For a landlord, the tenant's freedom to transfer its rights and obligations under a lease to a new tenant directly determines whether the landlord can control the identity and activities of the persons occupying its property. Restrictions on transfer of the tenant's interest may allow the

landlord to recover any increased costs arising from a transfer and to share in the financial benefit of an increase in market rental rates even after the lease is signed. The landlord also needs freedom to transfer its own interest under the lease in order to sell or finance its investment in response to cycles in the real estate market, even though such freedom may present the tenant with the risk of having to look to an unknown party, or even to a series of unknown parties, to perform the landlord's obligations under the lease.

This chapter discusses the assignment and assumption of leases of commercial space. The chapter reviews typical provisions in a lease of commercial space which restrict the assignment of the tenant's interest under the lease to a new tenant. Since such provisions also typically restrict subletting by the tenant of its interest under the lease, often without distinction between these two different types of transfers, this chapter discusses how such provisions may overlook significant differences between the effect of an assignment of a lease and the effect of a sublease under a lease. Some leases also contain conditions or restrictions which apply to assignment or subletting by the landlord of its interest under the lease; the discussion below addresses assignment of a lease not only by the tenant but also by the landlord.¹

[28.1] II. WHAT IS AN ASSIGNMENT OF LEASE?

[28.2] A. Transfer of Entire Interest

An assignment of a lease is a transfer by one party to the lease (the “assignor”) to another person (the “assignee”) of the assignor's entire interest in the lease. What elements comprise the “entire interest” in the lease, and must be transferred, in order to effect an assignment of the lease? The tenant's interest in a lease is defined by the duration of the interest (the “lease term”), the space subject to the lease (the “demised premises”), and the nature of the rights granted (the “permitted use”). There also may be other rights, such as renewal or expansion options,

1 The discussion below does not address collateral assignment of a lease, which is a method of securing financing by a pledge of the leasehold interest itself. Leasehold financing may be available to a tenant if the lease is drafted to allow, or not to prohibit, collateral assignment of the lease, and is available to a landlord in most cases. A discussion of collateral assignment of leases, however, is beyond the scope of this chapter. In addition, the discussion below is focused primarily on typical commercial space leases. Certain parts of the following discussion may not apply in part, or at all, to ground leases or to long-term net leases of buildings. A typical ground lease or net lease permits relatively free assignment and financing in order to create an alienable and financeable asset which the marketplace treats as comparable to a fee interest except to the extent of the leasehold asset's limited duration.

rights to extract natural resources or the right to construct improvements. The retention by the purported assignor of a lease of any material reversionary rights (other than a few exceptions such as rights exercisable upon default) defeats the attempt to assign a lease and instead makes the purported assignment a sublease.² A sublease is distinguished from an assignment of a lease by the sublessor's retention of some part of the tenant's interest in the lease.

[28.3] B. Privity of Contract and Privity of Estate

The rights and obligations of the parties to a lease are created both by the terms of the lease itself and by common law applicable to persons having an interest in the same parcel of real property. The lease is a contract which creates “privity of contract” between landlord and tenant; the lease contains express contractual terms which bind each party. The parties to the lease also share rights in a parcel of (or space in) the leased premises; this relationship creates “privity of estate” between landlord and tenant under common law.³

Once privity of contract is created between landlord and tenant, the reciprocal rights and duties under the lease agreement do not terminate except by agreement of the parties (including, of course, upon expiration of the term of the lease as agreed by the parties). Thus assignment of a lease, whether by landlord or by tenant, does not relieve the assignor of its contractual duties under the lease except to the extent that the lease so provides or the parties otherwise agree. Assignment of a lease, together with surrender by the assignor of occupancy of the demised premises, does, however, terminate the privity of estate between the assignor and the other party to the lease. At the same time that privity of estate terminates in connection with an assignment of the lease, the assignment of the lease creates a new privity of estate between the assignee and the other party to the lease.

The assignment of a lease does not, by itself, make the assignee liable for the performance of all of the obligations of the assignor under the lease. The creation of privity of estate between the assignee and the other

2 Milton R. Friedman, *Friedman on Leases* § 7.401, at 362–63 (4th ed. 1997) (hereinafter “Friedman”).

3 While statutes, in recent years, have created a third source of rights of the parties to a lease, such statutory rights apply primarily to residential leases. This orientation reflects the perception that a residential tenant needs protection from the landlord's unequal bargaining power and greater familiarity with leasing practices. *Caveat emptor* (“let the buyer beware”) remains the governing principle for most aspects of commercial lease negotiations.

party to the lease makes the assignee liable to perform only those obligations which under common law are considered to “run with the land.”⁴ Such liabilities are those which “touch and concern the property,” meaning those which relate primarily to the right to use the leasehold interest transferred. Other liabilities of the assignor, which are not considered to run with the land, are personal obligations of the assignor and do not transfer to the assignee automatically by virtue of privity of estate. The obligation to pay rent, the obligation to maintain and repair improvements, and the obligation to vacate the demised premises at the expiration of the term of the lease are examples of liabilities of a tenant which run with the land. A covenant of quiet enjoyment is an example of a liability of a landlord which runs with the land.

Since privity of contract between the assignor and the other party to the lease survives an assignment of the lease unless the terms of the lease expressly release the assignor from its contractual obligations, the assignor remains contractually bound to the other party to perform the lease notwithstanding an assignment of the lease.⁵ Thus a tenant seeks to assign its interest under a lease will want assurance that the assignee of the lease can and will perform the lease in all respects, unless the assignor has a right (which would be unusual) to be released upon assignment of the lease. In contrast, a landlord typically requires that the lease provide that the landlord is released upon assignment of its interest under a lease, and that the sole recourse of the tenant after assignment of the landlord's interest under a lease is to the successor landlord.⁶

[28.4] III. WHAT IS AN ASSUMPTION OF THE LEASE?

In order for an assignee of a lease to become contractually liable to perform all the obligations of the assignor under the lease, the assignee must assume the assignor's obligations by signing an assumption of the lease. While an assignment of a party's interest under a lease, coupled with the

4 Of course, the rights of the assignee also are subject to, and thus limited by, the terms of the lease.

5 Since there is no incentive for a landlord to release a tenant upon the tenant's assignment of the lease, a tenant, when negotiating the lease, may seek the right to be released from the lease upon its assignment of the lease to a new tenant. If a landlord were to consider agreeing to release a tenant upon assignment of the lease to a new tenant, any such release certainly would be subject to various conditions, discussed below, to ensure that the landlord would have recourse to a creditworthy assignee or otherwise would be adequately secured for the future performance of the lease.

6 As discussed below, even the liability of the successor landlord typically is limited by the terms of the lease to the successor landlord's interest in the leased property.

assignee's acceptance of the interest, is effective to transfer the leasehold interest (and create privity of estate) even without an assumption by the assignee, only an assumption by the assignee creates privity of contract between the assignee and the other party to the lease.⁷ Privity of contract encompasses all of the liabilities of the assignor under the lease, not only those liabilities which run with the land. An assignee of a lease who also unconditionally assumes the lease steps into the shoes of the assignor with respect to all of the rights and all of the obligations of the assignor.⁸

When a party to a lease assigns its interest, the other party to the lease always wants the assignee to assume the obligations of the assignor under the lease so that the other party can enforce its contractual rights against the assignee in addition to retaining its recourse to the assignor. The assignee, however, understandably may resist assuming all of the obligations of the assignor since the assignor's obligations include obligations from periods of time prior to the date of the assignment. An assignee may insist that it will assume only those liabilities which arise under the lease from and after the date of the assignment.⁹

7 Commercial leases may expressly provide that there shall not be even an implication of an assumption by a successor landlord upon assignment of the lease by the original landlord, with language such as the following:

If Landlord assigns its interest under this Lease, Tenant agrees that the execution of such assignment by Landlord and the acceptance of such assignment by the assignee shall not be deemed an assumption by such assignee of any of the obligations of the Landlord under this Lease unless such assignee shall specifically agree otherwise in writing.

This provision is intended in part to protect a lender to which the lease may be collaterally assigned: if a landlord default occurs and the lender must enforce the collateral assignment and actually take title to the lease, the lender will rely on such a provision to limit its liability to the tenant. The tenant will try to negotiate for a provision requiring, conversely, that the assignee assume the lease.

- 8 The assignee does not, of course, acquire any rights of the assignor to recover from the assignee any losses incurred by the assignor due to the failure of the assignee to perform its obligations arising from the assignment.
- 9 When drafting, note that the "date of the assignment" may differ from the "effective date of the assignment." Since leases often require that both a tenant assigning a lease and the assignee must sign an instrument of assignment and then submit the executed assignment to the landlord for the landlord's consent, lease assignments often provide that they are not effective until the landlord's consent has been given. The landlord may not give its consent until days or weeks following the date of execution of the assignment of lease. Care should be taken to refer to the intended effective date. The assignment itself can provide that, regardless of the date stated on the instrument or the date of execution by each party, the assignment is deemed dated, and is effective for all purposes, only on and as of the date the landlord's consent is received.

In many cases the assignee may have little negotiating leverage if landlord objects to allowing a successor tenant to assume the lease only with respect to those liabilities arising after the effective date of the assignment. A landlord may object to such a limitation of the assignee's liability because the landlord later might find it necessary to chase down the original tenant (who might be in a distant forum or may no longer be in business) for any liability arising which pre-dates the effective date of the assignment.¹⁰ If an assumption is limited only to liabilities arising under the lease after the effective date of the assignment, the non-assigning party can look to the assignee only for performance of obligations that arise after the assignment or which run with the land; for obligations arising prior to the date of the assignment, the non-assigning party to the lease can look only to the assignor.

Even if an assumption by the assignee creates recourse to the assignee in addition to the surviving recourse to the assignor, the assignee may be a reluctant, even hostile party when confronted with a demand to cure a condition pre-dating the assignment. The assignor and assignee may dispute, or it may be unclear, whether the liability arose before or after the date of the assignment.¹¹ It even is possible that the assignee, although prepared and able to meet the prospective obligations under the lease, is not prepared or able, financially or otherwise, to cure conditions which pre-date the assignment and of which the assignee may not have been aware.

10 Of course, since a landlord has the right to declare a default under the lease for non-performance of any obligation even if the obligation not performed was not assumed by the assignee, a successor tenant may have no choice but to perform even obligations arising before the effective date of the assignment in order to preserve the leasehold. The successor tenant then can seek reimbursement from the assignor in a separate action. Declaring a default may not be a satisfactory remedy for the landlord, however, and can sour what otherwise may be a satisfactory landlord-tenant relationship.

11 It can be difficult to determine whether the liability arose before or after the date of the assignment. Suppose, for instance, that a tenant performed initial improvements to the demised premises which were not in accordance with an applicable building code. Some time after completion of the improvements, the tenant assigned its interest under the lease to a new tenant. At a still later date, a building department official issued a violation notice concerning an element of the improvements. If the assignee of the lease assumed only the obligations of tenant arising under the lease from and after the date of the assignment, it is not clear whether the violative condition, and thus the responsibility to correct the condition and to pay any fine resulting from the violation notice, should be considered a liability which arose before or after the date of the assignment. As a drafting matter, an assignee which assumes "only those liabilities arising after the [effective] date of the assignment" should not be held responsible for liabilities which "arise" (only in the sense of first being asserted) after the date of the assignment but which concern conditions or events the existence or occurrence of which pre-dates the date of the assignment. Clearly, language referring to "a condition or event first arising after the effective date of the assignment" creates a brighter line.

To avoid this situation, the non-assigning party to a lease should seek to have the assignee assume all of the obligations of the assignor under the lease, regardless of the date they arise, recognizing, however, that many assignees may refuse to do so. If the assignee assumes all of the obligations of the assignor under the lease, the assignee should seek representations and warranties from the assignor regarding the absence of preexisting liabilities and an indemnity from the assignor covering any preexisting liabilities.¹² If the lease provides that the assignor is entitled to receive an estoppel certificate from the non-assigning party, the assignee should ask for an estoppel certificate to verify that there are no preexisting liabilities (or at least no known preexisting liabilities).¹³

[28.5] IV. ASSIGNMENT OF LEASE BY A TENANT

[28.6] A. Form of an Assignment of Lease

When a tenant wishes to transfer all of its interest under a lease to a successor tenant, the intent to effect an assignment, rather than a sublease, is clear. The instrument of assignment can be fairly simple: Appendix A is a basic form of an assignment of a lease, with language to effect an assumption in brackets. Often, however, assignment of a tenant's interests under a lease is subject to conditions and limitations set forth in the lease which must be addressed in the assignment. The assignment of the lease also may need to address deal-specific issues between the assignor and the assignee, such as apportioning costs or allocating liabilities. Appendix B is a sample of a more expansive form of an assignment of a lease which addresses some of these issues.

[28.7] B. Recourse after an Assignment of Lease

Except to the extent that an assigning tenant has the right to a release from liability upon assignment, the landlord will have recourse after the assignment of the lease, as discussed above, to both the assignor and the assignee. If the lease is assigned without an assumption by the assignee,

12 Of course such provisions compromise the assignor's goal of putting the lease, and the liabilities associated with the lease, behind.

13 A tenant's right to obtain an estoppel certificate from the landlord is important to a tenant's ability to assign its leasehold in interest, since an assignee will want, among other things, assurance from the landlord that the lease is in full force and effect and that the rent is current. *See* discussion of estoppel certificates in Section VI(B.) of this chapter. The landlord's right to obtain estoppel certificates from its tenants is equally important, since a purchaser of the property will want to confirm that the tenants shown in the rent roll are in occupancy and paying rent and that there are no undisclosed liabilities to, or claims by, the tenants. *But cf.* note 33 *infra*.

the assignee becomes (under privity of estate) liable for the tenant's obligations under the lease which run with the land, and the assignor nevertheless remains (under privity of contract) liable for all of the tenant's obligations under the lease. After an assignment of the lease and assumption of the lease by the assignee, typically both the assignee (under privity of contract and privity of estate) and the assignor (under privity of contract) will be liable for all of the tenant's obligations under the lease.

A commercial lease typically provides that upon assignment of the lease by the tenant, the assignee, as successor tenant, is required to assume the lease in writing and is deemed to have assumed the lease even if the assignee does not actually execute an express assumption.¹⁴ The privity of contract created by an assumption of the lease gives the landlord a direct contractual relationship with the new tenant. Privity of contract does not exist between the landlord and a subtenant; this is an important difference between an assignment and a sublease which an attorney should discuss with the client when considering these alternatives.

[28.8] C. Distinguishing an Assignment of Lease from a Sublease

In contrast to the privity of contract which assignment of a lease, and assumption of the lease by the assignee, creates between landlord and assignee, a sublease does not create a direct relationship between landlord and subtenant. The absence of a direct relationship with the landlord presents the sublessee with greater risk than an assignment of the lease because, without any direct agreement with the landlord, the subtenant has no direct control over, or direct knowledge of, whether the obligations to the landlord under the lease are being performed. When the subtenant pays its subrent or its share of real estate taxes to the sublandlord, for instance, the subtenant relies on the sublandlord's promise to use those funds to pay the rent or taxes due the landlord under the principal lease. The subtenant may not have a right to receive copies of any notices of default from the landlord, and, since the subleasehold estate is entirely dependent on the continuity of the term of the overlease, the subtenant has limited ability to prevent the exercise of remedies, including eviction, from terminating the subleasehold estate.

14 Such a provision may be difficult to enforce against the assignee, since without the signature of the assignee the basis for enforcement is not clear and, among other issues, may not comply with the Statute of Frauds. Since even liberal transfer provisions require delivery to the landlord of a copy of the assignment, however, the lease can require that any instrument of assignment of the lease include an express assumption of the lease even if the landlord's consent is not required to assign the lease.

A sublease also is more burdensome to administer than an assignment of a lease. For instance, while a landlord will accept rent payments directly from an assignee of the tenant's interest under a lease, the landlord may refuse to accept rent checks directly from a subtenant. The sublandlord must continue to make each monthly payment of rent to the landlord and to collect each monthly payment of subrent from the subtenant. This two-step process may frustrate the sublandlord's desire to extricate itself, for practical purposes, from managing unneeded space, in addition to leaving the subtenant at risk that a default in payment of rent to the landlord may occur even though the subtenant has timely paid all the subrent due.

A sublease also can be operationally burdensome if the landlord refuses to act on direct requests by a subtenant for building services, or to respond to a subtenant's other requests, unless the request is made in each instance by the sublandlord. In this case, obtaining building services becomes more difficult and, in this and other respects, the sublandlord is continually involved in facilitating the subtenant's use of the leased premises. An assignee, in contrast, is an actual, direct tenant of the landlord, having privity of contract in addition to privity of estate. As such, the assignee directly enjoys the rights, and directly shoulders the obligations, of its predecessor as tenant which run with the land, and the assignee also directly enjoys any and all other rights and, if the assignee also assumes the lease, shoulders any and all other obligations as well.

For the landlord, an assignment creates the advantage of direct recourse to an assignee under the contractual terms of the lease. With respect to a sublessee, the landlord is, at best, a third party beneficiary of the covenants made by the sublessee (although privity of estate with a subtenant does allow the landlord to exercise some remedies, primarily those in equity such as eviction, directly against the subtenant). Leases often contain remedy provisions that establish jurisdiction, damages and other rights upon default that are advantageous to a landlord; these provisions generally are applicable only in an action against persons with whom the landlord has privity of contract, such as the original tenant and an assignee of the tenant which has assumed the lease, but generally are not applicable in an action involving a subtenant or an assignee which has not assumed the lease.

A sublessor can transfer use of less than the entire premises or less than the entire remaining term of the overlease, while an assignment can only be made of the entire premises for the entire remainder of the term of the

lease.¹⁵ A sublandlord also has the advantage, relative to an assignor of a lease, of retaining title to (and thus any value of) the leasehold estate. Following a subtenant default, a sublandlord typically can terminate the sublease and thereby automatically recover the leasehold to cure defaults and relet the premises if desired. As discussed below, the remedies of an assignor upon default by the assignee often are less clear and may be considerably more difficult to exercise.

[28.9] D. Continuing Liability of an Assignor

An assignor of a lease remains liable under the lease after the assignment, absent provision in the lease to the contrary. Even if the assignee assumes fully all the obligations of the tenant under the lease, the assignor retains considerable risk due to its continuing liability under the lease. The assignor remains liable for defaults by the assignee under the lease, and for charges incurred by the assignee as tenant under the lease, yet the assignor has no right to recover the lease from the assignee or to exercise remedies against the assignee for non-performance.¹⁶ The assignor's sole recourse is to sue the assignee for money damages. While an assignor of a lease often is described as retaining the surviving liability of a surety with respect to the lease, in fact the assignor remains a primary obligor under the lease, with only such rights as are provided in the assignment to recover from the assignee any costs incurred under the lease by the assignor.¹⁷

Even though the assignor's liability continues after assignment of the lease as a primary obligor, certain concepts of suretyship do apply to the landlord-assignor relationship. Following an assignment of the lease, action by the assignee, whether independently or by agreement with the

15 *Friedman, supra* note 2, §7.402, at 363–64, however, discusses the possibility of an assignment of part of a demised premises for the entire balance of the lease term. Such assignments, called assignments *pro tanto*, are found primarily (although not exclusively) in the bankruptcy context and, in the opinion of the author, derive more from the extraordinary power of the Bankruptcy Court than from consistent application of the legal principles distinguishing an assignment from a sublease. *See, e.g., In re Brentano's, Inc.*, 29 B.R. 881 (Bankr. S.D.N.Y. 1983), in which the court, relying on a precedent from 1935, rejected the landlord's contention that *pro tanto* assignments are recognized only for a landlord's benefit or protection. *Id.* at 882, 884.

16 While a tenant can negotiate for the right to recover the leasehold if, following an assignment of the lease, the assignee defaults under the lease, this position is not commonly pursued by counsel and the author has not seen an assigning tenant succeed in negotiating such a position. Even if the landlord were willing to agree to such a provision, the assignee, and not the landlord, still would control the tenant's interest under the lease. Considerable thought would be required to create a viable process to effect such a right of recovery.

17 *See Friedman, supra* note 2, § 7.502 at 397–99.

landlord, which results in an increase in the tenant's liability under the lease or an impairment or surrender of the landlord's rights to recover under the lease, can extinguish the landlord's recourse to the assignor.¹⁸ Recourse will not be extinguished, however, if the assignor has waived its right to consent to acts which may increase the liability of the tenant under the lease. For this reason the form of consent to assignment used by landlords typically provides, and in any event the lease itself typically provides, that the assignor waives any such release from liability due to an increase or change in the tenant's liability under the lease, at least to the extent of the tenant's liabilities prior to the increase or change (and including any increase or change arising from the assignee's exercise of options or rights expressly provided under the lease).

An assignee's ordinary exercise of the rights of the tenant in accordance with the terms of the lease can increase the exposure of the assignor significantly. Consider the exposure which the assignor will face if the assignee performs improvements in the demised premises which the lease requires that the tenant remove at the end of the term, or if the assignee files bankruptcy or exercises a renewal or expansion option under the lease. An assignor also is at risk that the landlord and an assignee may enter into amendments of the lease on terms which were not contemplated by the terms of the lease at the time of the assignment. Such an amendment could extend the term, add more space, or increase the rent. A landlord is unlikely to release an assignor of the lease from increased liability arising from the exercise by an assignee of the lease of rights of the tenant under the lease which existed at the time of the assignment, such as a renewal option. A landlord's position may be the same regarding acts of the tenant which require the landlord's consent but where the landlord has agreed not to withhold, condition or delay its consent unreasonably. A tenant may secure from some landlords, however, relief from any additional liability arising from modifications of the lease made after the assignment by the landlord and the assignee and in the discretion of each rather than pursuant to exercise of a contractual right.¹⁹

18 See *Friedman*, *supra* note 2, § 7.502 at 397–401.

19 In some cases a tenant with a strong negotiating position may be able to negotiate in its lease that, following an assignment, the landlord will not hold the assignor liable for the additional liability arising from the exercise by an assignee of an expansion or renewal options in the lease.

[28.10] V. ASSIGNMENT OF LEASE BY A LANDLORD

Assignment of a lease by a landlord can arise in several circumstances, the most common of which is a landlord's sale of a rental property to a new owner. Typically, the new owner wants the seller to deliver the property with the seller's interest in the leases at the property intact since the leases are a source of cash flow. For financing purposes, a landlord also may wish to adopt an alternative approach, in which a landlord may enter into a ground lease or a net lease of a rental property or into a "sandwich," or intervening, leasehold, following which the seller retains the fee estate in the property but assigns the space leases at the property to the other party to such transaction.²⁰

As would be expected, a property owner rarely allows a tenant to impose restrictions on the property owner's ability to sell the property to a new owner. Consequently, leases typically do not restrict the freedom of a landlord to transfer the landlord's interest under leases to a new owner. The selling owner still considers the same issues as discussed above in assigning its leasehold interest: as an assignor, the seller has contractual liability to the tenants under the leases which will survive the sale and will continue to bind the seller unless provision is made for release. In this case, it is the tenants who will have no incentive to release the landlord once the leases have been executed and delivered, so a landlord typically requires that the lease provide for the landlord's liability under the lease to terminate upon sale (or other transfer) of the landlord's interest under the lease.

[28.11] A. Recourse Limited to the Property

The following, a typical provision in leases (with language sought by tenants indicated in brackets), limits the landlord's liability under the lease to the landlord's interest in the property itself:

Tenant shall look solely to the estate and interest of Landlord in the Property [including any insurance proceeds (to the extent provided in [the Article of the lease concerning casualty]), condemnation awards (to the extent provided in [the Article of the lease concerning condemnation]) and rentals accruing from and after the date of any judg-

²⁰ As mentioned above, ground leases, net leases and collateral assignments are beyond the scope of this chapter.

ment], only for such time as Landlord holds such estate and interest, for the collection or satisfaction of any judgment recovered against Landlord [based upon the breach by Landlord of any of the terms, conditions or covenants of this Lease on the part of Landlord to be performed], and no other property or assets of Landlord shall be subject to levy, execution or other enforcement for the satisfaction of Tenant's remedies under or with respect to either this Lease, the relationship of Landlord and Tenant hereunder, or Tenant's use and occupancy of the Demised Premises.

Obviously this provision is broader than is needed to release the landlord upon sale of the property alone, in that it limits the tenant's recourse to the landlord's interest in the property even if no sale of the property to a new owner has occurred.²¹ The provision effectively is a release upon sale of the property, because, after a sale of the property, the landlord will have no remaining interest in the property.²² The provision is not effective to release the landlord following a master lease or "sandwich" lease of the property. The following provision accomplishes this further objective (with the language to be sought by tenants indicated in brackets):

The obligations of Landlord under this Lease shall no longer be binding upon Landlord named herein [for events first arising] after the sale, assignment or transfer by Landlord named herein (or upon any subsequent Landlord after the sale, assignment or transfer by such subsequent Landlord) of its interest in the Property as owner or lessee[, and in the event of any such sale, assignment or transfer, such obligations [for events first arising after any such sale, assignment or transfer] shall

21 The limitation on recourse also is among the provisions a mortgagee typically requires so that it can foreclose title to the property and take over the leases while insulating the mortgagee's other assets from liability to the tenants.

22 Since the argument can be made that the interest of the landlord in the property includes "proceeds and profits" of that interest, the landlord may seek to exclude expressly any recourse to the "proceeds and profits" of the landlord's interest in the property, primarily sales proceeds. The tenant may seek to modify the language expressly to include proceeds and profits, at least to the extent of any pre-sale defaults by, or claims against, the landlord. The landlord's intent is to provide that the landlord will have no further liability once the property is sold thus may be frustrated by a tenant's insistence on recourse for any pre-sale defaults or claims. *See, e.g., Won's Cards, Inc. v. Samsondale/Haverstraw Equities, Ltd.*, 165 A.D.2d 157, 566 N.Y.S.2d 412 (3d Dep't 1991), for a case where the court found that a provision limiting recourse to a party's "equity in the property" allows recourse to the sales proceeds realized by a landlord.

thereafter be binding upon the grantee, assignee or other transferee of such interest, and any such grantee, assignee or transferee, by accepting such interest, shall be deemed to have assumed such obligations]. A lease of the entire Property shall be deemed a transfer within the meaning of the foregoing sentence.

While such a provision may seem overreaching, the practical effect is relatively limited, since individual commercial real properties commonly are owned by single purpose entities. The property typically is the sole asset of such an entity, and the form of organization of the entity and the entity's organizational documents effectively prevent recourse beyond the owning entity's assets.²³ Thus, for practical purposes, the typical provisions set forth above have become customary in that they are not perceived to constitute a significant concession by tenants. In any event, institutional owners of real estate and real estate lenders commonly require such limitations as a condition to providing equity and debt financing, both to insulate the owning and lending institutions from liability arising from the property after sale and to isolate the exposure to ownership risk, not only during but also after the term of ownership, to the owned asset alone.²⁴

[28.12] B. Recourse to the Security Deposit

An assigning landlord will want to assign any tenants' security deposits to the new landlord with the leases, and then be relieved of liability to the tenants for return of the deposit. The following sample provision so provides:

In the event of sale, assignment or transfer of the Property, Landlord shall transfer any Letter(s) of Credit and/or any remaining Cash Security then held by Landlord as security for the performance of Tenant's obligations under this Lease to the transferee, and Landlord shall

23 While there is the technical possibility of a tenant reaching other assets through such arguments as *ultra vires*, piercing the corporate veil, inadequate capitalization, preference, fraudulent conveyance, tracing distributions made without creating adequate reserves for liabilities or substantive consolidation, these are difficult arguments with which to succeed, and often are not likely to warrant the expense especially if there is any equity in the property to which recourse remains.

24 One exception to the limited recourse to the landlord is the payment of tenant improvement allowances and similar up-front cash inducements, for which a tenant often will require, and secure, recourse to a creditworthy entity, to a funding commitment from a mortgage lender, or to another form of credit enhancement or security for payment.

thereupon be released from all liability for the return of such security. Tenant agrees to look solely to the transferee for the return of any such security and it is agreed that the provisions of this sentence shall apply to every sale, assignment or transfer of the Property. A lease of the entire Property shall be deemed a transfer within the meaning of the foregoing sentence.

Such a provision may also provide that the assignee is responsible for the security deposit only to the extent that the assignee actually receives the deposit from the assignor. Because this limitation is appropriate only to insulate a mortgagee to whom the lease may be assigned in connection with foreclosure of a mortgage, the tenant should ask that any such limitation be so qualified.²⁵

[28.13] C. Attornment by the Tenant

Purchasers of leased real property require that the leases be assigned by the seller at closing. In furtherance of such assignment, each lease should provide that upon sale of the property to a new owner, the tenant agrees to accept the new owner as its successor landlord. Each tenant's acceptance of assignment of its lease to a successor landlord is demonstrated by the tenant's agreement to be bound to perform the obligations of the tenant under the lease for the successor landlord in the same manner as the tenant was bound to perform those obligations for the predecessor landlord. The tenant's agreement to perform those obligations is called attornment and typically is set forth in the lease. Appendix C is a sample provision for attornment by the tenant to a mortgagee which becomes a successor landlord. Note that in Appendix C, a mortgagee is protected from any liabilities of the landlord arising prior to the mortgagee's succes-

²⁵ As between the seller and the purchaser, ordinarily upon sale of a rental building the seller provides the purchaser with an accounting of the security deposits. The seller then transfers to the purchaser any cash security (by check or by credit against the purchase price) deposited by the tenants and any letters of credit which the tenants have delivered as security. Note that an endorsement or amendment of the letter of credit by the issuing bank to the new beneficiary, or re-issuance of the letter of credit in the name of the new beneficiary, is necessary to reflect the successor landlord as the beneficiary. The landlord should try to provide in the lease that the expense of re-issuance or amendment of the letter of credit is borne by the tenant, as the price for the privilege of posting a letter of credit; the tenant takes the opposite position.

sion to title, while other successor landlords take title subject to any pre-existing liabilities of the landlord.²⁶

[28.14] VI. RESTRICTIONS APPLICABLE TO ASSIGNMENT OF LEASE

A lease which is silent regarding the right of a party to assign the lease may be assigned without the need for any consent by, or notice to, the landlord and without regard to any other conditions or restrictions.²⁷ Among other things, restrictions on assignment of a lease are considered to be restraints on alienation of an interest in real property, and public policy does not favor restraints on alienation of interests in real property. For the same reason, restrictions on assignment of a lease will be construed strictly by the courts; lawyers seeking to draft restrictions on assignment must state expressly and with specificity each type of transaction which the parties intend to restrict. The following discussion assumes that, following an assignment of a lease by a tenant, the assignee expressly assumed the lease, and that, following a sale of the leased property, the successor landlord assumed the landlord's obligations under the lease.

One peculiarity of common law that applies to assignments of leases derives from the disfavored status of restraints on alienation of real property. Under long-standing law, the consent by a landlord to a tenant's assignment of a lease automatically terminates the continued force of any provision restricting future assignment by the tenant of the lease, unless the landlord's consent, when given, expressly provides that the restriction shall continue to apply to future assignments.²⁸ For this reason, a com-

26 This is not a uniform approach; some leases provide that any successor is relieved from a number of specified liabilities arising prior to such successor's succession to title, while other leases may adopt the date that control of the property is obtained (such as through a receiver or court order) as the date that a successor's liability commences, even though the actual acquisition of title happens at a later date.

27 Even if assignment of a lease is technically permissible under the article of the lease which specifically addresses assignment, other provisions of the lease may determine whether, for practical purposes, a tenant can use the leased space. For instance, a permitted use clause may limit the types of uses which can be made of the demised premises or the trade name under which business can be conducted in the demised premises. The alterations clause may restrict the tenant's ability to alter or improve the demised premises for the intended use. Provisions in a lease governing signage, telecommunications, or access to utilities or parking can affect critical rights of a prospective new tenant. For these reasons, to assess whether a lease can be assigned the lawyer often must review the entire lease in light of the assignee's particular intended use of the demised premises.

28 See *Dumpor's Case*, 4 Coke 119b, 76 Eng. Rep. 1110 (1603); *Friedman*, *supra* note 2, § 7.304e at 359-61.

mercial lease typically contains the following provision, which is drafted to apply to any type of transfer of rights under the lease even though the common law principle applies only to an assignment of a lease:

The consent by Landlord to any assignment, subletting, occupancy or use shall not relieve Tenant from the obligation to obtain the express written consent of Landlord to any further assignment, subletting, occupancy or use, nor shall such consent waive or terminate the condition set forth in this Section that any further assignment, subletting, occupancy or use shall require the express written consent of Landlord.

The separate document in which the landlord consents to any transfer also should contain similar non-waiver language.

[28.15] A. Why a Landlord Restricts Assignment of the Lease

One of the negotiating positions typically taken most strongly by owners of commercial property is that a lease should restrict assignment without the landlord's consent.²⁹ In real estate markets characterized by strong tenant demand and a limited supply of space, few tenants have the negotiating leverage to challenge this golden rule. Nevertheless, tenants question why a lease should restrict or condition assignment of the lease. From the tenant's perspective, so long as the tenant remains liable for performance of the lease, and performs the lease, for the balance of the term, the landlord will receive the benefit of the landlord's bargain. Assumption of the lease by the assignee following an assignment of the lease creates an additional obligor on the lease, a benefit for the landlord rather than a disadvantage. The tenant reasons that assignment of the lease should be subject only to restrictions which are reasonably, necessarily and directly related to ensuring the continued performance of the tenant's obligations under the lease. The tenant views other landlord restrictions on assignment of a lease as no more than the means for the landlord to condition its consent on changes to the lease, including increases in rent, which would represent, for the landlord, a windfall above and beyond the benefit of the bargain embodied in the original lease. The requirement for landlord consent to an assignment of the lease allows the landlord to leverage the requirement for its consent to secure an increase in rent if market rents

²⁹ While the same position typically is taken with regard to subletting, this discussion addresses only assignment of the lease.

have risen, while the tenant has no corresponding opportunity for rent relief if market rents have fallen.

Landlords historically have successfully defeated these arguments. Landlord responses include a variety of reasons for restraints on assignment of a lease. Some of these reasons bear directly on securing continued performance of the lease: to ensure that the assignee, as the actual occupant of the space, is of a certain quality and is creditworthy even if the assignor remains liable under the lease; to ensure that the assignee will use the space in a manner permitted under the lease and consistent with any exclusive commitments made to other tenants in the building; and to recover any increase in operating costs which may result from the assignee's use. Moreover, a tenant's assignment of a lease may signal that the tenant is experiencing financial difficulties; the landlord must consider that at a later date it may have no meaningful recourse to the assignor and thus then may have only recourse to a less-appealing assignee. Still, the fact that an assignment does not release the original tenant from its liability under the lease undermines the force of the landlord's concerns with creditworthiness of the assignee. Because the market reputation of certain buildings is unique, subjective and subject to change, however, a landlord wants the right to enforce standards for the creditworthiness and the character of its tenants without the risk of having its subjective judgment second-guessed.

Other reasons highlight legitimate concerns of a landlord even if not related to continued performance of the lease: to allow the landlord to manage the marketing and leasing of all available space in its building without being in competition with its own tenants; to control the mix of tenancies in its building in a manner which preserves the prestige and appeal of the building; and to restrict repeated division of floors, burdening of building systems and traffic levels. Landlords probably are just as concerned with having the greatest flexibility to pursue business opportunities which may arise during the lengthy term of a lease. For instance, a landlord may want to have the opportunity to recover excess space from one tenant to retain another tenant who wants to expand in the building or to obtain a new tenant who needs the space. To the extent that a tenant has less flexibility regarding the assignment of its leased premises, the landlord has more flexibility to recover the space in order to capitalize on a new opportunities which arise during the term.

Such other reasons are broader in scope and thus seem suspect to tenants. The common theme underlying such restrictions is the contention that the owner, and not the tenant, is in the real estate business. As tenants

in a building offer their leased premises for assignment, the landlord's concern is valid; without provisions restricting the tenant's marketing of such space and assignment of the lease itself, the landlord would be forced to market vacant space in the building in competition with its own tenants marketing unneeded space for assignment. Because such tenants seek the greatest relief they can obtain from their lease obligations as quickly as possible, and thus are not necessarily motivated to maximize their profit from the assignment, such tenants may offer space in the landlord's building for assignment or sublease at lower rents or with greater inducements than the landlord can offer. Even a small amount of space offered at low rents can affect marketing of all space in a building and create discontent among tenants whose contract rents are higher. The tenant's objectives do not necessarily coincide with realizing the highest and best use of space or preserving a particular quality or character of tenancies in a building.³⁰

In contrast with the concerns of the landlord, many tenants, and particularly retail tenants, believe that when they enter into a lease, they actually create an asset which may appreciate in value as market rents rise during the lease term even if the tenant's business itself does not fare well. The value of a tenant's leasehold also may appreciate due to the tenant investing considerable amounts to improve the leased premises. For a retail business which relies on establishing and retaining a clientele, the location often is intimately associated with the success of the business itself, and the tenant's ability to transfer the leasehold may be essential to realizing the value of the business itself upon sale.

Tenants also object to restrictions on assignment because the process of obtaining the landlord's consent is too slow, too uncertain, and in some cases too subjective. These concerns are magnified by the tenant not knowing who will be the landlord at the time in the future that the landlord's consent is needed. In addition, as discussed below, landlords typically require that the tenant pay to, or share with, the landlord either all or a percentage of any proceeds which the tenant realizes by assignment of the lease. While a tenant often regards any share claimed by the landlord as a windfall to the landlord, in fact any increase attributable to—rather than to improvement of the leased premises or establishment of retail traf-

30 In addition, a landlord considers tenants in a building to be an asset of the landlord; thus, even if a lease permits assignment of the lease, the lease typically and will prohibit any assignment or subleasing to existing tenants in the building, and will restrict general advertising of rents which are lower than the landlord's then-current asking rental rate for space in the building. This is to avoid creating dissension among tenants in the building whose rents may be higher.

fic—is a windfall to both parties to a lease. For this reason, the most common lease provision allocates the proceeds from assignment of a lease, after the tenant recovers its costs of effecting the assignment (and, sometimes, certain other costs), between landlord and tenant. Many tenants still contend, however, that since the tenant, in entering into the lease, assumed the risk of a long term financial obligation, the tenant should enjoy all profit which can be derived from the lease. Tenants reiterate that this approach is fair especially since the landlord would not share in any loss if market rental rates had moved in the other direction.

[28.16] B. Providing for an Estoppel Certificate

As a practical matter, in order to assign a lease, the assignor will need to confirm to the satisfaction of the assignee that the copy of the lease provided by the assignor is true, correct and complete, and that there are no outstanding defaults under the lease. While the assignor may be willing to provide representations and warranties concerning these and other matters, an estoppel certificate made by the non-assigning party to the lease provides not only an independent verification of the response to these concerns but also strengthens the hand of the assignee if the party which delivered the estoppel certificate later tries to assert that the facts or circumstances were not as certified in the estoppel certificate. A typical provision for delivery of an estoppel certificate:

From time to time (but no more often than once in any twelve month period) during the Term, within ten (10) days following written request therefor, either party shall deliver to the requesting party a written certificate executed and acknowledged by an [authorized officer] of the certifying party, (i) that the copy of the lease attached to the certificate is a true, correct and complete copy of the Lease, (ii) that the Lease is then in full force and effect and has not been amended or modified (or if amended or modified, setting forth the specific nature of each amendment or modification), (iii) setting forth the date to which the Fixed Rent and all other rentals have been paid, and (iv) stating whether or not, [to the actual knowledge of the certifying party,] [the requesting party is in default under this Lease][any state of facts exists which with the giving of notice or the passage of time or both would constitute a default under the Lease][any notice of default has been given or received by either party to the Lease which remains uncured], and, if the requesting party is in

default, setting forth the specific nature of all such defaults and notices thereof given, [(v) stating that Tenant has accepted and occupies the Demised Premises and that all improvements required to be made by Landlord pursuant to the provisions of this Lease have been made, or if such is not the case then setting forth the specific respects in which such is not the case,] and [(vi) such other matters as the requesting party shall reasonably request]. Tenant acknowledges that any certificate delivered pursuant to this Section may be relied upon by any owner of the Property, by the holder of any Mortgage, by any assignee of an interest under the Lease, or by any lessor under any Superior Lease.

Generally, practitioners regard an estoppel certificate as enforceable to estop the certifying party from asserting facts contrary to the statements in the certificate.³¹ An express provision to this effect in the lease may help ensure this result.

[28.17] C. Assignment by Tenant

During the term of a lease, the tenant may need or want to assign the lease for any number of reasons. The tenant may be unable to use or afford the leased premises due to such reasons as business setbacks, death of the tenant or of a principal of the tenant, merger resulting in overlapping facilities, growth creating a need for larger premises, or other reasons unrelated to suitability of the leased premises for occupancy. Changes in the tenant's organizational form, investors or financing, death or divorce of a business principal, or sale of the tenant's business, may make a formal transfer of the lease necessary. Tenant's counsel must be attentive, in negotiating the lease, to pursue rights as broad as possible for the tenant to assign the lease in such circumstances, to secure the landlord's consent if necessary on acceptable terms and within an acceptable time frame, and to benefit from any increase in the market rental value of the leased premises.

31 At least one case suggests, however, that an estoppel certificate alone may not be sufficient to effect a waiver, or a de facto amendment, of the provisions of a lease. *See Won's Cards, Inc. v. Samsondale/Haverstraw Equities Ltd.*, 165 A.D.2d 157, 566 N.Y.S.2d 412 (3d Dep't 1991).

[28.18] 1. Prohibition of Assignment Without Landlord's Consent

Commercial leases often provide that the tenant may not assign the lease without the landlord's prior written consent. This provision means that the landlord can grant or withhold its consent for any reason or for no reason and at its sole discretion.³² The Real Estate Board of New York includes the following provision in its published Standard Form of Office Lease (1999 edition):

Tenant, for itself, its heirs, distributees, executors, administrators, legal representative, successors and assigns, expressly covenants that it shall not assign, mortgage or encumber this agreement, nor underlet, or suffer or permit the demised premises or any part thereof to be used by others, without the prior written consent of Owner in each instance. Transfer of the majority of the stock of a corporate Tenant or the majority partnership interest of a partnership Tenant shall be deemed an assignment.

A tenant under a lease with this provision cannot assign the lease unless the landlord gives its consent. The landlord can withhold its consent for any reason, including to derive the benefit of an increase in the rental value of the premises, to lease the premises to someone else, or simply because the landlord doesn't like the tenant.³³

For most commercial leases of any significant value, the tenant will seek to negotiate some relief from the rigidity of the preceding provision. Where a landlord is willing to allow the tenant to assign the lease on more flexible terms, the landlord should do so through carefully drafted and limited exceptions to a comprehensive restriction on assignment. The following provision is typical of a comprehensive restriction which would precede limited negotiated exceptions:

32 Some leases will provide explicitly that unless the lease itself states that the landlord's withholding of consent must be reasonable, consent may be given or withheld "in the landlord's sole and absolute discretion."

33 Notwithstanding such language, a landlord could not withhold consent for unlawful reasons such as discrimination which is prohibited by law, and a bankruptcy court could override or disregard such language and assign, or allow the assignment of, the lease if assignment would be in the best interest of the bankrupt's estate and otherwise in accordance with the provisions of the Bankruptcy Code.

Except as otherwise set forth in this Section, Tenant, for itself, its heirs, distributees, executors, administrators, legal representative, successor and assigns, covenants that, without the prior consent of Owner in each instance, it shall not (i) assign, whether voluntarily, involuntarily or by operation of law, by merger, consolidation or otherwise, mortgage or encumber, directly or indirectly including by transfer of any direct or indirect legal or beneficial interest in Tenant, its interest in or rights under this Lease, in whole or in part, or (ii) sublet, or permit the subletting of, the Demised Premises or any part thereof, or (iii) permit the Demised Premises or any part thereof to be occupied, or licensed, or used for desk space, mailing privileges or otherwise, by any person other than Tenant. The sale, pledge, transfer or other alienation of (a) [a controlling] [any] interest in the issued and outstanding capital stock of any corporate Tenant (other than trades of such stock which are publicly traded on a recognized security exchange or over-the-counter market by stockholders who are not “insiders” as such term is defined in the Securities Exchange Act of 1934) or (b) a controlling interest in any partnership, limited liability company or joint venture or other business entity comprising Tenant, however accomplished, and whether in a single transaction or in a series of related and/or unrelated transactions, and whether through a transfer of direct interests or indirect interests, shall be deemed for the purposes of this Section to be an assignment of this Lease which shall require the prior consent of Owner in each instance.

The above language is typical of language in commercial leases which defines a broad range of transactions as an “assignment” even though such transactions do not involve a transfer of all of the direct or indirect interests of the tenant under the lease. A lease can provide, of course, that if a tenant allows another person to use desk space in the tenant's leased premises, for instance, such a transaction is subject to the transfer restrictions in the lease; if so restricted, however, such a transaction should be considered a sublease rather than an assignment. This distinction is significant since, as discussed later, a lease may accord the landlord different rights (such as recapture, leaseback or profit participations) in the case of an assignment than it does in the case of a sublease. Note also the incon-

sistency that a merger in which the tenant is not the surviving company is subject to the above restriction, while a merger in which the tenant is the surviving company is not subject to the above restriction, even though the landlord has the same concerns in either case with the creditworthiness of the surviving entity.

[28.19] 2. Reasonableness of Landlord's Consent³⁴

In the majority of jurisdictions, including New York, when a lease prohibits assignment or subletting without the lessor's consent, the lessor may refuse consent arbitrarily and for any or no reason at all, unless the lease specifically requires refusal of consent to be reasonable. Therefore, under New York law a landlord may impose conditions, including requiring the payment of additional rent or other consideration, on the grant of its consent.³⁵

However, there are compelling reasons why New York courts may soon adopt the minority position. First, because courts disfavor restrictions on alienation, New York courts may opt to strictly construe assignment clauses to dilute the restriction on assignment.³⁶ Second, because leases ultimately are just contracts, New York courts may opt to subject them to the principle of good faith and fair dealing and imply a reasonableness standard into an otherwise silent lease. Indeed, many state legislatures have already enacted legislation that imposes a reasonableness standard into silent leases,³⁷ thereby resolving this conflict between traditional real estate law and modern commercial law in favor of the tenant.

The simplest way for a tenant to qualify a strict prohibition on assignment is to secure the landlord's agreement in the lease that its consent will not be unreasonably withheld, delayed or conditioned. Where the tenant has secured the landlord's agreement to provide some flexibility to assign

34 The following discussion of the reasonableness of a landlord's consent was prepared by Joshua Stein, Dan Ross and Tiffany Barzal of Latham & Watkins and is gratefully acknowledged. See also Joshua Stein, *Assignment and Subletting Restrictions in Leases and What They Mean in the Real World*, 44 ABA Real Property Trust & Estate Law J. 1 (Spring 2009).

35 See *Durand v. Lipman*, 165 Misc. 615, 1 N.Y.S.2d 468, 473-74 (Mun. Ct. of N.Y., Bur. of Manhattan 1937) ("The landlord . . . could withhold such consent, even arbitrarily. Hence the landlord was at liberty to impose such conditions as he deemed proper as a prerequisite to his consent to the assignment."). See also *Herlou Card Shop, Inc. v. Prudential Ins. Co.*, 73 A.D.2d 562, 422 N.Y.S.2d 708 (1st Dep't 1979).

36 See *Kruger v. Page Management Co., Inc.*, 105 Misc. 2d 14, 432 N.Y.S.2d 295 (Sup. Ct. N.Y. Co. 1980).

37 See Stein, *supra* note 34, at 15.

the lease, the right to assign may be subject to specific and detailed negotiated limitations. More commonly, however, assignment of a commercial lease is “subject to the prior written consent of the landlord, which consent shall not be unreasonably withheld, delayed or conditioned.”³⁸ The standard of reasonableness in granting consent to an assignment (or sublease) or a lease may be among the most disputed issues in law.

Even in cases where a lease requires a landlord's refusal of consent to be “reasonable” or “not unreasonable,” it is far from clear what “reasonable” means. Although a lessor cannot seize upon absolutely any creative excuse for withholding consent, no single standard or set of rules for determining “reasonableness” exists. To some, reasonableness means that the landlord, in making its decision, must have a subjectively reasonable basis for the decision. The prevailing view is that reasonableness is an objective standard. The question is therefore generally left to the trier of fact to decide.³⁹ Generally speaking, this standard requires the court to consider whether a reasonably prudent person in the landlord's position would have withheld consent. Courts have held that considerations of a landlord's personal taste and convenience are not reasonable, but courts have not dismissed all subjective considerations when they are perceived to have a legitimate basis.

Despite the nebulous nature of the reasonableness standard, the court in *American Book Co. v. Yeshiva University Development Foundation, Inc.* set forth a list of “objective” standards for determining reasonableness, and these standards have been followed by other courts.⁴⁰ These standards, which “are readily measurable criteria of a proposed subtenant's or assignee's acceptability, from the point of view of any landlord,” are:

38 As this language is drafted, it is a *condition* to the granting of consent that consent not be unreasonably withheld, delayed or conditioned. A tenant should prefer that the landlord make a *covenant* not to unreasonably withhold, delay or condition its consent, because improper withholding of consent where landlord covenants to give its consent is a breach and may more readily be actionable for damages (absent specific restrictions on tenant's recourse to money damages in such circumstance) than improper withholding of consent where landlord's reasonableness in granting consent is a condition. Failure to satisfy a condition may give rise only to an injunctive remedy that consent is deemed granted and not give rise to an action for damages. See *Friedman, supra* note 2, § 7.304b at 335–38.

39 See *Am. Book Co. v. Yeshiva Univ. Dev. Found., Inc.*, 59 Misc. 2d 31, 33, 297 N.Y.S.2d 156 (1969) (“The standards of reasonableness have not heretofore been clearly delineated by any single New York case, but are left to the trial court to determine in accordance with the particular factual patterns before it, and the conceptual boundaries may be only faintly discerned in the few reported cases.”).

40 *Id.*

- (a) financial responsibility
- (b) the “identity” or “business character” of the subtenant—i.e. [the tenant's] suitability for the particular building
- (c) the legality of the proposed use
- (d) the nature of the occupancy—i.e. office, factory, clinic, or whatever.⁴¹

At a minimum, a landlord probably is reasonable in refusing consent unless the assigning tenant gives the landlord evidence that the proposed assignee is ready, willing, and able to perform the lease agreement.⁴² Therefore, a reasonable belief (supported by evidence) that a proposed assignee is unable to pay is almost always reasonable grounds for denying consent.⁴³ Other factors can, however, outweigh financial responsibility in certain cases. For example, a landlord's refusal to allow financially responsible parties as multiple subtenants was upheld where subdivision of the leased space would have been undesirable in a “prestige building.”⁴⁴

Although the second factor listed above, the “identity” or “business character” of the subtenant/assignee, may be used as a reasonable basis for a landlord to reject an assignment, landlords using this argument bear a heavy burden of proof.⁴⁵ One New York case involved a restriction on assignment that required the landlord to be reasonable but stated that the landlord could consider the “business reputation of the proposed assignee or subtenant,” as well as “the effect that the proposed assignee or subtenant's occupancy or use of the demised premises would have upon the operation and maintenance of the building and the landlord's investment

41 *Id.* at 33.

42 *See Golf Mgmt. Co. v. Evening Tides Waterbeds, Inc.*, 213 Ill. App. 3d 355, 572 N.E.2d 1000 (Ill. App. Ct. 1991).

43 *But see* Friedman, *supra* note 2, § 7.304c. Friedman points out that “inasmuch as neither assignment nor subletting releases the original tenant from his lease obligations, it may be argued that landlord has all he bargained for regardless of the wealth or skill of the assignee or subtenant.” However, he notes that the little relevant authority on the issue has held that the landlord is entitled to a responsible assignee. Furthermore, in practice, landlords prefer a financially responsible assignee in order to avoid litigation against the tenant should a default occur.

44 *See Time Inc. v. Tager*, 46 Misc. 2d 658, 260 N.Y.S.2d 413 (N.Y. Civ. Ct. 1965).

45 *See Ernst Home Ctr. v. Sato*, 80 Wash. App. 473, 910 P.2d at 485, 486 (Wash. Ct. App. 1996) (holding that while “tone” and “image” are valid considerations, the landlord must be able not only to articulate appropriate concerns, but also to produce evidence that a trier of fact could examine objectively).

therein.” Although the court in that case honored this list of factors for consideration, it rejected the landlord's substantial evidence that assignment to a financially responsible bank with an alleged “bad business reputation” would lower the value of the landlord's property.⁴⁶ The lesson of this case seems to be that courts will strongly disfavor rejections that are allegedly based on bad identity or character.

Courts have held that a landlord may “reasonably” deny consent if a proposed subtenant would compete with the landlord's business⁴⁷ or if a landlord is unaware of the assignee's proposed use.⁴⁸ Furthermore, it is reasonable to deny consent where the mix of tenants is critical to the success of the landlord, such as in a shopping center.⁴⁹

“Unreasonable” grounds for denial have included the fact that a tenant would make a profit from the assignment or sublease,⁵⁰ a landlord's philosophical objections to the proposed tenant's business,⁵¹ a landlord's dislike of a particular business or method of doing business⁵² or the mere fact that

46 *See Chase Manhattan Bank, N.A. v. Lincoln Plaza Assocs.*, N.Y.L.J., Jan. 19, 1989, p. 22, col. 5 (Sup. Ct., N.Y. Co.). In that case, the landlord rejected assignment by tenant Chase Manhattan Bank on grounds that the proposed assignee, Bank Leumi, had a “bad business reputation” was plagued by “image problems,” and was “simply not a Chase Manhattan.” The landlord's evidence included news articles discussing indictment of several of the bank's low-level officers and discussing economic problems and stock scandals in Israel (Bank Leumi's country of origin). The landlord also presented affidavits by real estate attorneys and appraisers that a change of tenant to Bank Leumi would lower the value of the building.

47 *See Arrington v. Walter E. Heller Int'l Corp.*, 30 Ill. App. 3d 631 (Ill. App. Ct. 1975). Note, however, that *Edelman v. F.W. Woolworth Co.*, 252 Ill. App. 142 (Ill. App. Ct. 1929), held that such denial was unreasonable where the landlord's business was located a block away from (rather than closer to) the potential competitor's.

48 *See Kroger Co. v. Rossford Indus. Corp.*, 25 Ohio Misc. 43, 261 N.E.2d 355 (Ct. Common Pleas 1969).

49 *See Warmack v. The Merchs. Nat'l Bank*, 612 S.W.2d 733, 272 Ark. 166 (1981) (upholding landlord's refusal to consent to assignment from a bank to a savings and loan).

50 *See Stauffer Chem. Co. v. Fisher-Park Lane Co.*, 63 Misc. 2d 511, 312 N.Y.S.2d 243 (Sup. Ct., N.Y. 1970). *See also Carter v. Safeway Stores*, 744 P.2d 458, 154 Ariz. 546 (Ariz. Ct. App. 1987).

51 *See Am. Book Co. v. Yeshiva Univ. Dev. Found.*, 59 Misc. 2d 31, 297 N.Y.S.2d 156 (Sup. Ct., N.Y. Co. 1969) (holding that the landlord's refusal to consent was unreasonable where the landlord objected to the tenant's sublease to a Planned Parenthood office).

52 *See Broad & Branford Place v. J.J. Hockenjos, Co.*, 39 A.2d at 80 (N.J. Super. Ct. 1994) (holding that refusal to consent to assignment was unreasonable where the proposed assignee was a dressed poultry store). *See also Roundup Tavern, Inc. v. Pardini*, 413 P.2d 820, 68 Wash. 2d 513 (1966) (involving a tavern).

the prospective assignee is already an existing tenant.⁵³ Most courts hold that it is unreasonable for a landlord to withhold consent merely to extract an economic concession or improve its financial position.⁵⁴ In other words, a landlord cannot reasonably require a tenant to agree to rent increases as a condition to the landlord's consent. In the same vein, a landlord cannot simply demand a standalone fee as a condition to the landlord's consent either. In a case where the assignment clause did not contain a reasonableness standard, however, the Supreme Court of New York notably granted the landlord's motion to dismiss the tenant's claim for failure to state a cause of action even though the landlord admittedly withheld consent because the tenant refused to pay a \$50,000 fee.⁵⁵

The above is by no means a complete list of factors that courts will consider. For example, as the complexity of leveraged real estate transactions increases, courts will also need to consider the issue of consent from the landlord's lender, particularly where the lender refuses to consent to an assignment. In this scenario, courts would need to decide whether the landlord can reasonably cite the lender's refusal as the basis for withholding its own consent—even where the assignment provision is silent on this matter.

Potential assignors and assignees should consult case law regarding “reasonableness” in each applicable jurisdiction and should be aware that courts may rule differently on the same grounds for rejection depending on the facts of the particular case. Landlords, in turn, should plan carefully and consult counsel before taking any actions or imposing any conditions upon a tenant that could create an appearance of substantive unfairness or economic duress.

[28.20] 3. Applying a Reasonableness Standard to the Landlord's Consent

Given the lack of specific guidance afforded by a “reasonableness” standard, it is important for a tenant that its lease provide for a step-by-step process, with specific time periods within which each party must respond, for the tenant to request, and the landlord to provide, any required landlord consent to assignment of the lease. In the absence of an

53 See *Catalina, Inc. v. Biscayne Northeast Corp.*, 296 So. 2d 580, 582-83 (Fla. Dist. Ct. App. 1974) (holding that such a refusal to consent would be reasonable if the proposed sublease would have destroyed or adversely affected the preexisting lease).

54 See *Worcester-Tatruck Sq. CVS, Inc. v. Kaplan*, 601 N.E.2d 485, 489 (Mass. App. Ct. 1992).

55 *Hili v. 517 Third Ave. LLC*, 2012 WL 9518032 (Sup. Ct., N.Y. Co., 2012).

express process, a tenant that has submitted a request for the landlord's consent would have to wait an indeterminate "reasonable period of time" for the landlord to act on that request. The unpredictability of the timing for the landlord's response would deter prospective assignees and leave the status of the lease in limbo. The following provision is typical of provisions which establish a procedure for the tenant to request the landlord's consent:

If Tenant shall desire to assign this lease or to sublet the demised premises [in a transaction for which Landlord's consent is required hereunder],⁵⁶ Tenant shall submit to Landlord, no less than thirty (30) days prior to the proposed effective date of the assignment or sublease, a written request for Landlord's consent to such assignment or subletting, which request shall contain or be accompanied by the following information: (i) the name and address of the proposed assignee or subtenant; (ii) a detailed summary of the financial and material terms of the proposed transaction and a copy of the proposed sublease or assignment of lease; (iii) the nature and character of the business of the proposed assignee or subtenant and its proposed use of the demised premises; and (iv) banking, financial and other credit information with respect to the proposed assignee or subtenant reasonably sufficient to enable Landlord to evaluate the financial responsibility of the proposed assignee or subtenant. Landlord shall grant or withhold its consent to the proposed assignment of sublease in accordance with the standards set forth in this Article ___ within thirty (30) days following the date that Landlord has received all of such information from Tenant. Tenant agrees to provide Landlord promptly with such additional information concerning the proposed assignee or subtenant as Landlord shall reasonably request. The failure of Landlord to grant or withhold its consent to the proposed assignment of sublease in writing within thirty (30) days following the date that Landlord has received all of such information from Tenant shall mean that Landlord has [granted] [withheld] its consent.

56 The bracketed language is intended to exclude from these provisions certain assignments of leases which are permitted without landlord's consent, discussed *infra*.

The lack of clarity concerning the standards which constitute a reasonable basis for a landlord to withhold consent to an assignment or sublease has led to lease provisions, such as the following, which set forth a list of specific threshold factors which the tenant must satisfy in order to obtain the landlord's consent. As a drafting matter, the threshold factors typically are stated as conditions which must be satisfied absolutely; a reasonableness standard, if applicable, applies only to criteria considered by the landlord in addition to the specific threshold factors, which themselves are not subject to the reasonableness standard. A typical provision:

Landlord agrees that it shall not unreasonably withhold, delay or condition its consent to a proposed assignment of this lease or subletting of all or a portion of the demised premises for which such consent is required hereunder, provided that Tenant is not in default under this lease (beyond the expiration of applicable notice and cure periods provided hereunder) on either the date of that the request for Landlord's consent is made or on the date that the assignment is proposed to take effect, and further provided that each of the following further conditions shall be satisfied:

a. The subletting or assignment shall be to a tenant whose occupancy will be in keeping with the dignity and character of the then use and occupancy of the building and will not be more hazardous than that of Tenant herein or impose any additional operating burden which is material in nature upon Landlord in the operation of the building;⁵⁷

b. The subletting or assignment shall be to a tenant whose financial responsibility is [at least as creditworthy as the financial responsibility of the assigning tenant] [in keeping with the then financial standards of the building] and whose business has been operating for at least three full calendar years, and during the three most recent cal-

57 Note that in the case of a retail tenant which has agreed to pay percentage rent based on the tenant's gross sales, the Landlord will have a valid concern that the proposed assignee's use will generate at least as much gross sales revenue as the assigning tenant would have generated. For the landlord's benefit, the percentage rent clause should provide for adjustment of the percentage rent calculation to offset any projected resulting diminution of percentage rent upon assignment or subletting. For the tenant, an assignee whose use will generate considerably higher gross sales revenue may require a reduction of the percentage at which percentage rent is payable.

endar years of its operation, the prospective sublessee or assignee has generated a net operating profit not less than ___ times the annual rental obligations under the lease;⁵⁸

c. No space shall be advertised or openly promoted to the general public other than through licensed real estate brokers, and no space shall be advertised or offered through any medium at a lower rental rate than the rental rate being charged by Landlord at the time of the assignment for similar space in the building or referring in any manner to Landlord or to the building other than by the street address of the building;

d. The proposed sublessee or assignee shall not be a tenant, subtenant, occupant or assignee of any premises in the building, or a party who then is actively negotiating, or who, during the six (6) months immediately preceding Tenant's request for Landlord's consent, had actively negotiated, with Landlord or Landlord's agent (directly or through a broker) with respect to space in the building, if comparable space elsewhere in the building is available for leasing on, or is expected to become available for leasing no later than ninety (90) days following, the effective date of the proposed sublease or assignment[, as to which circumstance Landlord agrees to inform Tenant upon Tenant's request (and which information shall apply on to a sublease or assignment proposed to be first effective more than six (6) months following the delivery of such information to Tenant);

e. Tenant shall pay on demand the reasonable costs that may be incurred by Landlord or any mortgagee of Landlord in connection with any assignment or sublease, including, without limitation, the reasonable costs of making investigations as to the acceptability of the proposed assignee or subtenant, and legal costs incurred in connection with the preparation of any requested consent;

58 Landlord may improve the prospects for a court to respect its judgment regarding a prospective tenant's "financial condition," and a tenant may take comfort from greater clarity in landlord's evaluation of a prospective tenant's "financial condition," if the lease sets forth more specific standards for net worth, liquidity, capitalization, net cash flow from operations, net operating income, ratio of debt and contingent liabilities to equity or other criteria for which accounting standards may provide guidance.

f. Tenant shall have delivered to Landlord a duplicate original of the fully executed assignment.

g. [Provisions which restrict excess subdivision of floors, additional alterations, the number of tenants in occupancy of the premises, violation of any restrictive use covenants applicable to the building under other leases, etc.]

In addition, landlords have responded to the lack of clarity regarding reasons which would constitute reasonable bases to withhold consent to an assignment by limiting the recourse of the tenant in the event that the landlord is determined by a court to have withheld its consent improperly. The following provision limits the tenant in such circumstance to remedies of injunctive or declaratory relief to secure specific performance of the landlord's obligation to be reasonable in providing its consent:

Tenant hereby waives any claim against Landlord which Tenant may have based upon any assertion that Landlord has unreasonably withheld or unreasonably delayed or conditioned any consent or approval requested by Tenant, and Tenant agrees that its sole remedy in such circumstance shall be an action or proceeding to enforce any related provision or for specific performance, injunction or declaratory judgment. In the event of a determination that such consent or approval has been unreasonably withheld, delayed or conditioned, the requested consent or approval shall be deemed to have been granted; however, Landlord shall have no liability to Tenant for its refusal or failure to give, or conditioning of, such consent or approval[, unless a court determines that any such action by Landlord was in bad faith.] Tenant's exclusive remedy for Landlord's unreasonable withholding, delaying or conditioning of consent or approval shall be as provided in this Section.

This limitation insulates the landlord from liability to a tenant for money damages for the landlord unreasonably withholding its consent unless the landlord has acted in bad faith. Appendix D provides sample conditions to reasonableness of consent.

To the extent the above provisions shed light on the meaning of "reasonableness," they provide clear benefit to a tenant. However, a tenant

should be wary of such provisions where the underlying lease may later become part of a merger or acquisition. In these scenarios, the disclosure requirements of the above provisions may prove problematic given the confidentiality requirement of most mergers and acquisitions. Incorporating language into both the securities purchase agreement and the lease that provides for ex-post facto landlord consent can mitigate this concern.

[28.21] 4. Ambiguities in the Definition of an Assignment

Although commercial leases may contain specific provisions defining “assignment,” often leases do not define “assignment” or rely on catch phrases or other terms which create ambiguity regarding the scope of the restrictions. Courts have focused their interpretation on those ambiguities which arise when the lease generally restricts assignment without further explanation or when the lease merely prohibits assignment “by operation of law.”

[28.22] a. General Assignment Restrictions

General assignment restrictions are those provisions that prohibit the tenant from “assigning the lease” without more detail or require the tenant to obtain landlord consent before “assigning” the lease. Since, as noted above, courts generally disfavor restraints on alienation, general assignment restrictions are often construed quite narrowly.⁵⁹ Thus, general assignment clauses may restrict only a limited range of transactions, and may give rise to uncertainty as to whether particular transaction structures require the landlord’s consent.

Although the case law in this area is lacking in uniformity, the majority of holdings indicate that the less a transaction seems like a formal assignment, the more likely it will be considered outside the purview of a general restriction on assignments. This trend is best illustrated by courts’ treatment of two types of transactions: transfers of interest in a tenant and the restructuring of a tenant.

The majority view is that transfers of interest in a tenant, such as stock transfers in a corporation or transfers of membership interests in a partnership or limited liability company, are not prohibited by general restric-

⁵⁹ See *Citizens Bank & Trust Co. v. Barlow Corp.*, 456 A.2d 1283, 1288 (Md. 1983) (“The policy against restraints on alienation does not flatly prohibit nonassignment clauses, but it subjects them to strict construction.”).

tions on assignment of a lease.⁶⁰ This is true even if the transfer is of a majority interest in the entity which is the tenant,⁶¹ or if the transfer is done for the purpose of evading the assignment restriction.⁶² These transactions are dissimilar to formal assignments in that the tenant involved is not transferring any of its leasehold obligations and is legally distinct from the transferring parties. Therefore, courts commonly have been unwilling to find such transactions restricted by general non-assignment clauses.⁶³

The issue of stock transfers (or transfer of ownership interests in other entities such as limited liability companies or partnership, which are all encompassed, for purposes of this discussion, within the discussion of “stock” transfers) in the context of assignment clauses becomes more complicated, however, where the assignment provision explicitly covers stock transfers. An “Advanced Assignment Restriction,” for instance, proscribes tenant corporations from transferring corporate control.⁶⁴ Some provisions even prohibit transfer of any direct or indirect beneficial interest in the tenant; imagine in such a case the dilemma presented by the death of an owner of the tenant after which the decedent’s stock transfers first to the decedent’s estate and then to his or her heirs, or by public transfers of stock if the tenant becomes, or is acquired by, a public company. While such provisions are presumably enforceable under New York

60 See *In re Ames Dep’t Store*, 127 B.R. 744, 748–49 (Bankr. S.D.N.Y. 1991) (“In Illinois, it is settled that the transfer of all of the stock issued by a tenant corporation does not effect an assignment of the tenant’s lease unless the lease so provides.”); *Ser-Bye Corp. v. C. P. & G. Markets*, 179 P.2d 342, 345 (Cal. Dist. Ct. App. 1947) (finding that a corporate lessee’s covenant not to assign a leasehold ran only against the lessee itself, and not against its stock or stockholders). See also Stein, *supra* note 34, at 8 (“Under general legal principles, the sale or transfer of a corporate tenant’s stock does not violate a Basic Assignment Restriction.”).

61 See *Burrows Motor Co. v. Davis*, 76 A.2d 163, 165 (D.C. 1950) (holding that the transfer of the majority of stock in a corporation did not constitute an assignment).

62 See *Ames Dep’t Store*, 127 B.R. at 749 (“[T]he rule [that a sale of all of the stock of a corporate tenant does not constitute an assignment of the tenant’s lease] applies even where an assignment of the lease was rejected by the landlord and the rejected assignee then proceeded to purchase the stock of the corporate tenant.”).

63 See Stein, *supra* note 34, at 8 (stating that a transfer of corporate stock does not violate a general assignment restriction because “a corporation exists separately from its stockholders”). See also *U.S. Cellular Inv. Co. v. GTE Mobilnet, Inc.*, 281 F.3d 929, 935 (9th Cir. 2002) (“[W]hen a party enters into an agreement with a corporation, it is presumed to do so with an understanding of the nature of the corporate form. In effectuating the reasonable expectation of the parties, the law presumes that if the parties intend to limit the corporation’s ability to engage in a legitimate and normal corporate transaction, such a limitation will be specified.”).

64 Stein, *supra* note 34, at 9.

Law,⁶⁵ one commentator suggests that New York courts will nonetheless narrowly construe such provisions.⁶⁶ For example, courts might distinguish between the transfer of existing stock and the sale of new stock.⁶⁷ Courts may also overlook such provisions where stock ownership of a corporate tenant is spread across over a dozen shareholders.⁶⁸ Further, courts should, and do, apply similar principles of narrow construction no matter what the business form. Therefore, if a lease only restricts transfers of stock and partnership interests, but the tenant is an LLC, a court may find that the restriction does not apply and allow the assignment of LLC interests.⁶⁹ Landlords and landlords' counsel that choose to include these provisions must carefully craft the restrictions. Conversely, tenants and tenants' counsel should urge landlords to exclude from assignment restrictions certain transactions, such as transmissions of publicly held stock or initial public offerings, legitimate estate planning and affiliate transfers, and transfers consistent with a mutually contemplated business plan, at a minimum.⁷⁰

Courts seem similarly unwilling to find the restructuring of a tenant to be restricted by general non-assignment clauses. Of the few courts that have considered the issue, most consider a tenant restructuring, such as a merger, to be a transfer by operation of law, and not an assignment.⁷¹ Therefore, so long as no restriction on transfer by operation of law is appended to the general assignment restriction, the tenant usually can engage in restructuring without the need for the landlord's consent. One rationale that courts have set forth for this result is that mergers which do not change the ownership or control of a tenant are not comparable to for-

65 *See id.* at 10.

66 *Id.*

67 *Id.*

68 *Id.*

69 *Id.*

70 *Id.*

71 *See Dodier Realty & Inv. Co. v. St. Louis Nat'l Baseball Club*, 238 S.W.2d 321, 324 (Mo. 1951) (holding that an assignment had not occurred because the merged corporation succeeded to the lease not by any voluntary act, but "solely and automatically by virtue of [a statute]"). *See also* Milton R. Friedman & Patrick A. Randolph, Jr., *Friedman on Leases* § 7:3.3[E][2] (5th ed. 2005) ("[T]he operation-of-law doctrine was based on the theories that non-assignment clauses are intended only to reach voluntary acts of the lessee, and that 'transfers by operation of law are always involuntary,' that is, death of the tenant, levy of execution, or involuntary bankruptcy.').

mal assignments as they merely change the tenant's form.⁷² However, if a tenant's restructuring will result in a change of the direct ownership or control of the tenant, courts may be more willing to apply a general assignment restriction. For this reason, it is important to ensure that the lease specifically narrows the definition of an assignment, as discussed below.

[28.23] b. Restrictions on Assignments “By Operation of Law”

While courts often are hesitant to read general non-assignment restrictions broadly, they may be willing to restrict a broader range of transactions when the lease prohibits assignments by operation of law. As described by one commentator in the context of lease assignments, “by operation of law ... refers to the transfer of rights or liabilities by court order, statute or the like—as opposed to a voluntary and express transfer made by a party.”⁷³ In particular, many courts have found that statute-forced mergers result in assignments by operation of law and are thus prohibited under leases restricting such assignments.⁷⁴ Like other assignments by operation of law, such as those resulting from bankruptcy and execution, statute-forced mergers result in the transfer of leasehold interests without any voluntary actions by tenants. Because of this similarity, courts have reasoned that such mergers also should fall within the scope of lease prohibitions on assignments by operation of law.⁷⁵ However, decisions regarding assignments by operation of law are varied, especially in the context of mergers. For example, some courts have found that mergers are not assignments at all, but instead are transfers that do not violate restrictions on assignment, by operation of law or otherwise, even where the assignment provision explicitly prohibits assignment by opera-

72 See *Brentsun Realty Corp. v. D'Urso Supermarkets, Inc.*, 182 A.D.2d 604, 582 N.Y.S.2d 216, (2d Dep't 1992) (“Under the facts of this case, the merger of the subsidiary corporation into its parent corporation did not constitute an assignment for purposes of violating the nonassignment covenant in the lease . . . [because] [t]he merger did not change the beneficial ownership, possession, or control of [the tenant's] property or leasehold estate. Only [the tenant's] corporate form was affected, not the corporate property.”).

73 See Stein, *supra* note 34, at 11.

74 See *Citizens Bank & Trust Co. v. Barlow Corp.*, 456 A.2d 1283, 1283 (Md. 1983) (finding that the statute-forced merger of a tenant into another corporation constituted an assignment by operation of law, thus it violated a non-assignment clause prohibiting assignments by operation of law).

75 See *Citizens Bank & Trust Co.*, 456 A.2d at 1289 (“The process of strict construction ordinarily does not accommodate treating transfers by merger differently than other transfers by operation of law, for example, involuntary bankruptcy or execution. To do so would cloud the effect of ‘operation of law’ language and raise doubts as to whether it has any vitality at all.”).

tion of law.⁷⁶ Therefore, landlords should specify any merger restrictions in the lease, and conversely tenants should make certain that the lease contains appropriate exclusions, as discussed below. As one commentator notes, corporate tenants should also be wary of titling agreements “Assignment Agreement” or otherwise creating the impression in the merger agreement that an assignment has taken place, rather than a mere “change in the identity of the tenant.”⁷⁷ In doing so, a tenant will have a better chance of success in arguing that only a transfer—rather than an assignment—has occurred.

[28.24] c. Totality of the Circumstances

Regardless of whether the assignment provision explicitly mentions assignment by operation of law or stock transfers, there also is some indication in the cases that courts will look towards the totality of the circumstances to determine whether an assignment in violation of a lease has occurred. Specifically, a court may also consider additional facts or circumstances outside of the assignment provision “for the purpose of preventing fraud, deception, evasion, or injustice” in its determination of whether an assignment has occurred.⁷⁸

[28.25] 5. Narrowing the Definition of an Assignment

Landlord's counsel seeks to make the restriction of assignment of a tenant's interests under a lease as comprehensive as possible by defining “assignment” as broadly as possible. In response, the tenant seeks to counter the all-inclusive drafting by landlord's counsel with specific exclusions for transactions which—although involving a transfer of legal or beneficial rights in the lease—are, for practical purposes, consistent with continuity of the tenant's interest under the lease. As discussed above, the general rule disfavoring restrictions on alienation of real property means that a restriction on assignment of a lease does not restrict a transaction which involves a transfer of an interest in stock but which is not technically an assignment. For this reason, a restriction on assignment

76 See Stein, *supra* note 34, at 14 (“Other courts, however, have held that mergers, although ‘transfers’ by operation of law, are not ‘assignments’ of any kind, and are therefore not covered by such clauses.”); *Albermarle, Inc. v. Eaton Corp.*, 357 S.E.2d 887, 888 (Ga. Ct. App. 1987) (“In this situation involving a corporate merger . . . the survivor is more properly described as the successor of the merged corporation [than as an assignee].”). See also *Santa Fe Energy Res., Inc. v. Manners*, 635 A.2d 648, 649 (Pa. Super. Ct. 1993) (“[A] merger of corporate enterprises does not automatically and without more result in an assignment of the rights of the merging parties.”).

77 *Id.*

78 49 Am. Jur. 2d Landlord and Tenant § 931 (2015).

of the lease does not, without more, restrict a sublease, or restrict the temporary use of leased space by others (even without compensation), each of which must be separately restricted. The following discussion addresses several categories of specific exclusions sought by tenants; each exclusion seeks to narrow the landlord's broad definition of an assignment.

[28.26] a. Affiliate Transactions

In the ordinary course of a tenant's business, new ideas, strategic goals or reasons to segregate assets or liabilities will arise which may require, or be addressed by, the creation or purchase of a separate company. The separate company may be entirely or mostly owned by the tenant (a subsidiary), may be created by the shareholders of the tenant but have no direct legal relationship to the tenant (a sister company), or may involve different degrees of common ownership with the tenant (an affiliate). The businesses of large corporate tenants often involve dozens—and may involve hundreds—of such related entities, and the corporate tenant's family of related entities often is continually changing, with spin-offs, new acquisitions and closures. A tenant needs to operate its business without having its ability to pursue business opportunities and make strategic decisions impaired or delayed by the need to obtain the landlord's consent to assignment of the lease. Exceptions from the restrictions on assignment in the lease may be essential to achieve this goal.

In addition to the range of related entity transactions described above, even individual tenants in smaller leases have similar needs: a father wishing to transfer the lease for a family-owned business to his son or daughter or to a family trust; or the executor of the estate of a deceased business owner who needs to transfer a lease to the estate and then to the decedent's heirs; or a business owner taking on a partner who needs to transfer the lease to a partnership or limited liability company as a new form of operation of the business—all can run afoul of transfer restrictions. The concern expressed here that the tenant have the ability to accomplish these transactions without the requirement for the landlord's consent may seem excessive if the lease provides that the landlord cannot withhold its consent unreasonably. Keep in mind, however, not only that there is no such reasonableness standard in many commercial leases, but also that the concept of “reasonableness” itself is rife with ambiguity: if the son or daughter does not have the same depth of business experience as the father, would the landlord be reasonable in withholding its consent to assignment of the lease to the son or daughter? In addition, the time to obtain even a reasonable consent can delay, and possibly jeopardize, completion of a transaction.

The following is a sample provision which provides an exclusion for related person transactions involving business entities:

Tenant, without Landlord's consent but upon prior written notice to Landlord as described below, shall have the right to allow any corporation or other entity which controls, is controlled by, or is under common control with Tenant (herein referred to as a "related corporation") to sublet all or part of the demised premises, or take an assignment of [and assume] Tenant's interest in this lease, in either event, for any of the purposes permitted to Tenant, subject however to compliance with all of Tenant's obligations under this lease, provided that (i) Tenant shall not be in default in the performance of any of its obligations under this lease, beyond the expiration of applicable notice and cure periods provided herein, on the effective date of such sublease or assignment, (ii) not less than ten (10) days prior to such subletting or assignment Tenant shall notify Landlord of the name of any such related subtenant or assignee and shall provide Landlord with an [officer's certification of] [opinion of legal counsel to] Tenant, and such other evidence as Landlord may reasonably request, that such subtenant or assignee is related to Tenant in such manner, and (iii) from time to time during the term hereof Tenant shall provide Landlord with an [officer's certification of] [opinion of legal counsel to] Tenant, and such other evidence as Landlord may reasonably request, that such subtenant or assignee continues to remain related to Tenant in such manner. Tenant, upon request by Landlord, shall provide to Landlord at any reasonable time and from time to time, but not more frequently than twice in any twelve (12) month period, evidence reasonably sufficient to establish that such subtenant or assignee continues to control, be controlled by, or be under common control with, Tenant. No such subletting or assignment shall relieve, release, impair or discharge any of Tenant's obligations, or Tenant, hereunder. For the purposes hereof, "control" shall be deemed to mean commonality of interests having the power to direct the management and policy of such corporation or other business entity and commonality of ownership of not less than fifty (50%)

percent of all of the voting stock of such corporation or not less than fifty (50%) percent of all the legal and equitable interests in any other business entity.

This provision permits an assignment among related entities without the landlord's consent only so long as the parties to the assignment remain related entities. Without such a limitation, the tenant would be permitted to assign the lease to a related entity without the Landlord's consent, and then to transfer all the interests in the related entity to a third party, and thereby evade the restrictions elsewhere in the lease on assignment of the lease to unrelated persons. The lease provides that it is a default if the commonality of interests terminates between the parties to the assignment without the parties obtaining the consent of the landlord in the same manner that the tenant must obtain such consent under the lease to an assignment between unrelated persons. While it is evident that a default should result, the default section of the lease should expressly provide for the default, and default should not require prior notice from the landlord or be subject to a cure right.⁷⁹ In addition, the lease should expressly state that if the commonality of interests which permitted an assignment among related persons without landlord's consent no longer exists, the assignment itself is either void from the date such commonality no longer exists, or is voidable by the landlord in its sole discretion. Although, if the assignment is voidable, the landlord can decide at such time whether it is better off with or without recourse to, and occupancy by, the assignee which formerly was a related entity of the original tenant, an assignment which is merely "voidable," rather than "void," implicitly is valid unless the landlord actually elects to void the lease.

[28.27] b. Transfers of Interests in the Tenant

A tenant can achieve the same economic and practical effects of a direct assignment of its interests under a lease by the transfer of direct or indirect interests in the tenant itself. For this reason, the initial draft prepared by a landlord or landlord's counsel of an assignment restriction, as illustrated above, often also restricts a transfer of direct or indirect interests in the tenant which, individually or in a series of transactions, consti-

⁷⁹ Tenant's counsel may contend that there should be a right to notice and a cure period, since the termination of the commonality of interests may be inadvertent. It is hard to see how this could be the case, and even if such a case should arise, a right to notice and cure would eviscerate the force of the restriction.

tutes 50% or more of the interests in tenant.⁸⁰ The determination of when a transfer of 50% or more of the interests in the tenant is relatively simple when applied to the transfer of shares in a corporation with a single class of common stock. Complexity is presented, however, by multiple classes of stock, the issuance of new stock with dilutive effect, the issuance of warrants, options, convertible debt, and other transactions affecting the equity structure of a corporation, or by distinctions among such attributes of partnership or limited liability company interests as management of the entity, rights to preferences, and general versus limited liability.

As noted above, a change in the membership of a partnership or a limited liability company generally is not held to violate a restriction on assignment absent express language to the contrary. Nevertheless, good drafting practice on a tenant's behalf would be to so provide expressly in the lease. On the landlord's behalf, a lease restriction, as illustrated above, should apply expressly to the transfer of direct or indirect beneficial interests in the tenant, at least if the interests transferred aggregate 50% or more of the total equity interests in the tenant.⁸¹ Such a provision prevents the tenant from effecting, through transfer of the interests in the tenant in a manner which does not require the consent of the landlord, an assignment of the lease which the tenant could not effect directly without first obtaining the consent of the landlord.

One effect of a restriction on transfer of greater than 50% of the interests in the tenant without the landlord's consent is to make the consent of the landlord a condition to sale of the tenant's business. The landlord's insistence on a right to consent is perceived by the tenant to be overreaching, particularly if the sale will not affect the financial standing of the tenant and the business will continue to operate in the leased premises as it operated before the sale of the business. Moreover, a tenant has a legitimate concern that, in the event of a profitable sale of a business operating in leased premises, the landlord will seek to attribute part of the profit to the increased value of the leasehold, and will condition its consent on the tenant sharing part of the profit from the sale with the landlord. For this

80 *See Modern Commc'n Serv. Inc. v. NEP Image Group, LLC*, 19 Misc. 3d 1134(A), 864 N.Y.S.2d 93 (Sup. Ct., N.Y. Co. 2008) (finding that a merger involving a tenant limited liability company's parents could trigger a lease provision that considered the transfer of more than a 50 percent beneficial interest in the tenant "an assignment").

81 *See id.* at *4 ("[The lease provides] that an assignment includes a 50% or more transfer of the 'beneficial interest in the lessee . . . whether of stock, partnership interest, company share or otherwise by any party in interest.' This language clearly states that the parties meant for the term 'beneficial interest' to encompass the partnership interest in . . . the lessee.").

reason a tenant may seek a specific exclusion for a sale of its business or a merger of its business with another firm, as follows:

Tenant, without Landlord's consent but upon prior written notice to Landlord as set forth below, shall have the right to assign its entire interest in this lease and the leasehold estate hereby created to a Successor Entity (as hereinafter defined) to Tenant; provided, however, that (i) Tenant shall not be in default in the performance of any of its obligations under this lease, beyond the expiration of applicable notice and cure periods provided herein, on the effective date of such assignment, (ii) not less than ten (10) days prior to such effective date Tenant shall have notified Landlord of the name of the proposed assignee and provided Landlord with an [officer's certification of] [opinion of legal counsel to] Tenant, and such other evidence as Landlord may reasonably request, that such assignee is a Successor Entity to Tenant, and (iii) the proposed occupancy shall not increase in any material respect the burden of Tenant's occupancy upon the building equipment or building services. A "Successor Entity," as used in this paragraph shall mean (a) a corporation or other business entity into which or with which Tenant is merged or consolidated, in accordance with applicable statutory provisions, provided that by operation of law or by effective provisions contained in the instruments of merger or consolidation, the liabilities of the entities participating in such merger or consolidation are assumed by the entity surviving such merger or consolidation, and (b) a corporation or other business entity which acquires, together with this lease and all the interests of Tenant hereunder, all the goodwill of Tenant and all or [substantially all] [a substantial portion of] the other property and

assets of Tenant,⁸² and which assumes all of the obligations and liabilities of Tenant under this lease and all or [substantially all] [a substantial portion of] of the other obligations and liabilities of Tenant,⁸³ and (c) any successor to a Successor Entity by either of the methods described in subdivisions (a) and (b) above. (continued below)

The expansion since the early 2000s of public stock issuance even by start-up companies has made the inclusion of language such as the following clause (d) more common:

and (d) a corporation (including, but not limited to, Tenant on the date hereof) or other business entity which engages in an initial public offering or follow-on offering of shares of stock or other ownership interest or debt[, whether by public offering or private placement of stock, other ownership interest or debt of Tenant, or in connection with a venture capital or other equity investment in Tenant,] [on recognized public stock exchange in the United States].

The sample provision continues as follows:

Any transaction described in clause (a), (b), (c) or (d) above shall be subject to the condition that such merger

82 This provision would not allow the sale of an operating division alone without the landlord's consent unless the division alone constitutes substantially all of the assets of the tenant. Since this often is not the case, a tenant with many divisions and which regularly buys and sells companies should seek a further exclusion which allows sale without consent of all the assets pertaining to a specific operating division. Such an exclusion is particularly common in the case of a tenant which owns several separate restaurant chains, or several separate retail store brands, or several separate manufacturing divisions, and wants to preserve the ability to sell any of them separately without being required to obtain the landlord's consent. In fact, in such circumstances the tenant may negotiate for the right to a secure a release of the assignor from liability under the lease following assumption of the lease by the transferee. The landlord often will agree to provide such a release since the obligations under any one restaurant or retail lease typically are small relative to the financial standing of the entire chain.

83 While this provision in leases often requires that the successor not only acquire all or substantially all of the assets of the tenant but also assume all or substantially all of the liabilities of the tenant in order to reinforce the concept that the successor as tenant is the successor to all aspects of the tenant's business, the tenant's financial standing obviously would be better if it acquired all or substantially all of the assets of the tenant and assumed less than all the liabilities of the tenant. This argument often persuades Landlord's counsel to remove the clause of this lease provision requiring the successor also to assume all or substantially all of the tenant's liabilities other than the lease.

or consolidation, or such acquisition and assumption, or such sale or investment, as the case may be, is for a valid, independent business purpose and is not principally for the purpose of transferring the leasehold estate created hereby. In addition, in each such transaction immediately after giving effect to any such merger or consolidation, or such acquisition and assumption or such sale or investment, as the case may be, the entity surviving such merger or acquisition or created by such consolidation or acquiring such assets and assuming such liabilities, or surviving such sale or investment, as the case may be, shall have assets, capitalization and a net worth, as determined in accordance with generally accepted accounting principles as established by reasonable evidence delivered to Landlord with the aforesaid notice to Landlord, [reasonably sufficient as of the date of such transaction to satisfy the obligations of Tenant under this lease during the term of this lease as they become due] [not less than the assets, capitalization and net worth of Tenant immediately prior to such transaction] [not less than the lesser of (x) the assets, capitalization and net worth of Tenant immediately prior to such transaction and (y) the assets, capitalization and net worth of Tenant on the date of this Lease].⁸⁴

During the explosion of internet companies in the late 1990s, the founders or venture capital funders of many start-up companies raised money by successive public offerings or private placements of shares. Such offerings or placements almost always eventually reduced the percentage of equity held by the original shareholders well below 50 percent. A tenant which regularly receives venture capital equity investment presents a particular challenge for the tenant's counsel, since over time a

84 The differences between the bracketed choices may be critical. The first standard, the tenant's ability to meet its obligations under the lease as they arise, is the most beneficial to a tenant, being essentially a standard of mere solvency. The second standard would allow the tenant to engage in a transaction which does not have an adverse impact on the tenant's financial standing, but is problematic for a tenant which—since the lease was signed—has greatly increased its financial standing or has been acquired by a much larger company which assumed the lease at the time of the acquisition. The third standard adopts two alternative tests to achieve a blended standard: the transaction cannot have an adverse impact on the tenant's financial standing which would cause it be less than the financial standing which the landlord underwrote when the tenant originally signed the lease. The third standard is most equitable, but many landlords reject this standard in favor of the second standard on the basis that part of what the landlord bargained for in accepting the tenant originally was the improvement of the tenant's credit standing over time.

change in the ownership of 50 percent or more of the equity is likely to occur through the combined effect of purchases of shares or interests by new shareholders, members or partners, issuances of additional shares which dilute the existing shareholders, and exercises of options, warrants and other rights. One approach to providing flexibility for tenants while addressing the landlords' concerns is to focus on the continuity of existing management (qualified for ordinary employee turnover) and the maintenance of a minimum level of equity ownership associated with existing management. The sample provision below is only a starting point, since each business has its own unique needs and each landlord has its own tolerances. One way to draft so that the tenant has flexibility with regard to both outright transfers and related person transactions, is to define "control" more narrowly than a 50% interest:

For purposes hereof "control" shall mean (i) commonality of interests having the power to direct the management and policy of such corporation or other business entity after giving effect to such transaction with the holders of such interests before such transaction and (ii) not less than ten percent (10%) of the voting stock or legal and equitable interests in such corporation or other business entity after giving effect to such transaction is held by persons or firms who in the aggregate held at least ten percent (10%) of the voting stock or legal and equitable interests in such corporation or other entity before such transaction.

In today's financial climate, it is more important than ever that leasing counsel discuss with a prospective tenant the tenant's capital structure and business model and the prospective tenant's plans for raising capital and for strategic business transactions during term of the lease.

One further drafting issue regarding lease restrictions which extend to transfers of control: while such restrictions often define a transfer of a certain percentage of interests in, or of a "controlling" interest in, the tenant as an "assignment," the requirements applicable to an assignment often fail to distinguish such a "deemed" assignment from an actual assignment. For instance, leases often provide that an assignee of the tenant's interest under the lease must assume the lease in writing. This requirement, if applied to the transfer of a 50% ownership interest in a tenant, would require the new shareholder of a corporate tenant or the new member of an LLC tenant to assume directly the leasehold obligations of the tenant, thereby wiping out the protection which the form of entity used

provides the investors in such entities. Conversely, a provision that an assignee of the tenant's interest under a lease must have a specified minimum financial standing will not achieve the landlord's goal of ensuring adequate recourse for performance of the lease if, following a change of control which is deemed to be an assignment of lease, the test is applied to the new shareholder or member even though it is the tenant, rather than the new shareholder or member, that is liable for the obligations under the lease. Such results are not intended, and counsel should review the treatment of a deemed assignment of lease with care to distinguish it from an actual assignment of lease where appropriate.

[28.28] c. Other Transfers of Rights in the Lease

The increased integration of the operations of many businesses have made it more common to find persons working in a tenant's space who are not employees of the tenant, and equipment located in a tenant's space which does not belong to the tenant. The space leased by a tenant for a securities trading operation, a real estate brokerage or a travel agency, may be full of desks and computer terminals at which the tenant's clients or independent contractors come to work every day and seem to all outward appearances to operate their own businesses within the tenant's space. A tenant which is a Web hosting or telecommunications switching business may fill its leased space with equipment and employees of the tenant's clients. Such "users" of space, whose occupancies typically are not evidenced by actual subleases or assignments, concern landlords as an end run around transfer restrictions in the lease, and concern tenants as a possible technical default under the lease arising from the tenant simply operating its business in the ordinary course.

Such uses are referred to generically as "desk space," reflecting the history of professional firms leasing out the use of individual offices, fitted out with desks, to other professionals in the same or related fields. Often the leasing of desk space arises from the tenant initially leasing more space than the tenant needs for its own business on the date of the lease so that the tenant will have future expansion space. The following provision allows such uses:

Notwithstanding anything contained to the contrary in this Article, Tenant shall have the right, without Landlord's consent, to share the use of portions of the demised premises [constituting not more than twenty percent (20%) of the total rentable area of the demised premises] with persons who are, or who are performing tasks for,

clients or customers of Tenant or vendors to Tenant in connection with Tenant's ordinary business operations, without being in violation of this Article, provided that each such occupant (a) shall not violate any term or condition of this Lease and shall not be employed by or agents of any other tenant in the building, (b) shall specifically be the responsibility of Tenant and shall be covered under the insurance policies which Tenant is required by this Lease to maintain or by insurance policies otherwise meeting the requirements of this Lease and reasonably acceptable to Landlord, under which Tenant, Landlord, any mortgagee of the building and any other party entitled to be so named on Tenant's insurance hereunder, are named as additional insureds, and Tenant shall have delivered to Landlord original certificates of insurance evidencing such coverage prior to the commencement of any such occupancy, and (c) at all times shall provide services primarily to customers and clients of Tenant or using Tenant's devices, infrastructure, intellectual property or business relationships, shall utilize Tenant's entrance to the demised premises, reception area and other facilities, and shall give the physical appearance that the demised premises is being occupied solely by one (1) entity for the purpose of Tenant's primary business operations.

Although a discussion of collateral assignment of leases in connection with leasehold financing is outside the scope of this chapter, it is worth noting that a lease also may be collaterally assigned as part of a general financing of all of the assets of a tenant. A blanket pledge of assets by a tenant would violate an unqualified restriction in a commercial lease prohibiting assignment of the lease, since the grant of the collateral assignment itself is, technically, a prohibited assignment. The following is an example of a provision which will avoid this technical default:

Notwithstanding the provisions of this Article, Tenant shall have the right, without Landlord's prior consent but upon ten (10) days' prior notice to Landlord, to pledge (subject to all of the terms, covenants, and conditions of this Lease) its entire interest in this Lease to any lender in connection with a borrowing by Tenant which is secured by all or substantially all of the [tangible] assets of

Tenant. The exercise by any such lender of its rights under any such pledge to acquire Tenant's interest in this Lease shall be deemed an assignment of this Lease and shall be subject to the terms of the other provisions of this Article.

[28.29] d. Obtaining Consent

In the face of uncertainty regarding the assignment provisions of a lease, a tenant may proceed in several ways.

First, a tenant can explicitly solicit the landlord's consent. A tenant may opt to do so even without reference to the specific lease provisions. For example, a tenant can request that the landlord agree to the following language:

Pursuant to the Lease, Tenant may be required to obtain your written consent to the Transaction. By countersigning this letter below, you acknowledge receipt of this notice, consent to the Transaction, acknowledge that Tenant has complied with the Lease, agree that you will have no right to terminate the Lease as a result of the Transaction and otherwise waive the applicability of any provisions of the Lease that might be triggered by the Transaction or otherwise by this letter. If, however, the Transaction is not consummated for any reason, you acknowledge that the Lease, as currently constituted and in effect, will remain effective and that this consent will not be construed to modify, waive, impair or affect any of the terms of the Lease as currently in effect or any rights or obligations thereunder. This letter is being provided for Landlord's benefit only and shall not be construed to create any obligation on behalf of Tenant to obtain Landlord's consent to the Transaction or any future transaction.

In the event the landlord rejects the request, a tenant could solicit a reasonably specific explanation, particularly where the lease requires reasonable consent.

Second, similar to the above, a tenant can solicit the landlord's consent, but instead state that, under the lease, the landlord's consent is not needed. Under this approach, a tenant can benefit under theories of reliance or laches should the landlord fail to respond to the notice, but later object. A

tenant can similarly argue that landlord's actions subsequent to the notice (e.g., failure to respond) constitute deemed consent.

Given the theory of deemed consent, the landlord must keep in mind that communication with a proposed assignee, or other conduct by the landlord with respect to a proposed assignee which creates an inference that the landlord has consented to assignment to the assignee, can be construed as a deemed consent by the landlord, especially if the landlord also accepts rent from the proposed assignee or otherwise deals with the proposed assignee. A lease can contain the following provision to a protect against a deemed consent:

All references to the consent or approval of, or similar action by, Landlord in this Lease shall be deemed to mean only the written consent or approval of Landlord in accordance with the terms and conditions of this Lease, and no consent or approval shall be effective for any purpose, nor shall any consent be deemed to exist based on any theory including estoppel, laches, course of dealing, verbal understanding or other basis, unless fully set forth in a writing delivered to Tenant.

A landlord and its counsel should be scrupulous to avoid dealing with any person other than the actual tenant in matters affecting the tenancy until consent to an assignment actually has been given by the landlord.

Finally, particularly where the lease does not appear to cover the assignment, a tenant can opt to proceed without notice to the landlord. While this option may prove harmless to a tenant if a court finds the assignment to be immaterial, which in itself may be unlikely, it also may impair the tenant's ability to argue that the landlord's subsequent objection was unreasonable: according to several cases, the less information that a tenant provides to the landlord regarding an assignment, the more likely that the landlord's refusal to consent will be held to be reasonable.⁸⁵

[28.30] e. Form of Consent

The landlord can grant its consent in any manner, and verbally or in writing. A written consent is preferable to establish clearly that consent was obtained and to set forth any conditions applicable to the consent. In some cases, a landlord simply will countersign a letter from the tenant

85 See Stein, *supra* note 34, at 22.

requesting the landlord's consent, with little to add other than the non-waiver language discussed above. For an assignment of a larger lease or of any lease for which more thorough documentation is needed, the landlord may require a separate instrument of consent. Appendix E to this chapter is a sample of a landlord's consent to assignment of a lease.

[28.31] D. Assignment by Landlord

As discussed above, a landlord rarely agrees to restrict its ability to assign the landlord's interest under the lease. The tenant may ask, rightfully, however, to whom it has recourse for performance of the landlord's obligations under the lease if the landlord sells the property and assigns the tenant's lease to the landlord's successor in connection with the sale.

The New York Real Estate Board form of office lease includes the following general provision that the lease is binding on successors and assigns of each party:

The covenants, conditions and agreements contained in this lease shall bind and inure to the benefit of Owner and Tenant and their respective heirs, distributees, executors, administrators, successors, and except as otherwise provided in this lease, their assigns.

Many leases include a similar provision. However, unless the buyer of the property, as assignee of the lease, affirmatively assumes the lease, such a provision is unlikely to support enforcement against the assignee of any provisions of the lease other than those which run with the land and thus are enforceable by virtue of the privity of estate between the tenant and the new owner. A tenant seeks a provision which requires that the new owner, as successor landlord, assume the tenant's lease. Since the landlord, when selling the property, has an interest in obligating the buyer of the property to perform the leases, the seller, as landlord, may agree to secure an assumption of the lease from any buyer of the property to whom the landlord's interest under the lease is assigned. The landlord may also agree to a tenant's reasonable request that the lease obligate the tenant to attorn to a successor landlord only if the successor landlord assumes the lease.

In the absence of an assumption of the lease by the buyer, the buyer takes title to the property purchased "subject to" all leases. Taking title "subject to" the leases obligates the buyer to perform those obligations relating to the tenancy which run with the land under the buyer's privity of

estate with the tenant. The buyer is not obligated, however, to perform any other terms of the lease which do not run with the land. Failure of the buyer to perform any terms of the lease which do not run with the land ordinarily would allow the tenant to exercise its contractual remedies against the seller of the property, but the exercise of any such remedies may be of little value since the lease provides that the recourse of the tenant to the seller is limited to the seller's interest in the property. The tenant also may elect to declare a default under the lease and exercise its remedies which may include termination of the lease; however, termination may be of no practical appeal to a tenant which has installed expensive improvements in leased premises, or to a retail tenant whose consumer traffic depends on association of its business with the leased location, or if the market rent is greater than the lease rent and the tenant's proposed assignment was intended to capitalize on the increased market value of the leasehold.

The distinction between the buyer merely taking the property subject to the lease, and actually assuming the lease, can be significant for the tenant. Suppose, for example, that the tenant has a lease at below-market rent. The new owner of the property may want the tenant to leave the demised premises in order to re-rent the space at the higher market rent. The new owner may not want to assume the lease and may rely on not having assumed the lease, and a narrow definition of which covenants run with the land, to withhold material services and rights to encourage the tenant to vacate the premises. The tenant then must decide whether to exercise any self-help remedies under the lease or to incur the expense of bringing suit against a recalcitrant landlord. Preserving the right of a buyer as successor landlord to pursue this course of action is one reason that a landlord may refuse to provide in the lease that a successor landlord must assume the tenant's lease.⁸⁶

Typically a buyer of leased property will require an estoppel certificate from each tenant, or from a substantial percentage of the tenants, at the property. The request for an estoppel certificate notifies each tenant of an impending sale or mortgage of the property. The tenant then has the opportunity to identify in the certificate any claims which the tenant has against the landlord (other than for prospective performance by the landlord under the lease). Even if the lease provides that the tenant has no recourse to the landlord after the sale of the property, the buyer is not

86 The issue may arise again whether the assignee, in this case the new landlord, assumes the obligations under the lease for the entire lease term or only for the portion of the lease term from and after the date of the assignment.

likely to accept title to the property when claims have been raised by a tenant unless the seller provides adequate assurance, such as an indemnity, to the buyer—protecting the buyer from liability for the asserted claims. In this manner the seller often is subject to surviving liability despite the limitation on liability in the lease. The owner of rental property will be better served by an express provision in the lease which sets forth what the liability will be of any successor landlord and what the recourse of tenants will be to any such successor.

[28.32] VII. ALLOCATION OF PROFITS FROM ASSIGNMENT

Restrictions on assignment of a lease exist to protect a number of legitimate interests of the landlord, as discussed above, concerning the use of its property. Clearly, however, one of the reasons for such restrictions is the desire to prevent or make more difficult a tenant assignment of its interest under its lease for a profit. A basic tenant of the real estate business for landlords is that the landlord, and not the tenant, is in the real estate business. While a landlord may allow its tenant to relieve itself of liability under the lease by assigning or subletting the lease, the landlord will try its utmost to capture any appreciation of the leasehold.

[28.33] A. Sharing Profits from an Assignment of Lease

As discussed above, many tenants, particularly creditworthy tenants who will remain liable under a lease notwithstanding an assignment, dispute that the landlord has any legitimate interest in restricting assignment of the lease. To the tenant, any profit which the landlord derives from an assignment of the lease by the tenant is a windfall for the landlord, above and beyond the contract rent for which the landlord negotiated. Moreover, the tenant will remain liable under the lease notwithstanding the assignment, and tenants believe that they are entitled to retain any appreciation of the leasehold as a return for the risk the tenant bore by agreeing to be liable under the lease for an extended term. In fact, any profit from assignment of the lease may reflect, at least in part, an increase in the rental value of the premises from the tenant's improvements to the space.

Where a tenant has secured the right (even with some limitations) to assign the lease, landlords nevertheless often do allow the tenant to retain part of any profit from an assignment of the lease. Landlords recognize that only by giving the tenant a participation in any profit from an assignment of the lease will the landlord ensure that the tenant has an incentive to maximize the profit from an assignment of the lease.

The term “profit,” outside the context of assignment of a lease, generally is understood to mean a positive net financial return over the time period in question. This general understanding does not control in commercial leases, where “profit” instead typically refers to the mathematical amount by which the aggregate payments (of rent and any other amounts) by an assignee exceed the aggregate payment obligations of the assignor to the landlord under the lease. The definition of “profit” in the lease determines the extent to which an assigning tenant can recover any of the costs incurred by it in making the assignment before having to pay, or share, the remaining proceeds from the assignment. The following is a sample provision for sharing of profits from an assignment:

If Landlord shall consent to an assignment of this Lease and Tenant shall either receive any consideration from its assignee (other than from a Related Entity) in connection with the assignment of this lease, Tenant shall pay to Landlord, as additional rent, fifty percent (50%) of so much, if any, of such consideration (including any sums paid by the assignee for the purchase of Tenant's property in and improvements made by Tenant to the Premises[, less the then net unamortized or undepreciated cost of such property and improvements determined on the basis of Tenant's federal income tax returns or, if Tenant does not file such tax returns, on the same basis as carried on Tenant's books]) as shall exceed the Permitted Expenses (hereinafter defined) in connection therewith. All sums payable to Landlord pursuant to this Section shall be paid to Landlord within ten (10) days following the date that the assignee makes such payments to Tenant. For purposes of this Section, “Permitted Expenses” shall mean the aggregate amount of (a) brokerage commissions, (b) reasonable out-of-pocket legal fees and disbursements and closing costs, (c) reasonable advertising expenses, (d) the reasonable out-of-pocket costs, if any, incurred by Tenant in preparing the subject space for occupancy or providing a contribution to such preparation, and (e) the monetary equivalent of reasonable and customary rent concessions.⁸⁷

87 Note that the definition of Permitted Expenses in this sample is favorable to the tenant in that it includes a breadth of categories of possible tenant expenses which may exceed what many landlords are prepared to provide. A tenant might seek, in addition, to recover any vacancy expense incurred by it before the assignment is effective or, following a default by an assignee, until another rent-paying tenancy is in place.

The tenant can be obligated to pay the landlord the amount of all such excess payments made by the assignee even if the tenant, in fact, will not realize a “profit,” in the commonly understood economic sense, because the tenant does not actually recover all the expenses it incurs. To illustrate this point, assume that four years remain of a lease term which originally was ten years,⁸⁸ and that the assignee makes a lump sum payment to the assignor for assignment of the lease.⁸⁹ Even though the assignor will not know if the assignee's initial payment represents a profit until the end of the lease term, when the assignee has fully performed all the terms of the lease, the lease typically will require that the assignor treat the entire lump sum payment as profit and pay the landlord any portion due the landlord at the time the assignment becomes effective. If, at a later date, the assignee defaults under the lease, the assignor, still liable under the lease, can be pursued by the landlord to resume paying the full rent under the lease for the balance of the term and to cure any other defaults under the lease.

While the revival of the obligations under the lease obviously diminishes the extent to which the initial payment from the assignee represents a true economic profit for the assignor, leases rarely allow the tenant to account for any expenses it incurs after the assignment in determining how much profit must be paid to the landlord. Profit sharing provisions in some leases refer to “excess rents” rather than “profits” so as to remove the implication that the parties intended the tenant to realize an actual economic profit before being required to pay, or share, the proceeds of the assignment with the landlord. In fact, since the landlord is paid in full when the assignment becomes effective, any credit to the tenant for costs incurred in the future would require the landlord to pay money back to the tenant or to allow the tenant to offset any amount which should be credited to the tenant against future rents coming due under the lease. It will come as no surprise that such a provision would be unusual (although not

88 For this discussion, which addresses only an assignment of the lease, the period in question is always the entire balance of the lease term since an assignment of a lease transfers all the remaining interest of the assignor under the lease. The period in question for a sublease may be less than the entire balance of the lease term.

89 When the market rental rate for leased space has risen above the contract rent under the lease (because, for instance, rental rates have risen generally, or space was rented unfinished and has been improved), the leasehold has value and an assignee often will pay the assignor for an assignment of the lease, in addition to agreeing to assume all the liabilities of the assignor under the lease. A lump sum payment is the most common form of payment for an assignment of lease. While it is possible for an assignee to agree to make payments to the assignor monthly during the balance of the lease term or periodically over time, this is rarely done; the assignor, having assigned the leasehold, would find it difficult to recover the leasehold in the event the assignee failed to make the future payments coming due after the date of the assignment.

unprecedented) and difficult, but not impossible, for a tenant to secure. An example of such a provision, which still takes effect only upon satisfaction of conditions which favor the landlord, follows:

The parties intend that Landlord shall be entitled to retain payments under this Section (“Landlord’s Net Profits”) in connection with an assignment of the Lease only to the extent that such payments represent the agreed Landlord's Percentage of a true economic profit to Tenant from the assignment of the Lease, after taking into account any expenses incurred by Tenant arising from the assignment of the Lease or under the Lease during the balance of the Term of the Lease following the assignment. If Landlord shall have received any payments under this Section (“Landlord’s Net Profits”) in connection with an assignment of the Lease by Tenant, and at any time after the Landlord's receipt of such payments (u) any assignee of the Lease shall default under its agreement with Tenant, (v) Tenant shall have pursued its legal remedies in a commercially reasonable and diligent manner, (w) a final unappealable judicial determination has been issued against Tenant in the event a legal action or proceeding is instituted, (x) all amounts payable by the assignee under the Lease or in connection with or under the assignment of the Lease have not been paid (to the extent not paid, hereinafter a “Shortfall”), (y) Tenant shall have used its commercially reasonable and diligent efforts to recover the Premises and to assign the Premises to a new assignee or to sublet the Premises, and (z) Tenant shall have applied its share of the Net Profits received by Tenant in accordance with this Section (after recovery therefrom of the Permitted Expenses described above) to reduce the Shortfall, Tenant then shall have the right, commencing fifteen (15) Business Days following written notice to Landlord (a “Profits Offset Notice”), to offset the amount of Landlord's Net Profits actually received by Landlord, to the extent of the Shortfall remaining after the reduction described in clause (z) above, against the unpaid rent obligations of Tenant under this Lease. [Landlord shall have the right, within ten (10) Business Days following receipt of a Profits Offset Notice, by written notice to Tenant in accordance with the terms of Section ____, to

[exercise any recapture right under the Lease] [recapture the Premises] and thereby preclude any such offset by Tenant.] If Landlord shall fail to exercise such recapture right in a timely manner, then, provided Tenant is not then in default under this Lease (beyond the expiration of applicable notice and cure periods herein provided), Landlord agrees to allow Tenant to credit against the Fixed Rent due hereunder the amount of the Landlord's Net Profits actually received by Landlord in respect of the assignment of lease, less the amounts, if any, thereafter recovered by Tenant from the defaulted assignee, until such date as the Premises shall have been sublet or shall have been re-assigned by Tenant.

Many variations on or additions to the above provision could be made. For instance, a landlord could require that any offset be amortized over the remaining term of the lease rather than applied immediately. Because such an offset right would be unusual, there is no market standard approach. Such an offset right would be consistent with the perspective that the landlord and tenant have negotiated to share “profits” rather than periodic excess cash flow. Perhaps the offset right discussed here may become more common when the pendulum of negotiating leverage again swings to tenants.

[28.34] B. Recovery of the Premises and Mitigation of Damages

The preceding provision contemplates that following an assignment of the lease, the original tenant which assigned the lease has the right to recover its leasehold interest from the assignee following a default by the assignee.⁹⁰ Recovery of the leasehold to assign the leased premises again or to sublet the leased premises can be an important means for the tenant to mitigate its damages in the event of a default by its assignee. In fact, however, many lawyers fail to provide for a right of recovery following an assignment. Even where the lease (or the landlord's consent to assignment, where applicable) provides for a right of recovery, the attorney should try to provide that any required landlord's consent is deemed given for reversion of the leasehold to the original tenant, that a recovering

⁹⁰ In fact, such a right is not common, although the author believes that the greater frequency of lease assignments in recent years and the resultant increased attention to the ramifications of assignment of leases will make such a right, or other rights of an assignor to cure defaults or mitigate damages following default by the assignee, more common.

assignee has an additional period to cure any uncured default by the assignee, and that a mechanism exists to resolve the practical difficulty of obtaining an actual assignment of the lease from an often recalcitrant assignee, without (if possible) releasing the assignee from its liabilities under the lease.

Unlike the case of a sublease, where the right to occupancy of the premises reverts to the sublessor automatically upon termination of the sublease following a default by the sublessee, an assignee of a lease becomes the owner of the leasehold for all purposes. The assignee remains the lawful tenant in the leased premises following a default, until termination of the leasehold itself by the landlord ends the assignee's right to occupy the space. The landlord will have the right not only to pursue both the assignee and the assignor for money damages, but also, without regard to any such recovery of damages, if the landlord terminates the lease, to re-lease the premises to a third party and collect and retain the rent from that lease. Since the lease may have significant value due to a below-market rental rate or valuable improvements the assignor will want the ability to prevent termination of a valuable leasehold due to the assignee's default, particularly if the landlord is likely to pursue damages from the assignor as a result of such termination. Even if the lease has no significant market value, the assignor still often will want the right to mitigate damages.

Tenant's counsel may be able to limit the damages to which the assignor would be exposed by negotiating for a credit in the amount by which the landlord is able to mitigate its damages. If the landlord elects to mitigate damages, a court may require that the damages recoverable by the landlord be reduced by the amount of any such mitigation.⁹¹ Although under New York common law a landlord is not obligated to mitigate its

91 Courts have not routinely reduced the damages by the amount of any reletting proceeds, however. See, e.g., *Holy Props. Ltd., L.P. v. Kenneth Cole Prods., Co.*, 87 N.Y.2d 130, 637 N.Y.S.2d 964 (1995). But cf. *Duda v. Thompson*, 169 Misc. 2d 649, 653, 647 N.Y.S.2d 401 (Sup. Ct., Westchester Co. 1996) (suggesting that in measuring damages the defaulted tenant may be entitled to a credit in the amount of any net reletting receipts of the landlord).

damages from default under a commercial lease,⁹² tenant's counsel can negotiate for a contractual agreement by the landlord to use its commercially reasonable efforts to mitigate damages and/or at a minimum to credit against any damages recoverable from the assignor the net proceeds actually realized by the landlord from any mitigation the landlord actually effects. Tenant's counsel also should try to secure for the tenant the opportunity to mitigate damages either by a right to recover the leasehold from the defaulted assignee or by a right to obtain from the landlord a new lease for the balance of the term of the lease following termination of the original lease term due to default by the assignee.

[28.35] C. The Landlord's Right to Recapture the Leased Premises

Many landlords insist on a lease provision that a request by a tenant for the landlord's consent to assign the lease constitutes an offer by the tenant to allow the landlord to recapture the leased premises and to terminate the lease or, at the option of the landlord, to sublease the leased premises from the tenant for the balance of the term. A recapture right is a means for the landlord to secure for itself the benefit of an increase in the market rental value of the demised premises—an alternative to sharing of profits with the tenant. The landlord also derives the added benefit of recovering control over the tenancy of its property. The following is a sample recapture provision:

Within thirty (30) days following the date of that Tenant gives Landlord notice of a proposed assignment of the Lease by Tenant, Landlord shall have the right, at Landlord's option, to give to Tenant written notice that one of the following shall apply:

(a) this Lease shall terminate on a date (the "Early Termination Date") not earlier than, and not more than sixty (60) days following, the proposed effective date of the

92 In *Holy Props.*, 87 N.Y.2d at 133–34, the New York Court of Appeals recently reconsidered and re-affirmed this doctrine on the basis that a lease, as a present transfer of an estate in real property, should not be governed by legal principles generally applicable to executory contracts. In so holding, the Court failed to accept the invitation to require landlords to mitigate damages, which is found in a number of lower court cases, including *Grays v. Brooks*, 148 Misc. 2d 646, 561 N.Y.S.2d 515 (N.Y. Civ. Ct., Queens Co. 1990) and *Rubin v. Dondysh*, 146 Misc. 2d 37, 549 N.Y.S.2d 579 (N.Y. Civ. Ct., Queens Co. 1989), *rev'd on other grounds*, 153 Misc. 2d 657, 588 N.Y.S.2d 504 (Sup. Ct., App. Term, 2d Dep't 1991). See *Forty Exch. Co. v. Cohen*, 125 Misc. 2d 475, 486–91, 479 N.Y.S.2d 628 (N.Y. Civ. Ct., N.Y. Co. 1984) for an interesting review of cases addressing this issue.

proposed assignment as set forth in the notice of the proposed assignment of lease. In the event such termination notice is given, the term of this Lease shall expire on the Early Termination Date with the same effect as if such date were the Expiration Date, the Fixed Rent and additional rent shall be apportioned as of said Early Termination Date, Landlord shall refund to Tenant any prepaid portion of Fixed Rent and additional rent for any period after said Early Termination Date, and Tenant shall surrender the demised premises to Landlord on or before said Early Termination Date.

or

(b) Tenant shall assign this Lease to Landlord, without merger of Landlord's estates, effective as of the proposed effective date of the proposed assignment as set forth in the notice of the proposed assignment of lease. In the event such notice of assignment is given, Tenant shall assign this Lease to Landlord, Landlord shall accept the assignment thereof and shall assume the performance, from and after the effective date of such assignment, of Tenant's obligations under all third party subleases of the demised premises then in effect to which Landlord shall have consented in writing pursuant to this Article, Landlord shall defend and hold harmless Tenant from any claim, loss or damage arising from Landlord's failure to perform such obligations, and Tenant shall be released from all liability for the performance of Tenant's obligations under this Lease [accruing from and after the effective date of such assignment].

Regardless of whether Landlord exercises either option set forth above, Landlord shall be free to, and shall have no liability to Tenant or to any broker claiming through Tenant, lease the demised premises to Tenant's prospective assignee or subtenant.

If the landlord recaptures the space, many lawyers for tenants contend that the tenant should be released from all remaining liability under the lease. The intent of recapture of the space by the landlord is to secure for the landlord, and deprive the tenant of, the benefit of any increase in the market value of the leased premises. If the landlord elects to sublease the

space from the tenant (a further recapture option not set forth above), the landlord typically would do so with the intention to further sub-lease the space to a new occupant. The tenant should ensure that the lease provides that it will have no liability for acts of the landlord, as subtenant, or for acts of the landlord's sublessees. Because the leaseback typically will be at the lesser of (x) the rent under the lease, (y) the rent under the transaction proposed by the tenant that triggered the recapture and (z) the then fair market rental value of the space, any increase in the market value of the space will accrue to the landlord even though the tenant remains liable under the lease. Tenants often object, successfully, to facing surviving liability without enjoying the appreciation of the lease, resulting in recapture provisions similar to the example above, under which the landlord must release the tenant in order to recover control of the leased space.

[28.36] VIII. BANKRUPTCY

While a full discussion of the treatment of leases in bankruptcy is outside the scope of this chapter, the general treatment of a lease whose landlord or tenant becomes subject to a bankruptcy proceeding should be familiar to any real estate lawyer. The extended duration of a typical lease presents unique issues when seeking to establish rules that treat fairly the landlord, the bankrupt tenant, and other creditors of the tenant. Often a lease is the tenant's contractual obligation of the longest duration. The damages for breach of a contract of extended duration can dwarf the claims of many other creditors. In addition, during the term of the lease the movement of market rents, and changes in the supply of and demand for lease space, can cause the lease to swing between being a net asset and a net liability, yet the lease itself remains an illiquid asset which on its face is subject to many contractual restrictions on assignment.

[28.37] A. Tenant Bankruptcy

All the generally applicable provisions of the Bankruptcy Code, such as the automatic stay, apply to the relationship between landlord and tenant in the event of the tenant's bankruptcy. In addition, the Bankruptcy Code contains a number of provisions which specifically address the bankrupt tenant's obligations under leases of space. The trustee of the tenant's estate in bankruptcy must assume or reject any lease for nonresidential space within 60 days of the date of filing of a voluntary petition or the lease will be "deemed rejected."⁹³ The 60-day period can be, and often is, extended by the bankruptcy court upon a showing of cause by the

93 11 U.S.C. § 365(d)(4).

trustee to allow further time to evaluate and market the lease. During this decision-making period, the tenant is required to timely perform all of the obligations under the lease.⁹⁴

If the lease is rejected by the bankruptcy trustee for the tenant's estate, the landlord is allowed to file a claim in the bankruptcy proceeding as a creditor for an amount not to exceed the greater of one year's rent remaining under the lease and 15 percent of the total rent remaining under the lease. If fifteen percent of the total rent remaining under the lease is greater, the amount of the claim still cannot exceed three years' rent remaining under the lease. Upon rejection, the lease is breached as of the date of the filing of the bankruptcy petition and the landlord may terminate the lease and recover the space.⁹⁵

The bankruptcy trustee for the tenant's estate has the right to assume the lease instead of rejecting the lease if the bankruptcy trustee (i) "cures, or provides adequate assurance that [it] will promptly cure" all defaults under the lease, (ii) compensates the landlord for actual pecuniary losses resulting from such defaults, and (iii) is able to provide "adequate assurance of future performance" of the lease.⁹⁶ If the lease is assumed by the bankruptcy trustee for the tenant's estate, the bankruptcy trustee has the right to assign the lease for the benefit of the creditors of the bankrupt tenant. The bankruptcy court has broad powers to override conditions or limitations which restrict the ability to effect an assignment of the lease, and these powers not only extend to provisions which merely procedurally impair assignment of the lease but also can reach provisions which diminish the marketability of the lease.⁹⁷

94 11 U.S.C. § 365(d)(3). See, e.g., *Centerpoint Props. v. Montgomery Ward Holding Corp.*, 268 F.3d 205 (3d Cir. 2001). Because § 365(d)(3) requires a trustee to perform all of the debtor's obligations under a lease, the failure to perform such obligations presumably will result in an administrative claim in favor of the non-debtor party to the lease.

95 11 U.S.C. § 502(b)(6). There is some disagreement whether "fifteen percent" refers to fifteen percent of the remaining term of the lease (the minority view) rather than to fifteen percent of the rents payable during the balance of the term of the lease (the majority view). See *In re New Valley Corporation*, Civ. Action No. 98-982, Slip Op. at 32-36 (D.C.N.J. Aug. 31, 2000) (op. of Alfred M. Wolin).

96 11 U.S.C. § 365(b). If there have not been any defaults under the lease, then the trustee may assume the lease without providing adequate assurance of future performance.

97 11 U.S.C. § 365(f)(1). The controlling principle, however, still is that the debtor takes the lease as it is; the Bankruptcy Court generally will not seek to impose substantive revisions which make the lease a more attractive asset, but will sweep aside most impediments other than the shopping center assurances to effect the assignment.

There is a considerable body of law applying these concepts, and those cases make clear that there is little a landlord can provide in the lease which will restrict the discretion of the bankruptcy court to maximize the value of the bankrupt's estate. Nevertheless, leases often include provisions intended to influence the decision of the bankruptcy court as to the intent of the parties to the lease or the entitlement of the landlord to the limited landlord protections which are in the Bankruptcy Code. The following is an example of such a provision (provided here without any representation of the extent, if at all, to which such a provision would be enforceable):

A. If this Lease is assigned to any person or entity pursuant to the provisions of the Bankruptcy Code, 11 U.S.C. §§ 101-1330 (the "Bankruptcy Code"), any and all monies or other consideration payable or otherwise to be delivered in connection with such assignment shall be paid or delivered to Owner, shall be and remain the exclusive property of Owner and shall not constitute property of Tenant or of the estate of Tenant in case under the Bankruptcy Code. Any and all monies or other consideration constituting Owner's property under the preceding sentence which is not paid or delivered to Owner shall be held in trust for the benefit of Owner and shall be promptly paid to or turned over to Owner. Any person or entity to which this Lease is assigned by a debtor in possession or a trustee in any case under the Bankruptcy Code shall be deemed without further act or deed to have assumed all of the obligations arising under this Lease on and after the date of such assignment. Any such assignee shall execute and deliver to Owner upon demand an instrument confirming such assumption.

B. If Tenant assumes this Lease in any case under the Bankruptcy Code and proposes to assign the same, pursuant to Section 365 of the Bankruptcy Code, to any person or entity who shall have made a bona fide offer to accept an assignment of this Lease on terms acceptable to the Tenant, then notice of such proposed assignment shall be given to Owner by Tenant no later than twenty (20) days after receipt by Tenant of such offer, but in any event no later than ten (10) days prior to the date that Tenant shall make application to a court of competent jurisdiction for

authority and approval to enter into such assignment and assumption. Such notice shall set forth (a) the name and address of such person, (b) all of the terms and conditions of such offer, and (c) adequate assurance of future performance by such person under the Lease, including, without limitation, the assurance referred to in Section 365(b)(3) of the Bankruptcy Code or any provisions in substitution thereof. Owner shall have the prior right and option, to be exercised by notice to Tenant given at any time prior to the effective date of such proposed assignment, to accept an assignment of this Lease upon the same terms and conditions and for the same consideration, if any, as the bona fide offer made by such person, less any brokerage commissions which would otherwise be payable by Tenant out of the consideration to be paid by such person in connection with the assignment of this Lease.

C. The term “adequate assurance of future performance” as used in this Lease shall mean that any proposed assignee shall, among other things, (a) deposit with Owner on the assumption of this Lease the sum of nine (9) months of the then Fixed Rent and all [escalation payments] [monthly additional rent] then payable thereunder as security for the faithful performance and observance by such assignee of the terms and obligations of this Lease, (b) furnish Owner with financial statements of such assignee for the prior three (3) fiscal years, as finally determined after an audit and certified as correct by a certified public accountant, which financial statements shall show a net worth, during each of such three (3) fiscal years, of at least six (6) times the Fixed Rent and all [escalation payments] [monthly additional rent] then payable thereunder, (c) grant to Owner a security interest in such property of the proposed assigned as Owner shall deem necessary to provide adequate assurance of the performance by such assignee of its obligations under the Lease.

In one case, the court held that, contrary to paragraph (A) of the preceding provision, any proceeds derived from assignment of the lease will be treated as property of the bankrupt estate. In this case, the bankruptcy

court held that a provision similar to paragraph (A) was unenforceable and that the proceeds of an assignment of a lease containing such a provision are property of the bankrupt tenant's estate. In that case, Boo.com North America, an Internet retailer, filed a petition under Chapter 11 of the Bankruptcy Code on October 31, 2000 seeking to conduct an orderly wind-down and liquidation of its assets.⁹⁸ The debtor sought to assume and assign its office lease pursuant to Sections 363 and 365 of the Bankruptcy Code.⁹⁹ The unexpired lease was the primary asset of the debtor and had significant value.¹⁰⁰

Among other objections, the landlord argued that if the debtor's motion to assign and assume were granted, the landlord, and not the tenant, would be entitled to all profits from the assignment under a "Subleasing Profit Provision" in the lease.¹⁰¹ The debtor responded to this argument that Section 365(f) of the Bankruptcy Code allows the trustee of the debtor's estate to avoid any provision in a lease which restricts or conditions assignment. The debtor contended that since the Subleasing Profit Provision "frustrates" the debtor's right to assign the lease, Section 365 preempts the provision, allowing the debtor to realize all profits to be derived from the assignment.¹⁰²

The court found that Section 365(f) voids the Subleasing Profit Provision and allowed the debtor to realize all the profits from assignment of the unexpired lease term.¹⁰³ The precedent on which the court relied in so ruling stated that Section 365 was designed to prevent anti-alienation or other clauses in leases from defeating the ability of a trustee in bankruptcy

98 *In re Boo.com North America, Inc.*, 2000 WL 1923949 (Bankr. S.D.N.Y. Dec. 15, 2000).

99 Memorandum of Decision and Order Concerning Assumption and Assignment of Debtor's Office Lease, *In re Boo.com North America Inc.*, dated Dec. 15, 2000 by United States Bankruptcy Judge Richard L. Bohanon, United States Bankruptcy Court, S.D.N.Y. (unpublished), Case No. 00-15123, at 2.

100 The lease was for 9,043 square feet of space at approximately \$27.50 per square foot, while the market rent for the space was then currently estimated at close to \$50.00 per square foot. In addition, the proposed assignee had paid \$350,000 for assignment of the lease and the debtor's telephone system plus \$150,000 as reimbursement of the debtor's security deposit. *Id.* at 2.

101 The lease stated that "[i]n the event the Tenant obtains the consent of the Landlord pursuant to paragraph (f) or (g) above and sublets or assigns all or a portion of the premises, the Tenant shall pay to the Landlord, monthly, as additional rent, one hundred (100%) percent of all Subleasing Profit." *Id.* at 2.

102 *Id.* at 1.

103 *Id.* at 3.

to realize the full value of the debtor's assets.¹⁰⁴ While the court's order found the conclusion it reached almost inevitable under bankruptcy precedents, the decision warranted sizable newspaper articles.¹⁰⁵ Reports of the decision prompted reactions of surprise, even disbelief, among many real estate leasing lawyers. To many of them, the Bankruptcy Code provisions invalidating restrictions on assignment of leases should not also invalidate a provision in a lease which permitted assignment of the lease, thereby allowing the debtor to secure another obligor for the rental (and other) obligations under the lease, and which then simply allocated among the parties the future appreciation of the leasehold. The "profits" from assignment were seen more as an opportunity than an asset. Among bankruptcy lawyers, however, the decision was, uniformly, no surprise at all.

The Bankruptcy Code protections for the landlord of a shopping center in the event of tenant bankruptcy remain among the most difficult for a debtor in possession or a trustee to override or circumvent.¹⁰⁶ These provisions recognize, at least on their face, that a shopping center is characterized by a unique interdependence of occupancies which the bankruptcy court is required by statute to weigh and preserve, even to the financial detriment of the creditors of the bankrupt's estate, in determining whether to allow assignment of a bankrupt tenant's lease.¹⁰⁷ Some commentators regard these protections more as evidence of the lobbying strength of the shopping center industry than as evidence that shopping center tenancies are more uniquely deserving of special protections than are tenancies at other types of real property. Nevertheless, these provisions are the law, and at properties which may benefit from the protection of these provisions, leases should include detailed operating requirements which correspond to the criteria identified in the Bankruptcy Code, tracking the such interdependent operating aspects of the shopping center as hours of operation, standards for fixturing, signage and merchandising, activities of a merchant's association, and a coordinated center-wide marketing plan. Doing so helps to ensure that any assignment of a bankrupt tenant's lease will be subject to compliance with all the operating requirements, and to prevent the Bankruptcy Court from approving an assignment of the lease which may undermine the regime of operating requirements if they are, in fact, being observed at the property.

104 *Id.* at 2.

105 *See, e.g.,* Jayson Blair, *Judge Rules That Failed Dot-Dom Can Resell Its Lease*, N.Y. Times, Dec. 30, 2000, p.8, col.3.

106 11 U.S.C. § 365(b)(3)(C).

107 *See, e.g., In re Federated Dep't Stores, Inc.*, 135 B.R. 941 (Bankr. S.D. Ohio 1991).

The following provision, typical of those found in a number of leases, purports to create by contract a right of the landlord, following the bankruptcy of its tenant, to a new lease with any prior tenant which had previously assigned the lease to the bankrupt tenant:

In the event that, at any time after Tenant may have assigned Tenant's interest in this Lease, this Lease shall be disaffirmed or rejected in any case under the Bankruptcy Code, 11 U.S.C. §§ 101 -1330 (the "Bankruptcy Code") or otherwise shall terminate, Tenant, upon request of Landlord given within thirty (30) days following (i) any such disaffirmance, rejection or termination and (ii) actual notice thereof to Landlord in the event of a disaffirmance or rejection or in the event of termination other than by act of Landlord, (x) shall pay to Landlord all Fixed Rent, additional rent and other charges due and owing by the assignee to Landlord under this Lease to and including the date of such disaffirmance, rejection or termination, and (y) as "tenant" shall enter into a new lease with Landlord of the Demised Premises for a term commencing on the effective date of such disaffirmance, rejection or termination and ending on the Expiration Date unless sooner terminated as in such lease provided, at the same Fixed Rent and on the same terms, covenants and conditions as are contained in this Lease, except that (a) Tenant's rights under the new lease shall be subject to the possessory rights of the assignee under this Lease and the possessory rights of any person claiming through or under such assignee or by virtue of any statute or any order of any court, (b) such new lease shall require all defaults existing under this Lease to be cured by Tenant with due diligence, and (c) such new lease shall require Tenant to pay all increases in the Fixed Rent reserved in this Lease which, had this Lease not been so disaffirmed, rejected or terminated, would have accrued under the provisions of this Lease after the date of such disaffirmance, rejection or termination with respect to any period prior thereto. In the event Tenant shall not enter into said new lease within ten (10) days next following Landlord's request therefor, then, in addition to all other rights and remedies by reason of such default, either at law or in equity, Landlord shall have the same rights and

remedies against Tenant as if Tenant had entered into such new lease and such new lease had thereafter been terminated on the commencement date thereof by reason of Tenant's default thereunder.

As discussed above, a tenant should consider negotiating for the right, in the event that an assignee of its interest under the lease defaults following the assignment, to secure re-assignment of the lease or a new lease so that the original tenant can mitigate its damages. The foregoing provision preserves all of the tenant's liability without providing any of the mitigation opportunities; securing those opportunities in addition may justify accepting the risk of a provision like the foregoing.

[28.38] D. Landlord Bankruptcy

All the generally applicable provisions of the Bankruptcy Code, such as the automatic stay, also apply to the relationship between landlord and tenant in the event of the landlord's bankruptcy. In addition, the Bankruptcy Code contains a provision which specifically addresses the rights of the tenants and the bankrupt landlord's obligations under any leases of space by the landlord. Unlike the case of a tenant's bankruptcy, the trustee of the landlord's estate is not required by the Bankruptcy Code to assume or reject any lease for space within 60 days of the date of filing of a voluntary petition.¹⁰⁸ The trustee of the landlord's estate, however, must still make a decision with respect to assumption of the lease during the bankruptcy case. During the decision-making period, the tenant is required to continue to perform its obligations under the lease, and the trustee is required to timely perform the obligations of the debtor under the lease.¹⁰⁹

If the lease is rejected by the bankruptcy trustee, the tenant has the right to treat the lease as terminated or remain in occupancy of the leased premises subject to the terms and conditions of the lease.¹¹⁰ If the tenant elects to retain its rights under the lease, the tenant has no right to pursue any claims for damages or other rights (such as to declare a default) arising solely from the bankruptcy against the landlord's estate. In addition, since the landlord is relieved of its affirmative obligations under the lease following rejection, the tenant cannot pursue damages against the landlord's estate for non-performance of the landlord's obligations under the lease.

108 Section 365(d)(4) of the Bankruptcy Code applies only to leases of nonresidential real property under which the debtor is the lessee. 11 U.S.C. § 365(d)(4).

109 11 U.S.C. § 365(d)(3).

110 11 U.S.C. § 365(h)(1)(A).

The tenant may exercise self-help remedies, however, by performing itself any of the landlord's obligations and offsetting the reasonable costs incurred by the tenant in doing so against the tenant's rental obligations under the lease as they arise.

The bankruptcy trustee has the right to assume the lease (instead of rejecting the lease) if the bankruptcy trustee (i) cures (or provides adequate assurance that it will promptly cure) all defaults under the lease, (ii) compensates the tenant for actual pecuniary losses resulting from such defaults, and (iii) is able to provide “adequate assurance of future performance” of the lease.¹¹¹ If the lease is assumed by the bankruptcy trustee, the bankruptcy trustee has the right to assign the lease for the benefit of the creditors of the bankrupt landlord; unlike in the case of the bankrupt tenant, however, this right is unremarkable since landlords typically have the unconditional right to assign the lease.¹¹² The bankruptcy court has broad powers to override any conditions or limitations which restrict the ability to effect an assignment of the lease, and these powers not only extend to provisions which merely procedurally impair assignment of the lease but also can reach provisions which diminish the marketability of the lease.

[28.39] IX. EFFECT OF VIOLATION OF TRANSFER RESTRICTION BY TENANT

Who is the tenant under a lease if an existing tenant purports to make an assignment of a lease to a new tenant in violation of the terms of the lease? This question can arise in a number of contexts. The tenant may have requested the landlord's consent to an assignment, and then proceeded with the assignment if the landlord withheld consent for reasons which the tenant believed not to be in accordance with the landlord's rights under the lease. The tenant may have entered into a business transaction such as a merger, acquisition, issuance of shares of stock or other change in control of the tenant without recognizing that the transaction was deemed to be an “assignment” of the lease, even though the same legal entity continued to hold the tenancy after the transaction. A business opportunity may have arisen which did not allow enough time to request a required landlord consent, or a transaction may have been consummated with the expectation or hope that the landlord would not object after the

111 11 U.S.C. § 365(b)(1)(A)–(C).

112 Assumption of the lease should be required by 11 U.S.C. § 365(f)(2), which requires a trustee to assume the lease and to provide adequate assurance of future performance (even if the lease is not in default) in connection with any assignment of a lease.

fact. In a number of other contexts, the tenant may purport to assign the lease in a manner which violates the terms of the lease.

The following provision, typical of those found in commercial leases, sets some initial ground rules following an assignment of the lease, even if the landlord's consent was required and was not obtained:

If Tenant's interest in this Lease is assigned, even if in violation of the provisions of this Article, Owner may collect rent from the assignee. If the Demised Premises or any part thereof are sublet to, or occupied by, or used by, any person other than Tenant, even if in violation of this Article, Owner, after default by Tenant under this Lease, may collect rent from the subtenant, user or occupant. In either case, Owner shall apply the net amount collected to the rents reserved under this Lease, but neither any such assignment, subletting, occupancy or use, even if without Owner's prior consent, nor any such collection or application, shall be deemed a waiver of any term, covenant or condition of this Lease or the acceptance by Owner of such assignee, subtenant, occupant or user as tenant. Neither any assignment of Tenant's interest in this Lease nor any subletting, occupancy or use of the Demised Premises or any part thereof by any person other than Tenant, nor any collection of rent by Owner from any person other than Tenant as provided in this Article, nor any application of any such rent as provided in this Article shall, in any circumstances, relieve Tenant of its obligations fully to observe and perform the terms, covenants and conditions of this Lease on Tenant's part to be observed or performed.

Typically, a lease provides that an assignment of a lease without first obtaining a consent which is required to effect the an assignment is a default under the lease. The parties to the lease negotiate whether the default exists immediately or only after the landlord has given any required notice of default and after any applicable cure period has expired.¹¹³ If the landlord prefers to terminate the lease and recover the

113 Typically a lease provides that breach of a non-monetary covenant by a tenant constitutes a default. After the landlord gives a notice of default, if required, and the time period, if any, within which the tenant is allowed to cure a default has expired without cure of the default, the default matures into a event of default, allowing the landlord to exercise remedies. Breach of a covenant not to assign or sublet the lease except on certain terms, however, often results in an immediate event of default without regard to rights to notice or cure.

demised premises, the existence of a default will allow the landlord to exercise its remedies to do so. The question remains whether the assignment is valid: Is the purported assignee the tenant under the lease?

No case provides a clear answer to this question under New York law.¹¹⁴ For this reason, landlord's counsel should consider including in the lease a provision which adopts one of the approaches embodied in the following sentence:

If Tenant's interest in this Lease is assigned, whether or not in violation of the provisions of this Article and whether or not Owner has collected rent from the assignee, [Landlord shall have the right, in its sole discretion, to declare the assignment of the lease void and of no force and effect] [such assignment shall be void and of no force and effect unless accepted in writing, in its sole discretion, by the Landlord] [such assignment shall be void and shall constitute an immediate default under this Lease].

If the default provision of the lease is drafted so that the landlord has the option to declare the assignment void, implicit in such language is the conclusion that the assignment is effective unless and until the landlord exercises its avoidance rights. Moreover, if the landlord does not give the tenant notice of default or take other action within a reasonable time following learning of the assignment, and particularly if the landlord accepts rent from the assignee, the assignment would seem to be ratified as effective, notwithstanding boilerplate provisions in the lease which state that landlord does not waive any rights by failing to act and which bar implication of consent from landlord's conduct to the contrary. For these reasons, as well as the reasoning that an act to which prior consent is required should not be effective unless the consent required in fact is given, the preferred drafting approach is to state that the assignment of the lease is void. It is not inconsistent to treat a purported wrongful assignment of the lease as void while still stating that the landlord can collect rent from the purported assignee. If the restrictions on assignment of the lease are drafted as covenants but not as conditions, however, a court could reach the conclusion that an assignment in breach of the covenant still is valid and the proper landlord's recourse is an action for breach of covenant and declaration of a default under the lease.

114 See generally Friedman, *supra*, § 7.304d at 354-56.

As discussed above, New York law does not require a landlord to mitigate damages following a default by a tenant which results in termination of the lease and/or repossession by the landlord of the demised premises. A corollary to that doctrine is that New York law also does not require a landlord to treat amounts collected from non-tenant occupants of the demised premises as partial payments of rent by the tenant or to credit such amounts to the tenant's obligations. While the tenant's right to a credit for any rentals actually collected by the landlord against any damages which the tenant owes the landlord would seem sufficiently equitable to be easily derived from basic contract law or principles of equity, a specific provision in the lease for such a credit is the better practice to ensure this result.

[28.40] X. STATUS OF ASSIGNOR AFTER ASSIGNMENT

Upon the execution and delivery of an assignment of lease, and the grant of any necessary consents, the assignment is fully effective and the assignee becomes the "tenant" under the lease. As discussed above, after assigning its interest under a lease the assigning tenant nevertheless remains liable under the lease unless released by the landlord. Does the assignor also remain a "tenant" under the lease? If so, can the landlord, after an assignment of the lease, declare a default under the lease on the basis of actions, or failures to act, or events affecting, the assignor alone and not the assignee as the new tenant? Or is the assignee the exclusive "tenant" for such purposes?

Suppose, for instance, that the landlord consented to assignment of the lease to an assignee of borderline creditworthiness because the original assigning tenant, a financially strong entity, would still be liable for the lease. Later, the assignor unexpectedly files bankruptcy, or its financial condition erodes so that it no longer would satisfy a minimum net worth test under the lease. Can the landlord declare a default under the lease on the basis that the assignor, as tenant, has filed bankruptcy, or that the assignor's financial condition has eroded, even though the assignee has been performing and continues to perform all the obligations of the tenant under the lease as applied to itself? Can the landlord enforce a covenant to provide annual financial statements against the assignor after an assignment of the lease? Can the landlord recover the leasehold and re-rent to a new tenant when the creditworthiness of the original tenant dissipates, or must the landlord wait, hands tied, until the assignee itself fails to perform under the lease? It is common for a landlord not to consider carefully

what enforcement rights and remedies it will have against the assignor following an assignment of the lease by the tenant. In fact, since the assignee is not technically the tenant, the landlord may have difficulty enforcing express remedy provisions in the lease against the assignor.

The following is a sample lease provision which defines “Tenant” to clarify the status of the assignor and the assignee under the lease:

“Tenant,” on the date as of which this Lease is made, shall mean [insert name of original tenant]. Thereafter, “Tenant” shall mean each successor as the tenant under this Lease at the time in question; provided, however, that the originally named tenant and any assignor of this Lease shall not be released from liability hereunder in the event of an assignment of this Lease.

This provision insulates a successor tenant from a default declared on the basis of a breach of a covenant by its assignor or another predecessor tenant. A landlord should carefully consider the purpose and benefits of the covenants in the lease, not only with respect to the tenant at each point in time but also as to predecessor tenants who remain liable under the lease. Where the continued liability of an assigning tenant was an important consideration for the landlord in agreeing to allow an assignment of a lease, the landlord may need to retain a right to exercise remedies for reasons relating to the assignor. If so, separate language should provide expressly for such rights and for remedies which survive against the assignor. Since the landlord's consent may not be a condition to an assignment, or since a condition that the landlord's consent be obtained may be subject to a reasonableness standard, a landlord for whom continued recourse to the original tenant is an essential element of its underwriting of the lease should include rights and remedies against even a tenant which has assigned the lease.

The assignor's status as a shadow obligor, without a technical status as “tenant,” can present the assignor with significant disadvantages relative to being a sublandlord. If the assignee defaults, the assignor has no right to recover the leasehold and to re-rent it to another person to mitigate the ensuing damages. The assignor also has no right of eviction, and since other direct remedies typically are not provided in assignment documents, the assignor may have only an action at law for money damages. As discussed above, the assignor may find the landlord willing to include in the lease a provision which addresses these concerns by giving the former

tenant certain rights to mitigate damages and to offset against damages due the landlord any proceeds of mitigation by the landlord.¹¹⁵

The assignor also exposes itself to the possibility that its liabilities may increase after the assignment. If the assignee modifies the lease by increasing the rent, adding space, exercising renewal options or extending the term, or if the assignee performs improvements in violation of law or causes damage to the building, the assignor will be liable for the ensuing obligations if the assignee tenant does not, or is not financially able to, satisfy the ensuing obligations, unless the assignor is able to negotiate with the landlord that the assignor's continuing liability under the lease after an assignment will be determined without regard to such changes or actions by the assignee.

[28.41] XI. GOOD GUY GUARANTEE

Landlords increasingly require that prospective tenants deliver a “good guy” guarantee by a principal of the tenant in order to strengthen the incentive for the tenant, following a default which the tenant has not cured, to vacate, and deliver possession of, the leased premises to the landlord. Under a good guy guarantee, an individual which exercises control over the prospective named tenant agrees to be liable personally for payment of rent (and in some cases of any other monetary obligations) accruing under the lease from the date that the tenant in default becomes obligated to vacate the leased premises until the date that possession of

115 An assignor also should consider the status of any personal property in the leased premises which is sold to the assignee at the time the lease is assigned. Having certain personal property in the leased premises may improve the prospects to re-lease the leased premises quickly and at a higher rental, so care should be taken to provide that title to any such personal property transfers only at expiration (but not earlier termination) of the lease term and only if all lease obligations have been performed, or to retain a security interest in any such personal property. The assignor should seek the right, following a default by its assignee, to retain in the premises telephone systems, office furniture and partitions and other similar property, which in the absence of specific provision will become part of a bankrupt assignee's estate and can be removed for sale for the benefit of other creditors of the assignee.

the leased premises, in fact, is delivered to the landlord.¹¹⁶ Landlords believe that good guy guarantees encourage tenants in default, and in particular tenants in bankruptcy, to vacate leased premises quickly, so that the landlord can avoid the expense and delay of an eviction or bankruptcy proceeding in order to re-rent the space quickly. In a market where rents are stable or rising, the landlord often is more concerned with recovering the leased premises quickly in order to re-rent it than it is with suing a tenant for unpaid rent or restoration of the premises.

The existence of any guarantee of the tenant's obligations can complicate assignment of a lease, since the assignor will want the assignee to assume all of its obligations under the lease, which will require that the assignee produce a separate successor as guarantor. If the assignor has negotiated for release of its obligations under the lease following an assignment (provided that the assignee meets certain credit standards or satisfies other conditions), the assignor of a guaranteed lease must also negotiate terms for release of its guarantor. When the guarantee is a good guy guarantee, these negotiations are more complicated since an appropriate successor good guy guarantor is not necessarily creditworthy, and since the landlord really is relying on the good guy guarantee not to recover accrued unpaid rent but instead to recover possession of the premises. To the landlord, it may be more important that the successor good guy guarantor have meaningful control of the tenant's actions than that it be creditworthy, and there may not be an individual principal or employee of the successor tenant (particularly if the tenant is a public company or a large enterprise) who exercises such control or whose employment relationship with or other interest in the tenant justifies assuming personal liability for the tenant's obligations, even to the limited extent provided in a good guy guarantee.

Because an assignor of a lease cedes control of possession of the leased premises to the assignee, assignment of a lease for which a good guy guarantee was delivered to the landlord when the lease originally was

116 Some landlords seek to have the amount payable under a good guy guarantee also include (1) the unamortized portion of any amounts previously paid by the landlord to build out the leased premises for the tenant or as a tenant improvement contribution, or to a broker in connection with the lease, (2) the unamortized rental value of any initial free rent period after amortizing such rental value over the entire lease term, (3) any costs to restore the leased premises to the condition in which it was supposed to be delivered to landlord, and (4) the cost to discharge any mechanic's liens affecting the leased premises as a result of work performed by the tenant. While the addition of such amounts increases the force of the incentive provided by the good guy guarantee, tenant's counsel should object to the inclusion of such items of recovery unless the parties have agreed that the good guy guarantee is intended to reach beyond its typical, narrow purpose, which is to assist the landlord in recovering the possession of the demised premises quickly.

made can greatly increase the exposure under the good guy guarantee. If the assignee of the lease files bankruptcy, the trustee of the assignee's estate in bankruptcy will have at least 60 days (possibly several months more with extensions) under the Bankruptcy Code to elect whether to assume or reject the lease. The individual who signed the good guy guarantee may be personally liable for the rent accruing during the pendency of the assignee's bankruptcy proceeding, even if the trustee eventually elects to reject the lease under the Code, because the tenant did not timely vacate the leased premises. If the trustee elects to assume the lease, the good guy guarantor will remain exposed under the guarantee for the balance of the lease term, notwithstanding assignment of the lease through bankruptcy to a further assignee.

Although the good guy guarantor may have considered the potential risk of continuing liability following an assignment of the lease, that risk was in the context of a voluntary assignment by a tenant which the good guy guarantor controlled. The good guy guarantor's exposure, originally limited under such guarantee so long as the guarantor can cause the tenant it controls to vacate the space quickly upon default, involves much more uncertainty once the risk of a successor tenant's bankruptcy and assignment of the lease in bankruptcy is considered. Counsel needs to use great care in considering the exposure which future tenancies can create for a good guy guarantor.

[28.42] XII. CONCLUSION

This chapter highlights, for a tenant that has decided to assign a lease of commercial space or sublease leased commercial space, many respects in which an assignment of the tenant's lease has implications materially different from a sublease. Counsel should advise its landlord and tenant clients of these differences in evaluating the options of each. Where possible, counsel should reflect the unique issues arising from an assignment of a lease in drafting the lease, the assignment of lease, brokerage agreements and other relevant documents and in commenting on the form of any landlord's consent required to effect the assignment.

The trajectory of boom and bust in recent years has transformed, and will continue to color, leasing practices in significant ways. The explosive demand for space starting in the mid-1990s among companies with limited creditworthiness under conventional business analysis produced rapidly escalating rental rates that in many cases overtook thoughtful legal practice. The collapse of that boom now has combined with an economic recession which some regard as ensuing and others as inevitable. The

September 11 attack surely has accelerated the trajectory of the downturn in most markets, even while creating a startling, but probably temporary, reversal in vacancy rates in New York City due to the loss of a huge portion of the available office space. The legal practices during the boom years now are being tested during one of the most adverse economic climates in decades. New laws regarding lease assignments, and changes in landlord practices, are almost certain to result from this very dynamic period.

APPENDIX A

Basic Form of Assignment and Assumption of Lease

ASSIGNMENT [AND ASSUMPTION] OF LEASE

[NAME OF ASSIGNOR], a [STATE OF FORMATION OF ASSIGNOR] [ORGANIZATIONAL FORM OF ASSIGNOR] having its principal place of business at [ADDRESS OF ASSIGNOR] (hereinafter "Assignor"), for good and valuable consideration paid by [NAME OF ASSIGNEE], a [STATE OF FORMATION OF ASSIGNEE] [ORGANIZATIONAL FORM OF ASSIGNEE] having its principal place of business at [ADDRESS OF ASSIGNEE] (hereinafter "Assignee"), the receipt and sufficiency of which is hereby acknowledged by Assignor and Assignee, does hereby assign, transfer, and convey to Assignee, all right, title and interest of Assignor in and to that certain Lease Agreement made by Assignor with [NAME OF LANDLORD] dated as of [DATE OF LEASE] (the "Lease") for the rental, use and occupancy of property located on the [FLOOR OF SPACE] at [ADDRESS OF BUILDING].

TO HAVE AND TO HOLD the same unto Assignee, its successors and assigns, from and after the date hereof [and Assignee, from and after the date hereof, assumes and agrees to perform in full and in a timely manner each obligation of Assignor under the Lease].

Dated this ____ day of _____, _____.

[ASSIGNOR]

[ASSIGNEE]

By: _____
Its Duly Authorized
[REPRESENTATIVE]

By: _____
Its Duly Authorized
[REPRESENTATIVE]

APPENDIX B

LEASE ASSIGNMENT AND ASSUMPTION

This LEASE ASSIGNMENT AND ASSUMPTION (this “Agreement”) is entered into as of [DATE], by and between [NAME OF ASSIGNOR], a [STATE OF FORMATION OF ASSIGNOR] [ORGANIZATIONAL FORM OF ASSIGNOR] having its principal place of business at [ADDRESS OF ASSIGNOR] (“Assignor”), and [NAME OF ASSIGNEE], a [STATE OF FORMATION OF ASSIGNEE] [ORGANIZATIONAL FORM OF ASSIGNEE] having its principal place of business at [ADDRESS OF ASSIGNEE] (“Assignee”).

WHEREAS, pursuant to that certain Lease (the “Lease”) dated as of [DATE OF LEASE] between [NAME OF LANDLORD] (“Landlord”) and Assignor, Landlord heretofore leased to Assignor that certain premises constituting the _____ floor at [ADDRESS OF BUILDING], as more particularly described in the Lease.

WHEREAS, Assignor desires to assign the Lease to Assignee, and Assignee desires to accept such assignment from Assignor and to assume all of the obligations of Assignor as the tenant under the Lease, on the terms and conditions set forth in this Agreement.

NOW, THEREFORE, in consideration of the mutual covenants, representations and provisions contained herein, and for other good and valuable consideration, the receipt and sufficiency of which is hereby acknowledged, the parties hereto hereby agree as follows:

1. Assignment. Assignor hereby sells, assigns, transfers, sets over, delegates and grants to Assignee all of Assignor's right, title, interest, claim and estate in and to the Lease as of the date of this Agreement as set forth above (the “Effective Date”), other than the Security Letter deposited and maintained by Assignor thereunder (the “Security Letter”).¹¹⁷

2. Assumption. Assignee hereby accepts the assignment of all of Assignor's right, title, interest, claim and estate in and to the Lease[, other than the Security Letter,] and assumes and agrees to pay and to perform, fully and in a timely manner, all obligations of the “Tenant” under or with respect to the Lease.

117 If the Assignee does not have sufficient assets to replace the security deposit originally made by the Assignor, the Assignor may need to maintain the security deposit with the Landlord notwithstanding the assignment of the lease.

3. Possession; Rent; Fixed Rent. Assignee shall be entitled to possession of the Premises on the date that the Landlord delivers its consent as described in Section 14 below. Assignee covenants and agrees to pay, from and after the Effective Date, all Fixed Rent, Additional Rent and other fees, charges, costs, expenses and other amounts payable of any kind and nature[, including New York City commercial rent occupancy tax, if applicable,] arising under the Lease or in respect of the Lease or this Agreement.¹¹⁸ Assignee acknowledges and agrees that it shall pay Fixed Rent from the Effective Date regardless of the date of, and any delay in, receipt of Landlord's consent to the assignment contemplated herein, which Fixed Rent shall be payable in accordance with the terms of the Lease.¹¹⁹

4. Late Payment Charge and Manner of Payment. If Assignee shall fail to pay when due any installment or payment of Fixed Rent or Additional Rent for a period of five (5) days after the date on which such installment of payment is due; Assignee shall pay to Assignor a late charge equal to three percent (3%) of the amount of such delinquent payment as compensation for the inconvenience caused by such late payment. Assignor shall have the right, without notice to Assignee and without being obligated to do so, to pay any amount not paid fully and in a timely manner by Assignee, and in the event of any such payment by Assignor, Assignee agrees to pay Assignor upon demand interest on any amount so paid from the date paid by Assignor until the date reimbursed by Assignee at a monthly rate of interest equal to the lesser of (i) one-twelfth (1/12) of the maximum annual rate of interest permitted by law and (ii) one and one-half (1-½%) percent.

5. Additional Rent.

(a) In addition to Fixed Rent to be paid pursuant to Section 3 hereof, and without limitation of Assignee's agreement in Section 3 to pay fully and in a timely manner all Additional Rent (however denominated) and other fees, charges, costs, expenses and other amounts payable of any kind and nature[, including New York City commercial rent occupancy tax, if applicable,] arising under the Lease or in respect of the Lease or this Agreement, Assignee acknowledges and agrees that it shall pay to Landlord from the Effective Date all Taxes, if any, payable by Tenant pur-

118 An Effective Date in the middle of a rental period may require an allocation of the rent for that period between the assignor and the assignee.

119 If the Landlord is entitled to any increase in the Fixed Rent as a result of assignment of the lease, this is where such an increase would be set forth.

suant to Section ___ of the Lease, Tenant's Share of the Operating Expenses for the Building payable by Tenant pursuant to Section ___ of the Lease, and any Attorney Fees payable by Tenant pursuant to Section ___ of the Lease.¹²⁰

(b) Assignee and Assignor agree that notwithstanding this Agreement any refund of Taxes for any period prior to the Effective Date, and any refund or credit due to Tenant under the Lease for overpayments of any Additional Rent or of other amounts paid under the Lease, shall belong to Assignor. Assignee shall promptly remit to Assignor any such amounts received by Assignee and shall promptly inform Assignor if Assignee learns of any such amounts to which Assignor shall or may be entitled.

6. Condition of Demised Premises. Assignee acknowledges that it has inspected the Demised Premises and is fully familiar with the physical condition thereof and agrees to take the same "as is." Assignee shall make no alterations, improvements or additions to the Demised Premises whatsoever without the consent of Assignor and without the consent of Landlord in accordance with the terms of the Lease.¹²¹

7. Fixtures. Assignee shall have the right to use all fixtures, furniture and equipment, including without limitation the telephone systems (collectively, the "Fixtures"), presently located at the Demised Premises. [Schedule A hereto sets forth an inventory of all of such property which is accepted by both parties hereto.] All right, title and interest in and to the Fixtures shall remain vested in Assignor. Assignee shall service, repair and maintain the Fixtures, shall keep the Fixtures in the Premises at all times, and shall maintain insurance coverage for the full replacement cost of the Fixtures for all risks including theft, naming Assignor as the owner thereof and as an additional insured in respect thereof with the sole right to settle any claim with respect thereto; provided, however, that so long as Assignee is not in default under the Lease or this Agreement, Assignor shall allow Assignee to settle any claim in respect thereof so long as Assignee applies the proceeds to replace, in the Premises, any Fixtures

120 It is not necessary to spell out each individual section under which rent is payable by the assignee since the assignee has assumed the obligation to pay all such amounts, but doing so ensures that the assignee fully understands its obligations and assists administrative personnel in tracking payment of the regular payment obligations by identifying them in one place.

121 If an assignee wants to make certain alterations to the demised premises, this section is where such alterations would be discussed. An assignee can attach its alteration plans as an Exhibit to the Assignment and may require that the Assignor and the Landlord provide any required consents to the alterations before signing the assignment.

which were the subject of a claim. [At such time as Assignee determines that it no longer desires to use all or any part of the Fixtures, it shall notify Assignor identifying with specificity the Fixtures no longer desired. Such notice shall be given no more often than once in any twelve-month period. Assignor shall have the right, within thirty (30) days from the date of receipt of such notice, to remove, at Assignor's expense, all or any part of the Fixtures identified in the notice. In the case of any such removal, Assignee shall cooperate with and assist Assignor and pay any fees due under the Lease (such as elevator charges). Any part of the Fixtures identified in such a notice and not so removed by Assignor shall become the property of Assignee to use, dispose of or otherwise deal with in its sole discretion.] At the end of the term of the Lease, provided that Assignee shall have performed all of its obligations under the Lease and this Agreement, title to all the Fixtures shall vest in Assignee.¹²²

8. Guaranty. The obligations of Assignee under this Agreement have been guaranteed by [PRINCIPAL OF ASSIGNEE] in accordance with the terms of a separate Guaranty, a copy of which is annexed hereto as Appendix A. Assignee agrees to maintain said Guaranty in force at all times until all amounts payable to Landlord and to Assignor in respect of the Lease or this Agreement have been paid in full. The terms and provisions of this Section 8 expressly shall survive the expiration or sooner termination of the Lease or this Agreement.

9. Insurance. Assignee shall, at Assignee's sole cost and expense, obtain and thereafter maintain, for the benefit of the Landlord [and its mortgagee and ground lessor, if any, from time to time] and, as an additional requirement under this Agreement, for the benefit of Assignor and its successors as additional insured parties, such personal injury and property damage insurance coverage, under a policy of general public liability insurance coverage, and with such coverage limits, as is required under the Lease on the date hereof or in such greater scope or amount of coverage as Landlord shall require in accordance with the terms of the Lease, and such fire and casualty insurance coverage of all Fixtures and all other fixtures, furnishings and equipment and other personal property located in the Premises, for an amount not less than their full replacement value, as

122 It is common for an assignor and assignee to agree that the assignee will buy all the fixtures, and even office equipment and furniture, since moving them may not warrant the expense. If title to the property is sold at the time of the assignment, however, and the assignee later defaults under the lease or files in bankruptcy, the assignor will not be able to recover the property sold, since such property will be included among the bankrupt's assets. This clause contemplates, instead, that the assignee has the use of the property through the term and acquires ownership of the property only after the assignee has fully performed the lease.

is required under the Lease on the date hereof or in such greater scope or amount of coverage as Landlord shall require in accordance with the terms of the Lease.

10. **Security Deposit.** Assignee shall deliver to Assignor on the Effective Date as a security deposit (the "Security Deposit") a letter of credit issued by a banking institution, and in form and substance, reasonably satisfactory to Assignor, which shall not expire sooner than 365 days from the date of issuance and shall be self-renewing unless not less than thirty (30) days prior notice of non-renewal is given to Assignor, in the amount of [six (6)] months Rent (including Fixed Rent and scheduled or determinable Additional Rent), which can be drawn upon in [New York, New York]. On the Effective Date the amount of the security deposit shall be _____ Dollars (\$ _____). Not less than thirty (30) days prior to each anniversary of the Effective Date during the term of the Lease, Assignee shall deliver to Assignor a renewal of the letter of credit in an amount which reflects the increased amount of [six (6)] months Rent (including Fixed Rent and scheduled or determinable Additional Rent) which will be due and payable next following such anniversary. Such Security Deposit is to be deposited and maintained with Assignor as security for the faithful performance and observance by Assignee of the terms, provisions and conditions of this Agreement, and in the event that any default occurs under the Lease or this Agreement beyond the applicable notice and grace periods, Assignor may draw on such Security Deposit for the payment of any Fixed Rent, Additional Rent or other amount or for any other sum which Assignor may expend or be required to expend by reason of Assignee's default, including any damages or deficiency which accrues before or after summary proceedings or other judicial action or exercise of other remedies by Assignor. If Assignor shall so use, apply or retain the whole or any part of the Security Deposit, Assignee shall, upon demand by Assignor, immediately restore the amount of the letter of credit by the amount so used, applied or retained, or deposit with Assignor a sum equal to the amount so used, applied or retained, so as to replenish the Security Deposit as aforesaid, failing which Assignor shall have the same rights and remedies against Assignee as Landlord has under the Lease for the non-payment of the Fixed Rent or Additional Rent. [Assignee shall not be responsible to maintain, and Assignor shall maintain (to the extent Landlord shall require the same to be maintained), with Landlord the Security Letter required under Section ___ of the Lease, and any release and/or modification of the obligation of Assignor under the Lease to maintain the Security Letter shall in no way change or

diminish the obligations of Assignee in respect of the Lease or under this Agreement.]

11. Brokerage. Assignee represents that in the negotiation of this Agreement it dealt with no broker or brokers other than [NAMES OF BROKERS] for payment of whose fees Assignor shall be responsible in accordance with a separate written agreement. Assignee hereby agrees to indemnify, defend and hold harmless Assignor from and against any and all claims, demands, liabilities, suits, losses, costs and expenses (including reasonable attorneys' fees and disbursements) arising out of any inaccuracy or alleged inaccuracy of the foregoing representation. Assignor shall have no liability for any brokerage commissions arising out of a sub-lease or assignment by Assignee. The provisions of this Section 11 shall survive the expiration or sooner termination of the Lease or this Agreement.

12. Indemnification. Assignee agrees to indemnify, defend and hold harmless Assignor from and against all demands, claims, actions or causes of action, assessments, losses, damages, liabilities, costs and expenses (including without limitation interest, penalties and attorneys' fees and expenses) asserted against, resulting from, imposed upon or incurred by Assignor, directly or indirectly, by reason of, resulting from or arising out of (i) any liabilities of Assignor under or relating to the Lease, (ii) Assignee's use and occupancy of, or the condition of, the Premises or (iii) the failure of Assignee to fully and timely perform its obligations under this Agreement or under the Lease.

13. Incorporation of Lease.

(a) Assignor represents that a true, correct and complete copy of the Lease is attached hereto as Appendix A.

(b) For the purposes of this Agreement, all the terms, covenants, conditions and regulations of the Lease are expressly incorporated herein and made a part hereof with the same force and effect as though set forth at length herein, it being understood that where reference is made with respect to said terms, covenants, conditions and regulations to "Tenant," the same shall be deemed to refer to Assignee, hereunder, and that Assignor shall have the right to exercise as against Assignee all rights and remedies accorded Landlord under the Lease.¹²³

(c) The time limits provided for in the provisions of the Lease incorporated herein by reference as provided above for the giving of notice,

making demands, performance of any act, condition or covenant, or the exercise of any right, remedy or option, are changed for the purposes of this Agreement, as specifically stated elsewhere herein, or if not so stated, shortening for Assignee, such limits by (i) three (3) days with respect to all such periods of more than three (3) days, and (ii) as much notice as reasonably practicable with respect to all periods of less than three (3) days, so that notices may be given, demands made, or any act, condition or covenant performed, or any right, remedy or option hereunder exercised by Assignor, upon any failure by Assignee to perform, within the time limit relating thereto contained in the Lease.

(d) With respect to any actions that Assignee desires to take for which the Lease requires the approval or consent of the Landlord, the approval of Assignor also shall be required with respect to such actions on the same basis and conditions as are applicable to the consent or approval of Landlord.¹²⁴

(e) Assignee shall neither assign the Lease nor sublet all or any portion of the Premises nor permit the use or occupancy of the Premises by any person other than Assignee without the prior written consent of Assignor. The consent of Assignor shall not be unreasonably withheld, delayed or conditioned in the event of a merger, consolidation or other reorganization of Assignee, provided that there shall not be a change in control of 50 percent or more of the direct or indirect beneficial or ownership interests in Assignee (in a single transaction or through a series of transactions),¹²⁵ that the financial condition of the surviving entity shall be at least as strong as the financial condition of Assignee prior to such transaction, and that the transaction shall be permitted under, or shall be approved by the landlord in accordance with, the terms of the Lease.

(f) No representations or warranties made in the Lease by Landlord to Assignor shall be incorporated into this Agreement as having been made by Assignor to Assignee.

123 There may be specific provisions of the Lease, such as an entitlement of the tenant to a landlord contribution to the cost of the tenant's initial improvements, that should be addressed specifically in this section to make clear that there are no remaining rights under such provisions. *See, e.g.*, Section 13(f) of this Agreement.

124 Alternatively, this provisions could provide that Assignor will not unreasonably withhold, delay or condition its consent, or even waives its right to consent, to any matter to which the Landlord has consented.

125 As discussed in detail above, a public company will require that a limitation of this type not include transfers of shares on a public stock exchange by non-insiders.

(g) In the event that Assignee shall default in the full performance of any of the terms, covenants or conditions on its part to be performed under this Agreement, then Assignor shall have the same rights and remedies with respect to such defaults as are given to the Landlord under the Lease with respect to defaults by Assignor under the Lease, all with the same force and effect as though the provisions of the Lease with respect to defaults and the rights and remedies of the Landlord under the Lease in the event thereof were set forth at length in this Agreement. [In addition, in such event Assignor shall have the right, at its election, if such default is not cured, to cause Assignee to re-assign the Lease to Assignor and thereafter to assign the Lease or sublease the Premises to any other person without being obligated to do so or to account to Assignee for, or to offset against the liability of Assignee to Assignor, the proceeds of any such assignment or sublease.]¹²⁶

14. Consent of Landlord. This Agreement shall take effect only upon the Landlord's execution and delivery of its consent to this Agreement and the acceptance of such consent [by each party as satisfactory in form and content] [by Assignor in its sole discretion].

15. Miscellaneous.

(a) Notice. Any notice, consent, payment, demand, or communication required or permitted to be given by any provision of this Agreement shall be in writing and shall be (a) delivered personally to the Person or to an officer of the Person to whom the same is directed, or (b) sent by facsimile with a copy by registered or certified mail, return receipt requested, postage prepaid, or (c) sent by recognized national overnight delivery service for delivery the morning of the next business day, addressed as follows:

If to Assignee:

Attention:

Fax:

With a copy to:

126 Exercise of this interesting remedy, which essentially is an opportunity for the assignor to mitigate its damages resulting from a default by the assignee, may require the consent of the landlord. Assignor can request that the landlord provide its consent to a prospective exercise of this remedy in the landlord's consent to the assignment itself.

Fax:

If to Assignor:

Attention:

Fax:

With a copy to:

Fax: (212) 123-4567

Assignor shall provide a copy to Assignee of each notice which it gives to Landlord, simultaneously with delivery, or receives from Landlord, as soon as reasonably practicable after receipt. Either party may change the address above by fifteen (15) days prior written notice to the other party. Notice shall be deemed given on the date of receipt (in the case of (a) and (c) above) and on the date of receipt of the facsimile (in the case of (b) above).

(b) Headings and Definitions. The headings contained in this Agreement are for reference purposes only and shall not in any way affect the meaning or interpretation hereof. Each capitalized term not defined herein shall have the meaning given such term in the Lease.

(c) Governing Law. This Agreement shall be construed under and in accordance with the laws of the State of New York applicable to contracts to be fully performed in such State, without regard to conflicts of laws. Exclusive jurisdiction of any dispute between Assignee and Assignor shall lie in the courts located in the [Borough of Manhattan, The City of New York.]

(d) Time of the Essence. Time is of the essence in this Agreement.

(e) Waiver. The waiver by any party of a breach of any provision of this Agreement shall not be deemed a waiver of any subsequent breach whether of the same or another provision of this Agreement.

(f) Counterparts. This Agreement may be executed in any number of counterparts, each of which shall be deemed an original, but all of which shall constitute one and the same instrument.

(g) Successors and Assigns. This Agreement shall binding upon, and inure to the benefit of, the parties hereto and their respective heirs, administrators, executors, assigns and successors in interest.

(h) Amendments in Writing. The provisions of this Agreement may not be amended or altered except by a written instrument duly executed by each of the parties hereto.

(i) Further Assurances. Each of the parties shall execute such other and further documents and do such further acts as may be reasonably required to effectuate the intent of the parties and carry out the terms of this Agreement.

IN WITNESS WHEREOF, the parties hereto have executed this Agreement as of the day and year first above written.

Schedule A

Inventory of Fixtures

Exhibit A

Copy of the Lease

APPENDIX C

SAMPLE ATTORNMENT PROVISION

If, for any reason (including as a result of a foreclosure of the Mortgage or the granting of a deed in lieu of foreclosure), any Mortgagee (or any Person claiming by, through or under Mortgagee), or any successor (as owner or as lessor under a superior or subordinate lease) to Landlord named herein, shall come into possession of or title to the Property, Tenant agrees, at the election and upon demand of any such Mortgagee (or any Person claiming by, through or under Mortgagee) or successor to Landlord, to attorn, from time to time, to any such Mortgagee (or any Person claiming by, through or under Mortgagee) or successor to Landlord, upon the then terms and conditions of this Lease for the remainder of the Term, provided that such Mortgagee (or any Person claiming by, through or under Mortgagee) or successor to Landlord, or receiver caused to be appointed by any of the foregoing, as the case may be, shall then be entitled to possession of the Premises; provided further, however, that in the case of any Mortgagee (or any Person claiming by, through or under Mortgagee), or receiver caused to be appointed by any of the foregoing, as the case may be, shall not be:

(1) liable for any act or omission of any prior landlord (including, without limitation, the then defaulting landlord), [but any successor as Landlord nevertheless shall be obligated to cure defaults of Landlord which arise after the date of such succession or which are obligations of Landlord which continue after the date of such succession,] or

(2) subject to any defense, abatement or offset which Tenant may have against any prior landlord (including, without limitation, the then defaulting landlord), [other than any abatement provided for under the express terms of this Lease to the extent such abatement is applicable to periods after the date of succession as landlord,] or

(3) bound by any payment of Rental which Tenant may have made to any prior landlord (including, without limitation, the then defaulting landlord) more than thirty (30) days in advance of the date upon which such payment was due, or

(4) bound by any obligation to make any payment to or on behalf of Tenant, or

(5) bound by any obligation to perform any work or to make improvements to the Premises, [except for (i) repairs and maintenance

pursuant to the provisions of Article __, the need for which repairs and maintenance first arises after the date upon which such Mortgagee (or any Person claiming by, through or under Mortgagee) shall be entitled to possession of the Premises, (ii) repairs to the Premises or any part thereof as a result of damage by fire or other casualty pursuant to Article __ hereof, but only to the extent that such repairs can be reasonably made from the net proceeds of any insurance actually made available to such Mortgagee (or any Person claiming by, through or under Mortgagee), and (iii) repairs to the Premises as a result of a partial condemnation pursuant to Article __ hereof, but only to the extent that such repairs can be reasonably made from the net proceeds of any award made available to such [Mortgagee (or any Person claiming by, through or under Mortgagee)], or

(6) bound by any surrender, cancellation, termination (which requires Landlord's consent, excluding thereby a termination pursuant to Article __ [casualty] or __ [condemnation] of this Lease), amendment or modification of, or waiver (which requires Landlord's consent) under, this Lease made without the consent of Lender, other than a termination pursuant to the following paragraph of this Lease, or

(7) bound to return Tenant's security deposit, if any, until such deposit has come into its actual possession and Tenant would be entitled to such security deposit pursuant to the terms of this Lease.

As long as the Mortgage shall remain in effect, Tenant shall not seek to terminate this Lease by reason of any act or omission of Landlord (except pursuant to an express right to terminate this Lease under Article __ [casualty] or __ [condemnation] of this Lease) until Tenant shall have given written notice of such act or omission to Lender and, if Lender shall have notified Tenant within ten (10) Business Days following receipt of such notice of its intention to remedy such act or omission, until a reasonable period of time (not to exceed thirty (30) days for monetary defaults and not to exceed ninety (90) days for non-monetary defaults unless, for the non-monetary default, more than ninety (90) days would be required, using commercially reasonable and diligent efforts, to remedy such act or omission, in which case such time period shall be extended for such additional time as shall be required, using commercially reasonable and diligent efforts, to remedy such act or omission) shall have elapsed following the giving of such notice, during which period of time Lender shall have the right, but not the obligation, to remedy such act or omission[; provided, however, that in no event shall such time period be extended to more than one hundred eighty (180) days unless, within the initial ninety

(90) days, Lender shall have commenced cure and thereafter is diligently proceeding with cure].¹²⁷

The provisions of this Section shall enure to the benefit of any such Mortgagee (or any Person claiming by, through or under Mortgagee), or any successor (as owner or as lessor under a superior or subordinate lease) to Landlord named herein, shall apply notwithstanding that, as a matter of law, this Lease may terminate upon the termination of any Superior Lease, shall be self-operative upon any such demand, and no further instrument shall be required to give effect to said provisions. Tenant, however, upon demand of any such Mortgagee (or any Person claiming by, through or under Mortgagee), or any successor (as owner or as lessor under a superior or subordinate lease) to Landlord named herein, shall execute, at Tenant's expense, from time to time, instruments, in recordable form, in confirmation of the foregoing provisions of this Section, satisfactory to any such Mortgagee (or any Person claiming by, through or under Mortgagee), or any successor (as owner or as lessor under a superior or subordinate lease) to Landlord named herein, acknowledging such attornment and setting forth the terms and conditions of its tenancy.

¹²⁷ Note that the lease also can provide that in the event of termination of the lease, the tenant is obligated, at the request of a successor landlord, to enter into a new lease with the successor landlord. Such a provision would address the concern following the events of September 11 that a tenant may acquire the right, under a variety of legal arguments, to terminate the lease for inability to access or to use the demised premises due to events that do not involve a breach by the landlord, and/or which it is impossible for the landlord to cure.

APPENDIX D
SAMPLE CONDITIONS TO REASONABLENESS OF
CONSENT

Restrictions on assignment of a leasehold estate, which would bind a leasehold mortgagee seeking to step into the shoes of a tenant which has defaulted, would include the following:

a. The proposed assignee/sublessee shall not be, and shall not use the premises for, a [detail specific uses which are not permitted, such as a school; employment or placement agency; real estate brokerage office; medical offices or other medical uses; foreign government; incarceration facility; etc.].

b. The proposed assignee/sublessee shall not be engaged in a use which is [detail specific character of uses which are not permitted, such as those involving excessive noise, excessive floor load, materially increased pedestrian or vehicular traffic, noxious, hazardous or obscene activities, materially increased demand for building services which would consume any available capacity in the building or disrupt the quality or character of utilities available to occupants of other parts of the building, or present risks of controversy, protests, labor strife or risks to security] or which violates any exclusive use or radius clause binding on owner.

c. Occupancy by the proposed assignee/sublessee shall be in keeping with the dignity and character of the then use of the building and the financial condition of the proposed assignee/sublessee shall be in keeping with the standard of other occupants of the building and superior to the extent the proposed assignee/sublessee is assuming rental obligations for a larger portion of the building. {Note that this language, which is typical, is rather general and we may prefer more specific requirements regarding financial standing, such as minimum net worth as a mathematical function of the rental obligation.}

d. Any space offered for assignment or sublease shall be offered exclusively through the managing agent for the building, and no space shall be [advertised or openly] offered at an effective rental which is lower than the greater of (i) the effective rental at which other [similar] space available in the building then is being offered, (ii) the rental then payable for the space to be offered, (iii) the fair market value of the space, or (iv) the then-prevailing rental rate in the building.

e. The proposed assignee/sublessee shall not be a tenant, subtenant, occupant or assignee of any space in the building, a party which then is, or which within the preceding twelve months was, actively negotiating for space in the building, or a party controlling, controlled by, or under common control with any of the preceding persons.

f. The Trustee shall pay on demand all reasonable costs incurred by the Owner in connection with the assignment or sublease including without limitation the costs of investigating the proposed assignee or sublessee and the legal costs incurred in review of the proposed assignment or sublease documents.

g. All defaults have been cured and the Trustee shall provide adequate assurance reasonably satisfactory to the owner that the Trustee will perform or cause to be performed the obligations of the Tenant under the lease in the event of the failure of the proposed assignee or sublessee to perform the obligations of the Tenant under the lease and will indemnify for the cost of performance of any work so that no liens shall attach to the building.

h. [No subdivided floors; only full-floor occupancies] [No slab penetrations. All work subject to the approval of owner, not to be unreasonably withheld, and subject to owner's approval of the plans and specifications, professionals involved, adequacy of contract provisions, bonding, insurance, etc., compliance with owner's rules for the performance of work and for move-in, {consider a labor harmony clause if required}.]

i. Form of assignment or sublease sublet to owner's approval. Assignee or subtenant to comply with the terms of any underlying documents. Right of owner to require, at its option, attornment upon default by Trustee with customary protections such as no liability for defaults, acts, omissions by prior tenant; for rent paid more than one month in advance; for unpaid contributions or to perform any work; for restoration to the extent cost exceeds insurance proceeds or condemnation award, as applicable; to return security deposit if not actually delivered to it.

j. No further assignment or sublease without satisfaction of the above conditions.

k. No increase in insurance costs

APPENDIX E
SAMPLE FORM OF LANDLORD'S CONSENT TO
ASSIGNMENT

CONSENT TO ASSIGNMENT

WHEREAS, _____ (the "Landlord"), entered into a certain lease dated as of _____, 20__ (the "Lease") with _____ (the "Original Tenant"), for the entire _____ (____) floor (the "Premises") in the building known as _____ Street, _____, New York (the "Building");

WHEREAS, pursuant to an Assignment and Assumption of Lease dated as of _____, 20__ ("Assignment"), a copy of which is annexed as Exhibit "A," _____ ("New Tenant") is assuming all of Original Tenant's rights, duties and obligations[, except as may otherwise be agreed to among Original Tenant and New Tenant,] under the Lease, a copy of which is attached hereto as Exhibit "B";

WHEREAS, the Assignment requires Landlord's consent under Article ____ of the Lease and New Tenant;

NOW, THEREFORE, for good and valuable consideration the receipt and sufficiency of which is acknowledged by all the parties hereto, on the terms and subject to the conditions set forth herein, Landlord hereby grants its consent to the Assignment.

1. **No Release.** This Consent to Assignment shall not release the Original Tenant or New Tenant from any of its covenants, agreements, liabilities and duties under the Lease and/or the Assignment, as the case may be, as the same may be amended from time to time, regardless of any provision to the contrary in the Assignment.

2. **Specific Provisions of Lease and Assignment.** THIS CONSENT TO ASSIGNMENT SHALL NOT BE CONSTRUED TO AMEND THE LEASE IN ANY RESPECT. ACCORDINGLY, LANDLORD HAS NOT, AND SHALL NOT, REVIEW OR PASS UPON ANY OF THE PROVISIONS OF THE ASSIGNMENT AND SHALL NOT BE (A) BOUND OR ESTOPPED IN ANY WAY BY THE PROVISIONS OF THE ASSIGNMENT OTHER THAN WITH RESPECT TO ITS CONSENT TO THE ASSIGNMENT OR (B) DEEMED TO HAVE WAIVED ANY OF ITS RIGHTS OR LEGAL REMEDIES UNDER THE LEASE. LANDLORD ACKNOWLEDGES, HOWEVER, THAT THE FOREGOING SHALL NOT PRECLUDE RELIANCE UPON

THOSE REPRESENTATIONS OF LANDLORD CONTAINED IN THE ESTOPPEL CERTIFICATE EXECUTED SIMULTANEOUSLY HEREWITH BY LANDLORD.

3. **Limited Consent.** This Consent to Assignment does not and shall not be construed or implied to be a consent to any other matter for which Landlord's consent is required under the Lease.

4. **Original Tenant's and New Tenant's Continuing Liability.** Each of Original Tenant and New Tenant shall be liable to Landlord for any default under the Lease, whether such default is caused by Original Tenant and/or New Tenant or by anyone claiming by or through Original Tenant and/or New Tenant. In the event of any default by Original Tenant and/or New Tenant in the full performance and observance of any of its obligations hereunder or in the event any representation or warranty of Original Tenant and/or New Tenant made herein shall prove to be false or misleading in any way, such event may, at Landlord's option, be deemed, in accordance with and subject to the terms and conditions of the Lease, a default under the Lease, and subject to the terms and conditions contained in the Lease, Landlord shall have and may pursue all of the rights, powers and remedies provided for in the Lease or at law or in equity or by statute or otherwise with respect to defaults thereunder or hereunder.

5. **Acceptance by Original Tenant, New Tenant and Assignee.** Original Tenant, New Tenant and Assignee understand and acknowledge that Landlord has agreed to execute this Consent to Assignment based upon Original Tenant's and New Tenant's acknowledgment and acceptance of the terms and conditions hereof.

6. **Additional Rent.** Original Tenant and New Tenant each acknowledge and agree that each is jointly and severally responsible for the prompt payment to Landlord of any Additional Rent owed to Landlord as required under the Lease, including, without limiting the generality of the foregoing, all of Landlord's reasonable attorney's fees (not to exceed \$____.00), incurred in connection with the Assignment and this Consent to Assignment.

7. **Insurance.** Assignee shall furnish the Landlord with new policies of insurance naming Landlord, Landlord's managing agent, Original Tenant, New Tenant and any mortgagee of Landlord as additional insureds, said policies containing personal injury and property damage insurance, under a policy of general public liability insurance, with such limits as are required under the Lease.

8. **Reservation of Rights.** This Consent to Assignment shall be deemed limited solely to the Assignment, and Landlord reserves the right to consent or to withhold consent in accordance with the terms of the Lease and all other rights under the Lease with respect to any other matters including, without limitation, any proposed alterations and with respect to any further or additional subleases, assignments or transfers of the Lease or any interest therein or thereto.

9. **Counterparts.** This Consent may be executed in several counterparts, each of which shall be deemed an original but all of which shall constitute one and the same agreement.

10. **Exculpation.** Neither Landlord, nor the members or partners comprising Landlord, nor the shareholders (nor any of the members or partners comprising same), partners, directors, officers, agents or employees of any of the foregoing (collectively, the "Parties"), shall be personally liable, in any manner, by reason of, or as a consequence of, the execution or delivery of this Consent. Original Tenant and New Tenant shall look solely to Landlord's estate and property in the Building within which the Premises are located and the rents, profits and proceeds derived therefrom and all rights provided to Original Tenant under the Lease in enforcing any of the rights which Original Tenant or New Tenant may have against Landlord hereunder or by reason of any of the foregoing, and shall not seek any damages against any of the Parties, except to the extent recoverable out of Landlord's estate and property in the Building within which the Premises are located and the rents, profits and proceeds derived therefrom.

11. **Original Tenant and New Tenant.** By executing this Consent to Assignment, Original Tenant and New Tenant each acknowledge and agree to be bound by all of the terms and conditions of this Consent to Assignment.

12. **Defined Terms.** Any capitalized term used herein without a specific definition stated shall have the meaning set forth in the Lease.

Executed at _____, New York as of the ____ day of _____, 20____.

LANDLORD: _____

By: _____

ORIGINAL TENANT: _____

By: _____

NEW TENANT: _____

By: _____

CHAPTER TWENTY-NINE

SUBLEASES: THE SAME THING AS LEASES, ONLY DIFFERENT

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* This chapter has been updated for the third edition by Andrew L. Herz, Esq., and Hope K. Plasha, Esq. Reprinted with permission (and with minor updates, revisions and format changes) from the Fall 2000 issue of *Real Property, Probate & Trust*, Volume 35, Number 3, published by ABA Publishing.

[29.0] I. INTRODUCTION

In this chapter, the authors analyze the unique complexities that distinguish sublease transactions from lease assignments. The authors discuss points for consideration when drafting subleases, such as determining and evaluating the “box of rights” created by the landlord and tenant under the lease and for the subtenant when exercising due diligence in the ensuing sublease transaction. Familiarity with sublease transactions is increasingly important, especially in times of economic uncertainty and retrenchment as tenants of all types frequently find themselves with excess space.

Sublease transactions are structured very differently than direct leases. Under a sublease, a tenant transfers only a partial interest in a lease.¹ For example, the original tenant may retain part of the original demised space, all of the space for some period of time after the sublease term expires, or some of the ancillary rights under the direct lease. These complexities do not exist in a lease assignment, which involves a transfer of the entire lease to another party who steps into the tenant’s shoes and usually assumes all of the responsibilities of the original tenant under the lease.²

When most lawyers think about subleasing, they focus primarily on the provisions in a direct lease which may allow, prohibit, or limit subleasing and assignment. Relatively little has been written on how to negotiate, evaluate, and review a sublease transaction from the subtenant’s perspective.³

A sublease transaction really involves two transactions in one. To a tenant, a direct lease is like a box that the landlord and the tenant have

1 *OTR v. Flakey Jake’s, Inc.*, 112 Wash. 2d 243 (Wash. 1989); 49 Am. Jur. 2d *Landlord and Tenant* §§ 918, 977 (2008); see also Milton R. Friedman, *Friedman on Leases*, § 7:4.1, at 7-81 (5th ed. 2004) (discussing the distinctions between assignments and subleases); Emanuel B. Halper, *Shopping Center and Store Leases*, § 10.02[8], at 10-9–10-10 (1996) (discussing the importance of distinguishing between a sublease and an assignment); John B. Wood & Alan M. DiSciullo, *Negotiating and Drafting Office Leases*, § 30.01, at 30-2 (1995) (introducing unique issues raised by subleasing).

2 *See Block v. Brown*, 199 Ga. App. 127 (Ga. 1991); *Weeks v. Cal-Maine Foods, Inc.*, 522 So. 2d 725 (Miss. 1987); *Siragusa v. Park*, 913 S.W.2d 915 (Mo. Ct. App. 1996); 49 Am. Jur. 2d *Landlord and Tenant* §§ 952, 956, 957 (2008); see also Friedman, *supra* note 1, § 7:4.1, at 7-81–7-82; 7-98–7-99; Wood & DiSciullo, *supra* note 1, § 30.01[2], at 30-3.

3 *See* Sidney G. Saltz & Martin P. Miner, *Subleases: A New Approach—A Proposal*, 34 Real Prop., Prob. & Tr. J. 1, 1 (1999); Sidney G. Saltz & Martin P. Miner, *Subleases: A New Approach Revisited*, 41 Real Prop., Prob. & Tr. J. 1 (2006); Mark A. Senn, *Assignments and Subleases: Have I Got the Right Form?*, Georgetown University Law Center Advanced Commercial Leasing Institute (1999).

built for the tenant to live in. The landlord allows the tenant to occupy specific space and agrees to provide certain services in exchange for the payment of rent. A sublease transaction involves two boxes: first, the one that the landlord has already built with the tenant, and second, one that the tenant and the subtenant must now build together within the confines of the first.⁴ As noted below, unique issues may be raised if the direct lease covers significant blocks of space and the sublease transaction covers a smaller amount of space (therefore the direct lease being a large box and the subtenant requesting a much smaller box).⁵

Usually, the parties to a sublease are unable, or the tenant is unwilling, to change the terms of the direct lease. For that reason, many parties consider subleasing to be easier than entering into a new lease; the landlord and the tenant presumably have already created an adequate set of rights and obligations between themselves.⁶ These rights and obligations are established and, for the most part, already working well. Frequently, the subtenant simply inherits most of these predetermined rights and obligations because the tenant or sublandlord can transfer only those rights that are contained within the box it created with its landlord.⁷ In the case of a large direct lease there may be rights that the tenant may not wish to transfer to a subtenant in a sublease covering only a portion of the premises (such as a right to cure (self help), a renewal right or a right of first offer, to note just a few examples).

The parties to a sublease usually cannot change the box that the landlord and the tenant have created because the landlord generally has no reason to agree to do so. While this resulting inflexibility may create problems, it also creates advantages by simplifying many aspects of the transaction. Many issues that landlords and tenants frequently negotiate in leases receive little or no attention in subleases. In major leases tenants often specifically negotiate for certain subletting and non-disturbance

4 As commercial markets for leased space have changed and as the consolidation and restructuring activities in the financial service and other industries have accelerated, some transactions have been structured as sub-subleases, adding a level of complexity and concern that will be discussed further below.

5 See Robert V. Guido, *Which Provisions of an Overlease Should Apply in the Sublease*, 12 *Comm. Leasing L. & Strategy* 8, 8 (1999); John A. Gose, *Assignment and Subletting Clauses*, *Commercial Real Estate Leasing*, ALI-ABA Course of Study, Apr. 10, 1989, ALI-ABA 175.

6 See Saltz & Miner, *supra* note 3, at 2.

7 There may be instances in larger sublease transactions where the landlord is entering into a direct lease with the subtenant upon expiration of the sublease. In these circumstances, the parties may have more flexibility in revisiting rights granted under the direct lease.

rights to make their space more desirable to a subtenant subletting substantial space. For example, in most cases, the landlord and tenant will have negotiated major issues in the lease such as construction, permitted alterations, and nondisturbance. Most subleases do not revisit these issues. When considering such issues as construction of the premises or even the building in which the premises are to be located, these issues may be moot for sublease consideration because they may already have happened. Despite these differences, a sublease has all the elements of a traditional lease transaction.⁸ There may also be instances where certain provisions, such as permitted alterations, are more heavily negotiated in the sublease because the sublandlord may actually want to have closer control over the subtenant than the landlord had over the tenant under the direct lease (given that the tenant may have to restore the premises at the end of the lease).

Careful analysis of a sublease raises many additional issues that the practitioner should review, consider, and confirm as appropriate, including a number of due diligence items that do not exist in a straight leasing transaction.⁹ As a result, the effort involved in preparing a sublease may be disproportionately high when compared to a lease transaction. Exhibit A at the end of this chapter provides an extensive due diligence checklist for a subleasing transaction, which goes beyond what parties typically consider in a routine subleasing transaction. However, in some cases these points may be crucial and so the list aims to provide a comprehensive checklist for a subtenant's counsel.¹⁰ It is important that the proposed subtenant client be made aware of the additional complexities and implications of a sublease transaction (as opposed to a direct lease).

Given a subtenant generally enters into a sublease transaction after the lease term has commenced, the direct lease already may have addressed some of the basic concerns of an occupant of the space. Such concerns include determination of the commencement date; delivery of possession (insofar as this is the landlord's obligation); determination of the base amounts for escalation payments; initial construction of the premises by the landlord; and delivery of subordination, nondisturbance, and attornment agreements. For a subtenant, the lease is already a "work in progress," although the financial details of the sublease may differ from those

8 *But see* Wood & DiSciullo, *supra* note 1, § 30.01, at 30-2 (discussing how "[s]ubleasing raises issues for a sublessee that are not necessarily encountered by a tenant under a lease . . .").

9 *See id.* § 30.05, at 30-45; Jerome Berkman, *Negotiable Issues in Commercial Subleasing*, 13 *Real Est. L.J.* 28 (1984).

10 *See* Brent C. Shaffer, *Sublease Due Diligence*, *Prob. & Prop.*, 44, Sept./Oct. 2003.

of the underlying lease based on the particulars of a specific transaction. For example, it is possible that a multi-floor direct lease written on a net basis will be subleased on a gross basis with escalations based on more current base years.

[29.1] II. DOES THE DIRECT LEASE “WORK”?

In evaluating a sublease transaction, the potential subtenant needs to decide, as a threshold issue, whether the direct lease “works.” This initial evaluation represents a major departure from a direct lease transaction. If a lease provision effectively prevents the potential subtenant from using the space (e.g., if the lease prohibits the subtenant’s anticipated use of the space), the subtenant must raise the issue with the landlord promptly or be foreclosed from the deal.¹¹

Once the subtenant knows that the direct lease can meet the needs of a sublease, the subtenant’s counsel should review the lease as a whole in order to:

1. determine whether the assignment and subletting provisions of the direct lease will allow the contemplated subleasing transaction;
2. understand the existing package of rights and duties created for the tenant in the direct lease and how the sublease needs to deal with them;
3. evaluate which provisions of the direct lease should govern the relationship between sublandlord and subtenant and which provisions should not apply to the sublease and should be expressly excluded; and
4. identify which matters the sublease should address as independent obligations of the parties.

[29.2] A. Can the Tenant Sublease?

To save time and to decide if the subleasing exercise is pointless, the subtenant’s attorney should, in fact, look first at the subletting provisions of the direct lease to determine whether the provisions permit the contemplated subleasing transaction; whether the sublease requires the landlord’s consent; the time within which the landlord must respond to a request; and whether the landlord can frustrate the transaction by “recapturing” the

¹¹ It is not always easy to determine this up front, however, as described in note 17.

space (either by terminating the lease as to the space proposed to be sublet or by subleasing it back from tenant).¹² A sophisticated direct lease in a competitive market place generally prohibits subletting without the landlord's consent in virtually all instances except subleases to related and successor entities. It is helpful to the potential subtenant if the direct lease expressly allows the periodic use of the space by auditors, contractors and other persons having a business relationship with tenant, and excludes these types of temporary occupants from the subletting conditions of the direct lease, including the need to obtain the landlord's consent.¹³ The direct lease also may contain provisions that allow the landlord to recapture the space to be sublet by granting the landlord the right either to enter into the sublease as a subtenant, eliminate the sublease space from the leased premises, terminate the lease as to the space the sublease covers, or even terminate the entire lease.

Many leases provide that if the landlord does not exercise the right of recapture, the landlord will not unreasonably withhold or delay consent to the sublease if the potential sublandlord and subtenant meet certain criteria and conditions. If the landlord has a recapture right, the potential subtenant should try to find out as early as possible whether the landlord has any intention of recapturing or if the landlord has previously waived recapture rights. If the subtenant's counsel cannot determine whether the landlord will exercise recapture rights, counsel should advise the subtenant of the risks in proceeding, including the potential time delays that the process may entail. Absent such a warning, the potential subtenant may expect to close the sublease transaction quickly; will spend money on attorneys, architects, and other professionals; and may pass up opportunities to lease alternative premises that do not pose the same risk of losing the transaction. If the landlord does decide to recapture, or otherwise blocks the sublease transaction, the subtenant will lose the advantage of lead time and may experience an emergency situation in trying to find alternate space before its existing lease ends.

12 See generally Friedman, *supra* note 1, § 6:8, at 6-38 (defining recapture and step-up clauses in leases); Halper, *supra* note 1, § 10.02[14], at 10-20 to 10-23 (discussing issues regarding subletting provisions); Berkman, *supra* note 9, at 32-33 (discussing effects of landlord's right to recapture on parties with equal bargaining power); Martin D. Polevoy, *Assignment, Subletting and Lease Transfers*, 1994 Prac. Law Inst. (providing a discussion of the basic elements of assignment and subleasing provisions for landlord or tenant attorneys); Marc A. Sobel, *Negotiating a Sublease or Assignment Clause*, 4 Prob. & Prop. 44, 45 (1990) (discussing important aspects of a lease's subletting and assignment provisions and considerations of the parties).

13 See *Karbelnig v. Brothwell*, 244 Cal. App.2d 333 (Cal. Ct. App. 1966); *Dudley v. Rapanos*, 353 Mich. 237 (Mich. 1958); Friedman, *supra* note 1, § 7:1.1, at 7-5-7-6, § 7:3.3[E][3], at 7-33-7-34.

Assuming that recapture rights are not present, that the landlord waives the rights, or that the subtenant assumes the risk of proceeding without certainty, counsel for the subtenant must next review the subletting provisions of the direct lease to determine (1) what information the tenant must furnish to the landlord in connection with the sublease and the potential subtenant and (2) whether the tenant and the subtenant can satisfy with the requisite conditions that obligate the landlord to grant consent.¹⁴

To start the landlord's clock ticking, either to exercise recapture rights or to grant or deny consent to the sublease, the parties to the sublease frequently must furnish certain information to the landlord. Usually, the tenant must submit to the landlord either a proposed or executed sublease or a term sheet outlining the essential terms of the subleasing transaction. The sooner the landlord's recapture time period starts to run, the sooner the parties will know if a sublease will work. Accordingly, if only a term sheet is required, the tenant should submit it promptly to its landlord while the sublease parties proceed with negotiating the sublease.¹⁵

In some instances, the direct lease may give the tenant the right to approach the landlord with an intention of subletting. Subsequently, the landlord must determine whether or not to exercise any recapture right. In this situation, the landlord's right of recapture probably will expire before the parties fully negotiate the proposed sublease transaction. If the right of recapture expires, the tenant should give the subtenant evidence that the recapture right no longer is an impediment.

Many direct leases require the tenant to provide the landlord with financial information about the subtenant, including, frequently, certified financial statements and references. The subtenant's failure to have certified financial statements or the subtenant's unwillingness to release them to the landlord will frustrate the subleasing transaction unless the landlord waives the requirement. Quite often, however, the landlord will enter into a confidentiality agreement with respect to financial information provided by the subtenant in order to alleviate a subtenant's unwillingness to release such financials. If the tenant retains occupancy of most of the leased premises, a waiver would not be an unreasonable request. Sometimes landlords require a meeting with the proposed subtenant. In that

14 *See Keep Control of Tenant's Right to Sublet and Assign*, Comm. Lease L. Insider, Sept. 1996, at 5, 6 (contributions from Alan Eidler, Richard F. Muhlebach, Harvey M. Haber, and Neil E. Botwinoff).

15 Alternatively, the parties may elect to wait for the landlord's response before proceeding to the actual sublease document. This may save money, but will cost time.

case, the subtenant should be aware of the meeting requirement and make the necessary parties available.

Even when a landlord cannot unreasonably withhold or delay consent to subletting, the direct lease frequently has conditions that the sublandlord or subtenant must satisfy.¹⁶ Although these conditions may appear reasonable, in practice they often fall into the “gotcha” category; i.e., even though the lease seems to allow subletting in theory, the “fine print” is intended to preclude subletting. Conditions that are subject to landlord’s judgment or even its reasonable satisfaction may create potential roadblocks to a smooth subleasing transition.¹⁷

At the outset of any subleasing transaction, the subtenant’s counsel must read carefully every restriction and condition limiting subleasing in the direct lease. For example, the lease may provide that the sublease rent cannot be less than the rent the landlord is then charging for comparable space in the building. In a depressed commercial real estate market this is an impossible condition to satisfy and even in a more robust market a tenant usually cannot meet such a condition unless the tenant has made substantial and valuable improvements to the premises. As the sublease is a lesser estate¹⁸ and the parties typically cannot customize the “box of rights” created under the lease, sublease rentals usually amount to less than the rentals that a landlord could charge if the landlord leased the space directly for a comparable term to a new tenant.¹⁹ Although the sublease rent may be greater than the rent under the direct lease, this generally reflects either a dramatically improved leasing market or the substantial value of improvements made by the tenant to the space. A tenant, having only a lesser estate, generally can extract payment from a

16 See *Amjems, Inc. v. F.F. Orr Constr. Co.*, 617 F. Supp. 273 (S.D. Fla. 1985); *Arrington v. Walter E. Heller Int’l Corp.*, 30 Ill. App.3d 631 (Ill. App. Ct. 1975); *Newman v. Hinky Dinky Omaha-Lincoln*, 229 Neb. 382 (Neb. 1988); Friedman, *supra* note 1, § 7:3.4[D][3], at 7-56-7-70; Berkman, *supra* note 9, at 29-32; Sobel, *supra* note 12, at 45; Jon M. Laria, Note, *Julian v. Christopher: New Standards for Landlords’ Consent to Assignment and Sublease*, 50 Md. L. Rev. 464 (1991). For a discussion of consent from the prime landlord’s perspective, see Richard S. Rosenstein, *Get Safeguards in Sublet Consent*, Comm. Lease L. Insider, May 1993, at 1.

17 Subjective concerns about the use, character, or reputation of a subtenant can be particularly problematic. See *Van Sloun v. Agans Bros.*, 778 N.W.2d 174 (Iowa 2010), where a landlord refused to consent to a financially viable food service tenant because, among other reasons, of its fear that the subtenant’s cooking odors could offend other tenants.

18 See *supra* note 1.

19 For these reasons it is preferable that landlord negotiate in the direct lease that tenant not advertise the space as being available at a lesser rental than landlord is charging for comparable space in the building, but that tenant may enter into a sublease at any rental rate.

subtenant only for those rights that the tenant already holds and that are transferable. Thus, some restrictions on subleasing contained in the direct lease which may not appear at first to be intended to prohibit a sublease transaction may nevertheless make the sublease transaction problematic absent a waiver or express consent from the landlord.

[29.3] B. Is the Existing Package of Rights Under the Direct Lease Acceptable to the Subtenant?

Once the subtenant's counsel has determined that the sublease transaction will work, counsel must review the direct lease to make sure that its terms are acceptable.²⁰ Obviously, the terms of the direct lease must be consistent with those of the proposed sublease transaction; i.e., allow the use contemplated under the sublease, cover at least the space proposed to be sublet, and have a term at least as long as the sublease term. All other terms of the direct lease must be tolerable for the subtenant. Common problem areas involve alterations, services, and other landlord covenants. In some cases, counsel may be pleased to find that the tenant's transferable rights exceed the rights that the subtenant reasonably could have negotiated for in a sublease. This can be true if the tenant is extremely creditworthy and has leased a large block of space or if the tenant signed a lease when landlords were hungrier for tenants. Even in such instances the tenant as sublandlord may not want to pass along all of the benefits and rights it has under the direct lease to the subtenant.²¹

If a provision in the direct lease is not acceptable, the parties to a sublease must address the issue in the subleasing transaction. In some situations, the parties can only solve problems by going back to the landlord to modify the landlord's rights and obligations. Often the landlord will seek compensation for changing the rights under the direct lease. These modifications may be for the benefit of the subtenant alone or for the benefit of both the tenant and the subtenant. In the first case, this can be handled in the landlord's consent to sublease, which the tenant must obtain, in which case the sublease should make inclusion of such modifications express

20 See *Faucett v. Provident Mut. Life Ins. Co. of Phil.*, 244 Ala. 308 (Ala. 1943); *Pedro v. Potter*, 197 Cal. 751 (Cal. 1926); 52 C.J.S. *Landlord & Tenant* §§ 60, 61 (2008); Friedman, *supra* note 1, 7:7.1, at 7-123 (noting that "a subtenant has been said to be under a duty to ascertain the terms of the headlease").

21 For example, if in a direct lease of a significant block of space the tenant may sublet without the consent of landlord, that is unlikely to be a right tenant as sublandlord would want to offer to a subtenant of only a portion of the space covered by the direct lease.

conditions of the landlord's consent.²² In the second case, an amendment to the direct lease may best solve the problem. As landlords rarely have any incentive to change the terms of direct leases, the sublease parties must agree fairly quickly whether the tenant or the subtenant bears the responsibility and the costs of gaining concessions from the landlord. A tenant who is remaining in occupancy of some of the demised premises may not want to risk alienating the landlord by demanding changes, however.

Finally, the prospective subtenant's counsel must review all documents that constitute the lease or affect the tenant's rights and obligations. These documents include all lease amendments, all estoppel certificates²³ that the tenant has given to the landlord or anyone else, all commencement date agreements, information regarding any disputes between the landlord and tenant, copies of approvals the landlord has granted, any nondisturbance or recognition agreements the tenant has received, and all relevant material communications that the tenant has received from the landlord. The subtenant should also understand all relevant "non-legal" information about the building such as construction rules; approved contractors and subcontractors; freight elevator hours; charges for heating, ventilating, and air conditioning; and other overtime services and cleaning specifications.

Analysis of the existing lease needs to take into account as well that the sublease may be beginning after the tenant is already "living in the box" and has performed substantial construction work or improvements. For a major tenant, this might include above-standard installations such as supplemental air conditioning, dining facilities, and trading floors. The cost of this work may reach millions of dollars. Therefore, the subtenant may be assuming an obligation to restore any changes upon moving out.²⁴ The subtenant must understand this obligation (or negotiate it out) and must have copies of all documents relating to the tenant's construction. Installations transferred from the tenant to the subtenant may represent a substantial portion of the consideration that the subtenant will pay under the sublease. The subtenant should get the full benefit of all of these improvements, including any warranties and guaranties, because the subtenant assumes responsibility for their continued maintenance and operation.

22 See Wood & DiSciullo, *supra* note 1, § 30.04, at 30-34; Senn, *supra* note 3, at 20-25.

23 For a general discussion on the importance of estoppel certificates, see Andrew L. Herz, *The Use and Misuse of Estoppel Certificates*, Am. C. Real Est. Law Newsl., Mar. 2000.

24 See Robert C. Epstein, *Hidden Sublease Restrictions*, N.Y.L.J., Oct. 9, 1996, p. 5, col. 2.

From the subtenant's viewpoint, it is vastly preferable that the subtenant only be responsible for restoration with respect to special alterations and improvements made by subtenant, as opposed to these made by the tenant. (The extent of this restoration obligation will be governed by the direct lease as it applies to alterations and improvements by either the tenant or the subtenant.)

[29.4] C. Interplay Between the Direct Lease and the Sublease

The last step in reviewing the direct lease determines the level of interplay between the rights and obligations under the direct lease and the sublease. Practitioners differ on how to draft the sublease document. Most prefer to incorporate the direct lease into the body of the sublease document, with modifications and deletions as appropriate. The next section addresses how this can be done.

[29.5] III. DOES THE SUBLEASE “WORK”?

As with any direct lease, the preparation and negotiation of a sublease must cover a range of areas. Counsel in a sublease transaction will want to make sure that the sublease document does the following:

1. Accurately sets forth the terms of the proposed transaction between the tenant (sublandlord) and the subtenant;
2. Complies with the requirements of the direct lease, which must be addressed in the sublease (it is typical, for example, that specific provisions of the direct lease be included and restated in full (e.g., subordination of sublease provisions) in the form of sublease);
3. Allocates any risks or obligations that the lease sets forth between the tenant and the subtenant in the manner that the parties have agreed upon;
4. Covers matters that are independent of the box of rights created under the direct lease; and
5. Whenever possible, streamlines the sublease document by the appropriate incorporation by reference of provisions of the direct lease to save time, space, and effort, as well as to prevent errors and inconsistencies.

In addition, the sublease generally will need to set forth the conditions for its effectiveness, particularly the need for and conditions of the landlord's consent, which consent should be obtained within a specific number of days after the sublease is executed and delivered.

[29.6] A. Preliminary Inquiries

Before deciding whether the client's subleasing goals are accomplished, the subtenant's counsel must think about some of the same issues that are important in a traditional direct lease.²⁵ Beyond the basic economic terms regarding rent and escalations, the subtenant should determine that the subleased space as described in the sublease will work for the subtenant. A diagram exhibit of the subleased premises early in the process will help confirm the understanding of the parties. The subtenant should seek all of the rights that the direct lease grants to the tenant, including the right to use portions of the lobbies, elevators, and common areas of the building needed for access to, and full use of, the subleased premises, and availability of directory listings, signage and parking (to the extent applicable).

The sublease should describe the condition in which the subleased space must be delivered.²⁶ Must the sublandlord perform any construction work or simply deliver the space in vacant "broom-clean condition"? At a minimum, the space generally must be free and clear of all other occupancies. The subtenant would also like to know that the subleased premises comply with applicable governmental requirements, are free from hazardous materials (unless legally encapsulated or otherwise managed in accordance with applicable law) and that building systems serving the subleased premises are in good working order.²⁷ More complex transactions may contemplate delivery of portions of the space in stages. The subtenant's counsel must consider what happens if the sublandlord cannot deliver the space. Does the sublease terminate? Are there financial or rent penalties for delay? A right of cancellation seems like a major penalty but is rarely practical. The earlier these issues can be raised and resolved, the better for both parties.

25 See Wood & DiSciullo, *supra* note 1, § 30.01, at 30-2.

26 See Elizabeth Kluger Cooper, *Ten Key Non-Monetary Sublease Provisions*, 7 Comm. Leasing L. & Strategy 6 (1995).

27 In physically complex spaces, HVAC may be provided by a combination of the landlord's "base building" systems and "supplementary systems" installed by the tenant. It is important to know where one system leaves off and the other picks up.

Counsel should also determine whether the sublease transaction includes the use or transfer of any personalty, furniture, equipment, telephone systems, and the like. If so, must these items be in working order? If items of personalty, furniture or equipment are being sold to the subtenant there may be sales tax payable on that sale (and, as discussed below, the landlord may want to include the proceeds of such sale in the subleasing profit received by tenant for the purpose of allocating such profit between landlord and tenant). Will the network cabling or telephone systems work correctly for just the subleased space? Are there available or additional risers available for the subtenant's telecommunication and data cabling? In appropriate instances can the subtenant obtain roof space for a microwave dish or antenna? Is the electrical service to the subleased space sufficient for the subtenant's current and anticipated future use? Does the sublandlord have emergency generator capacity available for the subtenant's use? This, in turn, will cause the parties to focus on issues of timing, cost, and coordination.

The sublease often does not cover all of the space demised by the direct lease. In these cases, the subtenant must decide whether to construct new walls to demise the subleased space and whether the sublet premises provide legal means of ingress and egress. The parties also must address issues such as the equitable allocation of charges relating to utilities and shared areas or services. If the subtenant desires overtime air conditioning or other shared services and the facilities cannot separately serve the subleased premises, the parties must allocate the charges. Similar allocation applies to shared electrical consumption when a single meter or submeter serves all of the space.²⁸ Allocation of the charges based upon the respective floor areas of the sublet space and the space that the sublandlord retains might be unfair depending upon how the parties use the two portions of space. To the extent separate submeters can be installed to measure subtenant's usage, that can be very beneficial. The cost of initially installing and maintaining such submeters will be a business issue to be negotiated between the sublandlord and the subtenant.

[29.7] B. Compliance With the Direct Lease

Although the sublease needs to comply with the requirements of the direct lease, compliance is relatively easy to accomplish. If the sublandlord's counsel has properly reviewed the direct lease, the parties can set forth any necessary provisions to be incorporated from the direct lease in the initial draft of the sublease.

²⁸ See Wood & DiSciullo, *supra* note 1, § 17.02, at 17-11.

[29.8] C. Allocation of Risks and Costs

In allocating risks between the parties, a sublandlord properly will make clear to the subtenant those obligations that by their nature only the landlord can perform.²⁹ These obligations include providing building services, making repairs to the common areas and the building structure and systems, or otherwise performing landlord- or owner-specific obligations, including restoring the building and building systems after a casualty or condemnation.³⁰ Subleases usually provide that the sublandlord has no responsibility or liability for failing to fulfill these obligations. Except in those instances when the sublandlord's default caused the landlord's failure to perform these obligations, this is an appropriate position for a sublandlord to take because the sublandlord is entitled to receive these services or benefits from the landlord and is not in a position to perform the obligations independently. However, because the subtenant is not in privity with the landlord, the sublandlord should agree to either use reasonable efforts to enforce the landlord's obligations under the direct lease or take such reasonable steps as will enable the subtenant to proceed directly against the landlord if the landlord defaults under the direct lease.³¹ Exhibit B at the end of this chapter provides a model clause requiring the sublandlord to take certain actions against the landlord for the benefit of the subtenant.

The subtenant's counsel should make sure that the sublandlord remains responsible for any of the sublandlord's own acts or omissions (not caused by the subtenant's default) that would allow the landlord to stop performing the landlord's obligations under the direct lease, thus depriving the subtenant of landlord services. To the extent that the sublandlord was able to negotiate self-help rights in the direct lease, the subtenant will want the sublandlord to agree to exercise those rights on behalf of the subtenant. The sublandlord should be agreeable to such an arrangement unless the sublease covers only part of the premises that the direct lease demises and the sublandlord, in good faith, disagrees with, or could incur liability from, granting the subtenant's request. Exhibit C at the end of this chapter provides sample language for dealing with some of these issues.

29 See Staton Schuman, *Assignments and Subleases*, Commercial Landlord/Tenant Practice ¶ 6.6, at 6-7 (Ill. Inst. for Continuing Legal Educ., Supp. 1998).

30 See *id.* ¶¶ 6.9-6.10, at 6-8.

31 See Wood & DiSciullo, *supra* note 1, § 30.2[2][i], at 30-30-30-31 (noting that "[t]he Sublessor agrees to cooperate with the Sublessee in an effort to obtain the services or Landlord's performance [but] this should provide little comfort").

Conversely, the sublandlord typically will pass through to the subtenant any obligations under the direct lease that relate to the subtenant's use and occupancy of the sublet space. Such obligations often include a pass-through of an appropriate percentage of the real estate tax and operating cost escalations, with a change in applicable base years for the escalations (if that is part of the business deal). The subtenant also will generally agree to bear an appropriate share of other monetary obligations, such as payment for electrical consumption. It is also appropriate where the landlord bills the sublandlord for services requested by subtenant, such as after hours HVAC or for use of the loading dock, that the subtenant pays 100% of such amounts since these relate to services provided directly to the subtenant. In appropriate instances it may be desirable to attempt to have the landlord accept requests for such overtime services directly from the sublandlord. To the extent that the landlord gives the tenant any documentation about costs, the subtenant should insist on promptly receiving copies.³² The subtenant's obligation to pay these amounts should be within an agreed period of time after receipt of a bill together with reasonable supporting back-up documentation. Counsel for the subtenant should be sure that these periods within which payments are required to be made by subtenant will, in fact, work for the subtenant.

In appropriately sized transactions, the sublease should allow the subtenant to challenge the landlord's operating statements. The subtenant should request that the sublandlord preserve the subtenant's rights through sublandlord under the direct lease to dispute all escalation and other pass-through obligations and also should request that the sublandlord exercise any such dispute rights on the subtenant's behalf. If the dispute proves successful, the subtenant should receive a share of any credit received by the sublandlord upon resolution of the dispute. Given the sublandlord's dispute rights under the direct lease often depend upon the timely delivery of notices and elections, the subtenant may seek some control over these matters. If the direct lease provides for the arbitration of disputes, such as a dispute over the right to terminate the direct lease if there is casualty damage or over proposed new rules and regulations, the subtenant similarly may want to be involved in these matters. In some cases, the subtenant has no right to advise or participate; in other cases, the parties may agree upon reasonable cooperation. As with any negotia-

32 "The sublessee's job is to gather and have the right to gather in the future, adequate data to determine whether or not its share of additional rent is fair and equitable. . . . [I]f the Landlord does not want the Sublessee to see these records, the Sublessee has no right to enforce this provision against the Landlord; those two parties are not in privity of contract and Landlord has no obligation to cooperate." *Id.* § 30.03[2][e], at 30-27.

tion, the outcome of these matters is dependent on the particular facts and circumstances.

When considering issues related to the direct lease, the subtenant must always remember that two separate boxes of rights and obligations exist: the box within which the landlord and tenant live and the smaller box within which the tenant and subtenant live. The subtenant's counsel also should think about the possibility that the sublandlord could lose the direct lease, either because the sublandlord defaults under the direct lease, or because the landlord defaults under a mortgage, which may lead to lease termination in a foreclosure action.³³ The practical importance of such issues depends on the size and term of the subleasing transaction. Typically, the parties do not consider these issues for any sublease that is either less than a full floor or less than three years; however, disregarding these issues is the client's decision rather than the lawyer's. In order that the subtenant does not receive bills for escalations or items of additional rent under the sublease for periods after the expiration thereof, it is desirable that the subtenant negotiate for an outside date after which the sublandlord waives the right to bill such amounts. Although the sublandlord may only agree to pass along whatever similar relief it has under the direct lease, it is reasonable for a subtenant to negotiate for a period (for example, 24 months) after the end of a particular period beyond which sublandlord may not bill for such items. This protects the subtenant from a sublandlord sitting on escalation or other bills for a commercially unreasonable period of time.

If the subtenant is concerned about default by the landlord, the subtenant should determine whether the landlord has sufficient financial strength and whether the tenant is adequately protected against the landlord's default or failure to otherwise perform the obligations of the direct lease. Does the landlord have security for building work obligations? Does the sublandlord, as tenant, have the benefit of a nondisturbance agreement from the mortgagee? Without protections such as these, the

33 See *V.O.B. Co. v. Hang It Up, Inc.*, 691 P.2d 1157 (Colo. Ct. App. 1984) (holding sublease terminated upon termination of sublessor's lease); *127 Korea House, Inc. v. House of Korea, Inc.*, 49 A.D.2d 736, 372 N.Y.S.2d 679 (1st Dep't 1975) (holding sublease terminated after foreclosure of landlord's interest); *Hooper v. Seventh Urban, Inc.*, 70 Ohio App. 2d 101 (Ohio Ct. App. 1980) (noting that order of restitution against lessee terminated sublessee's right to possession); see also Friedman, *supra* note 1, § 7:7.3, at 7-133-7-136 (discussing the effect of the termination of the prime lease on sublease); Epstein, *supra* note 21, at 1 (discussing recognition language); Michael P. Carbone, *Strategies for Effectuating Assignments and Subleases*, 10 Comm. Leasing L. & Strategy 3, 3 (1998). For a discussion of nondisturbance agreements from the prime landlord's perspective, see *Report of the Subcommittee on Nondisturbance Agreements*, Comm. Leasing Committee, 1993 Real Prop. Sec., NYSBA.

subtenant runs the risk of losing its investment because if the tenant's estate terminates, so too does the subtenant's. In this regard, the subtenant also should consider the effect of a bankruptcy of the sublandlord.³⁴

For a major sublease, a subtenant should seek a recognition agreement from the landlord, stating that if the direct lease ever terminates, the landlord will recognize the subtenant as a direct tenant.³⁵ The subtenant would prefer that this recognition relationship incorporate all the terms and conditions of the sublease.³⁶ As a fallback, the subtenant may be willing to be recognized under the terms of the direct lease, as opposed to the sublease, equitably applied to the subleased space. The relationship can become rather tricky and unsatisfactory for the party (landlord or subtenant) that may have to operate under a non-negotiated document. Accordingly, landlords hesitate to provide recognition agreements for subtenants, particularly smaller subtenants. If the tenant had both foresight and leverage during direct lease negotiations, though, the landlord may have no choice but to recognize the subtenant's rights.³⁷ Similarly, in a major direct lease, the major subtenant may be entitled to receive a non-disturbance agreement from the landlord's mortgagee or a ground lessor, if any, and should request one in any event.

Although a subtenant may want to understand the financial strength of the landlord, the inquiry does not end with the landlord's assets. A subtenant also must understand the financial strength of the sublandlord. Just as a landlord may default in failing to perform obligations under the mortgage of the building, so too may a sublandlord, as tenant, default in failing to perform its obligations under the direct lease. A subtenant should insist that the sublandlord expressly agree to perform all of its obligations as

34 See *Chatlos Sys., Inc. v. Kaplan*, 147 B.R. 96 (D. Del. 1992) (holding rejection of direct lease operates to reject subleases as well), *aff'd*, *In re TIE Communications Inc.*, 998 F.2d 1005 (3d Cir. 1993); Friedman, *supra* note 1, § 7:7.3, at 7-133 n.570 (compiling cases addressing the insolvency of a prime tenant and the effect on a subtenant); see also Carbone, *supra* note 29, at 3 (holding when debtor's lease is rejected pursuant to bankruptcy statute, any subleases under primary lease are also rejected).

35 See *Chumash Hill Props., Inc. v. Peram*, 39 Cal. App. 4th 1226 (Cal. Ct. App. 1995) (holding nondisturbance agreement between landlord and subtenant gave non-breaching subtenant right to retain possession after sublandlord's bankruptcy); see also Friedman, *supra* note 1, § 7:7.5[B], at 7-142 (discussing the protection that a nondisturbance agreement affords a subtenant with a prime landlord).

36 The subtenant will want to protect any offset rights it may have under the sublease for non-payment by the sublandlord of any improvement allowance payable under the sublease.

37 See Ira Meislik, *Sublease Consents and Recognition Agreements: Now Comes The Really Hard Part*, *Prob. & Prop.*, 34, Nov./Oct. 2004.

tenant under the direct lease, including timely payment of all rent. A sublandlord often will, and probably should, condition these obligations upon the subtenant's not being in default under the sublease. As a matter of convenience, the subtenant often will want the right to request overtime and other extraordinary services directly from the landlord and the right to pay such charges directly to the landlord. If the sublandlord fails to perform, the subtenant will want enough flexibility to have the time and ability to cure defaults under the direct lease.³⁸

[29.9] D. Interplay of Direct Lease and Sublease Provisions and Independent Matters to Address

[29.10] 1. Generally

As a sublease transaction has a double set of rights and obligations, the direct lease by itself cannot adequately cover the interplay between the provisions of the direct lease and those of the sublease. Some provisions of the sublease transaction are independent of the direct lease transaction and cannot be incorporated by reference. The distinction between the independent provisions and interplay provisions can be blurred and hard to understand. And in some instances the direct lease may address many of the independent provisions discussed below. By drafting the independent provisions from scratch, though, counsel avoids creating the complexity, confusion, and possible mistakes that may result from trying to incorporate by reference and then extensively modifying the corresponding provisions from the direct lease.

Provisions from the direct lease that interact with the provisions in the sublease, or require independent provisions in the sublease, usually fall into one of the following five categories:

1. The status of the direct lease and of the sublet premises;
2. The sublandlord's exercise or non-exercise of certain rights under the direct lease as against the subtenant;
3. Recomputation of time periods;
4. Assignment and subletting, construction, restoration, consents, and insurance; and
5. General and separate boilerplate provisions.

³⁸ Refer to Form Rider Exhibit B at the end of this chapter.

[29.11] 2. Status of Direct Lease and Condition of Sublet Premises

Although practitioners often view representations and warranties as an invitation to future disputes and claims, certain representations and warranties about the underlying direct lease documents are essential in a sublease transaction. A subtenant should demand a full set of representations to identify all of the direct lease documents. By making such a demand, a subtenant will know with certainty the “box of rights and obligations” that comes with the sublease. A sublandlord should be willing to represent and warrant, among other things, that (1) the direct lease, together with all other identified amendments and agreements, is the entire agreement between the landlord and the sublandlord; (2) the lease documents are in full force and effect; and (3) no outstanding uncured notices of default or termination exist.³⁹ A subtenant also may want to know whether any notices of default have issued under the direct lease. It is likely that the copy of the direct lease documents provided to the subtenant will have certain business terms redacted. In this event, the subtenant should seek a representation from the landlord that the redacted provisions of the direct lease do not affect the subtenant’s rights or obligations under the sublease.

A subtenant should insist that the sublandlord not modify the direct lease documents in any way that would adversely affect the subtenant without obtaining the subtenant’s consent. If the direct lease already provides for certain future modifications, the sublease parties would need to permit them, and the subtenant would need to understand them as part of due diligence about the direct lease. A sublandlord may want to keep the right to amend the direct lease. As a reasonable resolution of these issues, a sublandlord often will agree not to amend the lease voluntarily if such an amendment would adversely affect the subtenant’s rights under the sublease, increase the subtenant’s obligations under the sublease, decrease the size of the sublet premises, or shorten the term of the sublease.⁴⁰

[29.12] 3. Exercise of Rights

A subtenant’s rights derive entirely from the sublandlord’s rights under the direct lease. Accordingly, the subtenant should request that the sublandlord agree not to exercise rights under the direct lease that could hurt the subtenant or the sublease. Unless the subtenant has obtained a recognition agreement from the landlord, the subtenant must limit the right of

³⁹ See Herz, *supra* note 20 (discussing estoppel certificates).

⁴⁰ See Saltz & Miner, *supra* note 3, at 33.

the sublandlord to terminate the direct lease voluntarily. The subtenant should not permit the sublandlord to terminate the direct lease without the consent of the subtenant other than in the case of termination due to condemnation or casualty, or (potentially) a specifically negotiated cancellation right. The subtenant may even limit the right of the sublandlord to effect a casualty termination to those situations in which the landlord terminates the direct lease. The subtenant may want the sublandlord to agree to exercise, or in some instances, refrain from exercising, one or more renewal or expansion options. Such an agreement is especially appropriate in transactions in which the subtenant has pre-negotiated a direct lease with the landlord that will commence when the sublease ends. In the instance where the subtenant is subleasing only a small portion of space demised under the major direct lease, however, it is appropriate and important that the sublandlord reserves a broad ability to act with respect to the direct lease without the subtenant's consent so long as the subtenant's rights or obligations are not adversely affected.

[29.13] 4. Recomputation of Time Periods

Many times during the life of a sublease, the sublandlord is simply a courier who conveys messages between the landlord and the subtenant. The sublandlord needs more time than the direct lease provides when the sublandlord must communicate with the landlord and get the landlord to act under the direct lease. Correspondingly, time periods need to be shorter when the sublandlord must convey a message to the subtenant and get the subtenant to take action. Otherwise, the sublandlord may default under the direct lease. Accordingly, the parties must change almost all time periods in the direct lease when they are incorporated into the sublease. The subtenant's goal is to make sure that the sublandlord is a speedy messenger. The subtenant wants enough time to take any actions that the landlord requires and also wants to make sure that the landlord responds promptly to any requests. Counsel for the sublandlord must be careful that by adjusting any of these time periods it is left with sufficient time to cure or otherwise take action.

[29.14] 5. Generally Independent Provisions

Provisions regarding assignment and subletting, construction, restoration consents, insurance, and general boilerplate are the provisions that the parties most often independently set forth in the sublease. To some degree, the parties also will incorporate these provisions by reference from the direct lease. Use of both methods helps to avoid ambiguity; how-

ever, it is important to provide in the sublease that, as between sublandlord and subtenant, any conflicts are resolved in favor of the sublease.

[29.15] a. Assignment and Subletting; Alterations and Consents

Depending on the language of the assignment and subletting provisions of the direct lease, the parties may simply want to incorporate these provisions wholesale from the direct lease.⁴¹ At a minimum, whether as an independent provision in the sublease or as an incorporated provision from the direct lease, the sublease should address whether the sublandlord can “recapture” the subleased premises or participate in any profits from an assignment of the sublease or a further subletting. A landlord usually will try to participate in assignment or subletting “profits” under the theory that the only party who should make any “profits” from the landlord’s building is the landlord. The sublandlord may seek to include in “profits” any amounts paid for furniture, fixtures or leasehold improvements to the extent the subtenant is purchasing those items. This argument does not extend to the treatment of “losses,” of course. The strength of this argument is diminished substantially when the landlord is only a sublandlord. Similarly, because the sublandlord has no long-term residual interest in the building itself, the case for including onerous requirements on construction and insurance in any sublease is not as compelling as it might be in a direct lease.

A critical issue for any subtenant is the need to obtain approval from the sublandlord and landlord for the subtenant’s initial alterations and any possible future assignment or subletting. If the direct lease requires the landlord’s approval, the subtenant normally will want the sublandlord to agree to submit approval requests to the landlord for quick approval. Ideally, the subtenant wants the sublandlord to agree that anything that the landlord approves will be deemed approved by the sublandlord automatically. If the subtenant’s leverage is not strong enough to obtain such a provision, the sublandlord often will still agree to be reasonable about granting approvals. The subtenant should seek to negotiate acceptable time periods within which sublandlord will respond and if the sublandlord fails to respond, its consent will be deemed given. The subtenant also should try to persuade the sublandlord to agree that if the subtenant ever believes the landlord is unreasonably withholding consent, the subland-

41 *See Boston Props. v. Pirelli Tire Corp.*, 134 Cal. App. 3d 985 (Cal. Ct. App. 1982); *see also* Friedman, *supra* note 1, § 7:7.1, at 7-124 (stating that “[a] restriction against assignment, included in a headlease, does not bar assignment by a subtenant. For this reason landlord may want to include a restriction . . . under a sublease.”). *But see Krasner v. Transcon. Equities, Inc.*, 70 A.D.2d 312, 420 N.Y.S.2d 872 (1st Dep’t 1979).

lord will challenge the landlord's denial of consent to the extent that the direct lease permits a challenge. Of course, the subtenant should pay any costs of a challenge and protect the sublandlord against liability. To the extent the direct lease requires the sublandlord to reimburse the landlord for third party review of the subtenant's alterations, subtenant may seek to limit its exposure to additional third party expenses incurred by sublandlord in reviewing the subtenant's alteration plans and specifications (depending on the particular facts in some transaction, sublandlord may waive or cap those expenses for subtenant's initial alterations).

A subtenant also should focus on any obligation to remove tenant improvements at the end of the sublease. This obligation may be particularly burdensome if the sublandlord already has made substantial improvements that the landlord may require to be removed at the end of the direct lease term. This obligation can impose substantial costs upon a subtenant or tenant if not appropriately addressed.⁴² The most desirable position for the subtenant is to only be responsible for restoration of improvements or alterations performed by the subtenant and which are required to be removed under the direct lease.

[29.16] b. Insurance

A sublease often requires the subtenant to provide insurance for the sublet space.⁴³ Just as a tenant must, a subtenant should confirm with insurance advisers that the subtenant will be able to obtain the required insurance at a reasonable cost. To the extent that the sublease requires more insurance than the subtenant would otherwise provide, any resulting cost is simply another cost of the sublease. The subtenant should also protect itself from the sublandlord increasing the amount of insurance or requiring additional types of insurance unless these changes are consistent with the particular market and comparable transactions.

Most direct leases contain a waiver of subrogation and release of liability clause for the benefit of the tenant. The subtenant's risk management professionals should determine whether the clause protects the subtenant from claims by the landlord or the landlord's insurer. If the direct lease clause does not protect the subtenant, it is an appropriate issue to raise

42 For example, compliance with the 2002 National Electrical Code relating to removal of abandoned wire and cabling may require expensive work.

43 For a discussion of insurance and other issues for consideration, see Halper, *supra* note 1, at § 12.06; see also Schuman, *supra* note 29, ¶ 6.11, at 6-9 (discussing need for insurance, indemnities, and waivers in sublease agreement).

when reviewing and negotiating the landlord's form of consent to sublease. Although, in practice this typically does not happen and/or the landlord will not so agree.

[29.17] c. Boilerplate Provisions

A sublease usually includes the typical boilerplate provisions found in most substantial legal documents, as well as a few provisions of unique importance to subleases (described below). These boilerplate provisions may include mutual brokerage representations and indemnities (which may or may not be factually correct with respect to the sublease, if incorporated from the corporate lease clause), separate arbitration clauses, protections for successors and assigns, and assurance against oral modifications and waivers. The sublease can safely incorporate most boilerplate provisions, default provisions, and remedial provisions contained in the direct lease.

[29.18] 6. Incorporation by Reference

After the parties have considered the substantive issues discussed above, they still must decide exactly how much of the direct lease they should incorporate by reference into the sublease.⁴⁴ The terms of any direct lease usually fall into one of the following four categories: (1) terms that require modification before incorporation by reference into the sublease; (2) terms that the sublease normally should incorporate by reference; (3) general terms that the sublease can incorporate without change and (4) terms that almost certainly will not apply to the sublease and should be expressly excluded.

In its simplest form, a sublease provides for incorporation by reference of all terms of the direct lease with a notation that “landlord” refers to “sublandlord” and “tenant” refers to “subtenant.” This approach, however, may be overly simplistic.⁴⁵ Other terms in the direct lease may be incorporated, but with changes to fit the specific business deal. For example, the sublease should provide its own definitions for “premises,” “fixed rent,” “additional rent,” and “commencement date.”

44 See Guido, *supra* note 5; Schuman, *supra* note 29, ¶ 6.6, at 6-7.

45 As a practical matter on smaller sublease transactions, clients may limit how they want counsel to proceed and live with a catch-all such as “to the extent applicable and consistent with the sublease transaction.”

One standard lease clause that a subtenant will certainly not want to incorporate by reference is a provision that limits the landlord's liability to the interest in the building or the premises. Given that sublandlords often lose money on subleases (and therefore its value may be zero), a subtenant should know that the general credit of the sublandlord backs the sublandlord's obligation to preserve the direct lease. If the sublandlord's liability is limited to the interest in the building (i.e., the direct lease), the subtenant may have no claim against the sublandlord if the sublandlord decides to abandon its entire position. Non-recourse clauses may make sense in some real estate transactions, but not generally in subleases.

The following list summarizes many terms of a direct lease that a sublease often will incorporate by reference. Following each term is a quick summary, if relevant, of the position a subtenant may take regarding each of the terms and any limitations or modifications that may be desirable when the sublease incorporates a term by reference. These annotations reflect a subtenant's idealized view of the world. The subtenant may ask for these changes, but may not be able to obtain all or any of them.

Issue	Subtenant's Position
Abatements	Pass through to the subtenant.
Alterations and Approvals of Alterations	One review or consent process. If the landlord approves, the sublandlord is deemed to have approved.
Compliance with Law	Especially if the sublandlord has retained space, limit the subtenant's obligation to the subtenant's particular use and alterations of the space.
Defaults	No right to exercise remedies set forth in excluded or redacted provisions.
Dispute Resolution	The sublandlord must exercise the sublandlord's rights under the direct lease, including arbitration rights, for the subtenant's benefit or permit the subtenant to exercise such rights in the sublandlord's name and at the subtenant's expense.

Escalations	If the subtenant agrees to pay escalations, the subtenant should have the right to challenge (or require the sublandlord to challenge) the landlord's calculations and statements pursuant to the mechanisms provided in the direct lease. The counsel to subtenant should confirm that the subtenant's proportionate share for calculation of escalations is correctly computed.
Estoppel Certificates	Mutual obligation.
Holdover	If the sublease covers only a portion of the premises covered by the direct lease, counsel for the subtenant may seek to mitigate consequences of a holdover (this may be very difficult to achieve).
Notices	If the subtenant notifies the sublandlord of any matter, such notification satisfies the subtenant's obligation. The sublandlord should give the subtenant copies of all notices from the landlord regarding sublet space or otherwise affecting the subtenant's obligations under the sublease.
Renewal and Expansion Rights	Very deal-specific. If the subtenant's rights depend on the sublandlord's exercise of renewal options, the subtenant may want a power of attorney or the landlord's agreement that the subtenant can exercise on behalf of the sublandlord. As a practical matter may only arise where the subtenant is leasing the entire premises covered by the direct lease.
Repairs (Building)	Although the landlord repair obligations are usually not assumed by the sublandlord, the sublease must address the need for repairs made necessary by the sublandlord or a third party.
Roof Rights	Pass through to the subtenant. If the sublandlord has moved out, the subtenant can exercise exclusively any roof rights held by the sublandlord.
Surrender at End of Term	Delete any obligation to remove existing or installed alterations. Surrender may depend on whether alterations generally are usable by other office tenants.

Tenant's Property	Very deal-specific. The sublandlord may release its rights and provide a bill of sale. Consider sales tax implications.
Use	Allow the subtenant's contemplated use.
Violations	Expand to protect the subtenant from the sublandlord's acts or omissions.

A subtenant usually will not want to incorporate by reference the following matters covered by the direct lease: (1) payment of rent (if it varies from rent payable under the sublease) and (2) matters that have occurred already, such as the commencement date and initial construction.

In addition to the items listed above, a common-sense approach makes identifying objectionable provisions fairly easy. Analysis depends almost entirely on the level of sophistication of the direct lease. However, if the parties do not delete or address certain "traps" in the economics of the transaction, they can result in significant implications to a subtenant or tenant. These traps include the sublandlord's ability to impose separate rules and regulations; access to the sublet premises; governmental compliance issues, such as the sublandlord's obligation to obtain an amended certificate of occupancy for space already built-out; rent abatement provisions at the beginning of the term; rights to recapture and share profits; limits on further subletting and assignments; responsibility for environmental hazards not caused by the subtenant; insurance for the building; notice provisions; the covenant of quiet enjoyment; and, depending on the agreed-upon business transaction, expansion options, renewal options, and cancellation options.

If the direct lease is a major lease there will likely be a variety of provisions that would not be incorporated by reference in a sublease of a small or even a moderate portion of the premises covered by the major direct lease. There may be provisions granting exterior or lobby signage, monument rights, lobby security desk or even messenger center that are personal to the named tenant. There may be rights to sever the direct lease, options to purchase or other rights that would clearly, on review of the direct lease, not be applicable for the subtenant. Often, in these provisions of the direct lease expressly exclude the benefit of these rights inuring to the benefit of a subtenant.

[29.19] 7. Conditions to Effectiveness of Sublease

The final hurdle for the parties to the sublease is setting forth the conditions that the sublease must satisfy before it will become effective.⁴⁶ The most important condition for the parties to satisfy is obtaining the landlord's consent to the transaction. As described earlier, the direct lease may give the landlord rights that allow the landlord to thwart or delay the sublease transaction. Timing is often a critical issue for the subtenant. As the sublease undoubtedly will be contingent upon obtaining any required consent from the landlord, a subtenant often will want to specify an outside date for obtaining consent. The subtenant should tie the consent deadline to the period in which landlord must grant or deny consent pursuant to the provisions of the direct lease. If the subtenant does not obtain consent by the deadline, the sublease should provide that the subtenant, and possibly the sublandlord, has the right to terminate the sublease and recover any money and letters of credit that the subtenant may have provided when the parties signed the sublease.

The sublease also should deal with other matters directly related to the landlord's consent. The sublandlord should agree promptly, or within a specified time period after execution and delivery of the sublease, to submit the request for consent and any required information to the landlord. The subtenant should agree to cooperate with the sublandlord's effort to obtain the landlord's consent. The sublease should also state which party will bear costs incurred in obtaining the landlord's consent (potentially subject to a cap). If the subtenant has identified problems regarding particular provisions of the lease, the subtenant may want to insist that the landlord's consent contain certain additional consents or assurances. Such consents and assurances may include the landlord's consent to the subtenant's anticipated use of the subleased premises, if different from that permitted by the direct lease; consent to the subtenant's initial alterations; the number of listings for the subtenant on the building directory; and a landlord waiver of subrogation for the benefit of the subtenant and rights similar to those of the tenant regarding future assignments or subletting. This last point may be particularly important because many direct leases do not permit any further assignments or sublettings. If the subtenant wants nondisturbance or recognition protections, the sublease should be conditioned upon delivery of those documents.

⁴⁶ See *supra* note 1; see also Murray S. Levin, *Withholding Consent to Assignment: The Changing Rights of the Commercial Landlord*, 30 DePaul L. Rev. 109 (1980).

[29.20] IV. CONCLUSION

Subleases are deceptive. They seem much easier to negotiate because the landlord and tenant have completed much of the work in negotiating the direct lease. But because the sublease is a hybrid, the subtenant and counsel face many issues that are more complex than they appear at first blush.

A sublease transaction has all of the traditional elements of a direct lease transaction, but it is different because of the two boxes of rights that the parties must evaluate, interconnect, and make work.

EXHIBIT A**DUE DILIGENCE FOR THE SUBLEASE TRANSACTION**

Unlike the typical leasing transaction in which the landlord and tenant are free to define their relationship, a sublease transaction requires a subtenant to step into a “relationship in progress.” The subtenant and counsel need to ask many important questions about the relationship in progress. Not only must the subtenant decide if the proposed deal is affordable and suitable, but the subtenant must also understand what has already occurred in the existing landlord-tenant relationship and how that history will affect the subtenant.

The following due diligence checklist attempts to cover only issues that are unique to a sublease transaction.

The starting point in all instances is the direct lease and all identified amendments and modifications. These documents ultimately are the starting point for examining the box of rights and obligations between the landlord and the tenant from which the box of rights and obligations between the tenant and the subtenant derives. Obviously, the size of the subleasing transaction affects the appropriate level of scrutiny. It is not unusual for the sublandlord to redact specific economic provisions of the direct lease (such as rent, free rent periods or work allowances, as examples). In larger, more significant subleasing transactions, sensitivity to these due diligence items allows the practitioner to advise the subtenant appropriately about hidden risks, costs, and benefits. Next, the prospective subtenant must examine all communications between the landlord and the tenant under the lease. Finally, the prospective subtenant must examine any actions the tenant has taken already with respect to the leased space.

Underlying Lease

- a. Identify the lease document.
- b. Have the parties amended the lease document?
- c. Do any of the following agreements operate as amendments?
 - i. Estoppel Certificates
 - ii. Consents to Subletting or Assignment

- iii. Commencement Date Agreement
 - iv. Exercise or Waiver of Option, Renewal, or Expansion Rights
 - v. Subordination, Nondisturbance, and Attornment Agreements
 - vi. Recognition Agreements
 - vii. Alteration Agreements
 - viii. Consent to Alterations (With or Without a Waiver of Restoration Obligation)
- d. Do collateral documents exist that bind the tenant or subtenant?
- i. Rules and Regulations (Have they been amended?)
 - ii. Construction Rules
 - iii. Overtime or Supplemental Service Rate Schedules
 - (a) Freight Elevators
 - (b) Building HVAC
 - (c) Supplemental HVAC/Condenser Water
 - (d) Security Services
 - iv. List of Approved Contractors and of Required Insureds
 - v. Approval of Signage
 - vi. Default Notices
 - vii. Miscellaneous Notices
 - viii. Condominium documents if the premises are in a commercial condominium unit.
- e. Have any documents changed the relationship between the landlord and the tenant that might affect the subtenant?
- i. Escalation or Additional Rent Statements

- ii. Taxes
 - (a) Review underlying real estate tax bill.
 - (b) Note changes in actual base year taxes as a result of tax protest proceedings.
 - (c) Confirm whether the building is subject to tax abatements being phased out over time.
- iii. Operating Expenses Statements
- iv. Cleaning Charges
- v. CPI Calculations
- vi. CAM Calculations
- vii. Percentage Rent Calculations
- viii. Electricity: Electrical Surveys or Notices of Rate Increases
- ix. Settlement Agreements Regarding Disputed Items
- x. Other Issues
 - (a) Has the landlord transferred its interest and, if so, has the new landlord assumed the obligations, and has the old landlord been released?
 - (b) Are there pending disputes between the landlord and tenant?
 - (c) Is the landlord bankrupt?
- f. Performance by the Landlord
 - i. Has the landlord completed all required construction?
 - ii. Has the landlord delivered any required evidence relating to removal or abatement of asbestos?
 - iii. Has the landlord delivered all required governmental approvals, e.g., Certificate of Occupancy?

- iv. Confirm financial responsibility for compliance with laws, including those relating to the upgrading of fire protection systems (New York City).

- g. Tenant's Actions
 - i. Construction and Alterations
 - (a) Plans and Specifications for Build-out or Alterations
 - (i) As-builts
 - (ii) Schematics
 - (1) Wiring: Telephone, Fiber Optic, Computer Cable
 - (2) HVAC
 - (3) Uninterruptible Power Supply
 - (4) Chases and Conduits
 - (5) Trading Floor
 - (6) Cafeteria, Dining Room, or Other Special Uses
 - (b) Licenses and Approvals for Build-out, Including Asbestos Abatement and Special Use Permits
 - (c) Architect's Contract for Build-out or Alterations
 - (d) Construction Contracts for Build-out or Alterations
 - (e) Guarantees and Warranties for Improvements and Systems
 - ii. Service Contracts
 - (a) Cleaning Contract
 - (b) Systems Maintenance Contracts
 - (i) Mechanical Equipment
 - (ii) Uninterruptible Power Supply

- (iii) Supplemental HVAC
 - (iv) Telecommunications
 - (1) Fixed Systems
 - (2) Satellite
 - (3) Video Conferencing
 - (4) Cabling from Premises to Rooftop
- iii. Insurance Certificates
- iv. Violation Notices Received by the Tenant
- v. Previous Subleases Entered Into by the Tenant
- vi. Correspondence Between the Tenant and the Landlord
- vii. Liens Caused by the Tenant
- viii. Does the transaction include equipment (e.g., telephones, computers) or furniture? If so, review purchase orders and leasing agreements and prepare schedule of included items.

EXHIBIT B**ENFORCEMENT OF RIGHTS AGAINST LANDLORD**

If Landlord defaults in any obligation to Sublandlord regarding the Subleased Premises, then Sublandlord shall not, except as and to the extent set forth in this paragraph, be obligated to bring any action or proceeding or to take any other steps to enforce Sublandlord's rights against Landlord. Sublandlord shall cooperate, at no cost to Sublandlord, in seeking to obtain Landlord's performance under the Lease. Upon Subtenant's written request, Sublandlord shall make written demand upon Landlord to perform Landlord's obligations regarding the Subleased Premises. If, after Subtenant makes such demand, Landlord's grace period under the Lease expires and Landlord fails to perform Landlord's obligations under the Lease, then Subtenant shall have the right to proceed against Landlord in Subtenant's own name. All rights of Sublandlord under the Lease necessary for that purpose shall be, and hereby are, conferred upon and transferred to Subtenant. Subtenant shall be subrogated to such rights to the extent that they apply to the Subleased Premises. If Subtenant cannot proceed against Landlord in Subtenant's name because of lack of privity, non-assignability, or any other reason, Subtenant shall have the right, at its sole cost and expense, to proceed against Landlord in Sublandlord's name, provided Subtenant is not in default under this Sublease beyond any applicable notice or grace period. Sublandlord shall execute all documents and take all actions that Subtenant reasonably requests in connection therewith. To the extent that the Lease allows Sublandlord to exercise "self-help" rights and a reasonable basis exists for Subtenant to request that Sublandlord exercise such rights with respect to the Subleased Premises, Sublandlord shall exercise such rights for Subtenant's benefit. To the extent that, as a result of Landlord's default under the Lease affecting the Subleased Premises, Sublandlord recovers any sum from Landlord or is entitled to any abatement, credit, set-off, or offset, such recovery, abatement, credit, set-off, or offset, or the benefit thereof, shall belong exclusively to Subtenant.

EXHIBIT C
COOPERATION CLAUSE—GENERAL

Sublandlord shall use reasonable efforts to cooperate with Subtenant in (i) obtaining for Subtenant: (a) additional services requested by Subtenant under the Lease (as incorporated into this Sublease) and this Sublease; (b) any benefit to Sublandlord relating to the Subleased Premises under the Lease that would directly benefit Subtenant, including without limitation any dispute rights regarding operating expenses, real estate taxes, other escalations, or electricity payments as set forth in the Lease; and (c) Landlord's consent to any action for which the Lease (as incorporated into this Sublease) requires Landlord's consent, and (ii) delivering any notice to Landlord as required by any provision of the Lease (as incorporated into this Sublease) including, without limitation, promptly forwarding any request made by Subtenant to Landlord for services, or consent or approval, and providing Landlord with all information required (or that Landlord may reasonably request) regarding any such request. If Landlord consents to any matter that requires Landlord's consent under the Lease, then Sublandlord shall automatically be deemed to have given such consent under this Sublease, except for approvals and consents relating to Alterations (other than items for which neither Landlord's nor Sublandlord's consent shall be required). If Landlord grants any consent requested by Subtenant regarding Approvals, then Sublandlord shall not unreasonably withhold or delay consent or approval with respect thereto.

CHAPTER THIRTY

MODEL OFFICE SUBLEASE

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This Model Office Sublease is intended for simple and casual subleases of excess office space, typically in New York City. It is not appropriate for long-term or development-related subleases or subleases that contemplate major improvements. With changes, this Sublease can easily be used for retail or other space. The first version of this Model Office Sublease (much shorter) was prepared in 1992 or 1993. It was the first substantial model document that Joshua Stein ever prepared. It has been updated (and, unfortunately, complexified) over the decades since. It has also been joined by hundreds of other model documents prepared by Joshua Stein.

This Model Office Sublease starts from Sublandlord's perspective, but assumes all parties want to avoid protracted negotiations. Hence the model is partly prenegotiated. It includes protections that a Subtenant would often request, but a Sublandlord could choose to delete, especially in a first draft. Sublandlord's counsel will typically prepare the first draft of any Sublease, but will often propose a reasonable and balanced document because: (i) Sublandlord usually needs Subtenant more than the converse; (ii) every day of negotiations costs Sublandlord lost Subrent, with a dollar value that can exceed the value of whatever issues drive the parties' negotiations (this is also true with direct lease negotiations but to a landlord it's part of the ordinary course of business); (iii) Sublandlord is not in the real estate business and regards the entire exercise as a headache rather than offering any form of opportunity; and (iv) the issues are relatively narrow though not always simple.

In using this Model Office Sublease, consider these points:

1. SUBRENT AND ESCALATIONS

Focus special care on the definition of Subrent and the allocation of escalations, particularly defining the base years and any later adjustments that might affect those years. The provisions in this model reflect only one of many possible business deals. They must be fully thought through and edited for every transaction. Sublandlord may intuitively expect that Subtenant will pay a "fair share" of tax escalations. That would typically not be true, as the Sublease will have a new tax base. Sublandlord's counsel must make sure Sublandlord understands what that means, i.e., the fact that Subtenant won't contribute much to real estate taxes at the beginning.

2. TECHNICAL DETAILS

Read the entire Overlease, including all amendments and any other document that may have modified the Sublease. Add correct Section ref-

ferences in the Sublease. Confirm that the Sublease defines all terms it uses (or properly refers to the Overlease for definitions), particularly “Sublandlord’s Rent.”

3. EXCLUDED ISSUES

This Model Office Sublease does not fully consider these issues, except through selective and limited incorporation from the Overlease:

- 3.1. *Bankruptcy*. Effect of Overlandlord’s bankruptcy, including control over rejection, control of proceedings, allocation of damages, etc.
- 3.2. *Delivery*. Any delay or failure in delivery of the Subpremises.
- 3.3. *Financial Statements*. Obligation for either Sublandlord or Subtenant to deliver periodic financial statements. Subtenant is at least as concerned about Sublandlord’s credit as Sublandlord is about Subtenant’s.
- 3.4. *Fixturation*. Required fixturation by Sublandlord or Subtenant. If the parties plan any fixturation, they must substantially expand the Sublease to deal with, e.g., plan development and construction approvals. Optional language toward the end of the Sublease offers some possibilities.
- 3.5. *Nondisturbance*. Nondisturbance or recognition agreements from mortgagees or Overlandlord.
- 3.6. *Time Limits*. Shortening and lengthening of Overlease time limits to preserve Sublandlord flexibility (common but probably more trouble than it’s worth).

4. ADDITIONAL POINTS

Checklist of points to consider:

- 4.1. *Use*. The “use” clause should permit Subtenant’s use. If any issue or concern exists, the Sublease should: (i) say that notwithstanding anything in the Overlease, as incorporated by reference, Subtenant may conduct its intended use; and (ii) Overlandlord’s Consent must also include a consent to Subtenant’s intended use or a confirmation that it complies with the Overlease.

- 4.2. *Partial Premises.* If the Subpremises consist of only part of Sublandlord's Premises, consider issues regarding demising of the space. If the Subpremises will be separately demised, who pays for that? Does treating the Subpremises as a separate occupancy raise any code or practical issues (e.g., access, reception arrangements, signage)? If the Subpremises will not be separately demised, confirm this is legally permissible. Also, consider co-existence issues, e.g., no loud construction work in business hours, administration of mail, office services, preservation of confidentiality, general rules. From Sublandlord's viewpoint, perhaps the Sublease can just allow Sublandlord to establish rules and procedures for these matters and Subtenant should agree to comply with them.
- 4.3. *Comparison.* Review the Overlease to confirm that Sublandlord is not promising Subtenant anything that Sublandlord cannot deliver or greater rights than Sublandlord possesses under the Overlease. The desire to prevent such a disconnect drives the use of a Sublease format that largely incorporates the Overlease by reference, as opposed to a Sublease that is a standalone and independent document. In reviewing the Overlease, also identify any requirements relating to the Sublease or possible issues any Sublease needs to address.
- 4.4. *Nonrecourse?* This Sublease does not contain language that would: (i) limit Sublandlord's liability to Sublandlord's interest in the Overlease; (ii) terminate the Sublease automatically if the Overlease terminates; or (iii) terminate all liability of Sublandlord if Sublandlord assigns the Overlease and the assignee assumes it. Nonrecourse clauses of this type typically do not make sense in a Sublease, where the value of the Overlease is probably negative. A Subtenant should insist that: (a) Sublandlord commits to preserve the Overlease and hence the Sublease; and (b) Sublandlord's general credit backs that obligation. In addition to rejecting any nonrecourse clauses in the Sublease, a Subtenant should also check the Overlease provisions incorporated by reference into the Sublease. Do they include a nonrecourse clause that would benefit Sublandlord? Conversely, is Sublandlord creditworthy and likely to pay its rent to Overlandlord?

If the parties do intend to give Sublandlord nonrecourse protections, Sublandlord should beware of case law that uses the "implied covenant of good faith and fair dealing" to let Subtenant assert personal liability against Sublandlord.¹

- 4.5. *Special Provisions.* The last section of this Sublease, before signatures, offers language to cover many special agreements often included in any Sublease, relating to such matters as occupancy, Alterations, FF&E, and other practicalities. Before writing any such provisions, take a look at the language offered here.
- 4.6. *End of Term.* When the Overlease and Sublease end, who is responsible for complying with any obligations that arise at the end of the Overlease term?
- 4.7. *Guaranty.* This Sublease contemplates use of a guaranty. The guaranty could cover all Subtenant's obligations or just Subtenant's obligations until Subtenant surrenders possession (a "good-guy guaranty"). In the context of a Sublease, however, a good-guy guaranty may not work that well. All it does is assure that Subtenant will move out if Subtenant defaults, but at that point Sublandlord would still need to find a new Subtenant – which would potentially be quite difficult given the Sublandlord's limited timeline. In contrast, a good-guy guaranty works better for a typical landlord, who can then relet the premises for whatever term makes the most business sense. Sublandlord doesn't have that flexibility. In other words, just because a good-guy guaranty may be industry standard, that doesn't mean it makes sense for a Sublease. Sublandlord should try to do better, though the market may not allow that. Delete all references to a guaranty if none exists.
- 4.8. *Other Issues.* Subleases raise many issues, both: (i) all the same issues as leases²; and (ii) many issues unique to subleases. As a result, subleases can in some ways be more complex than direct leases, just as a sale of a mortgage loan can be more complicated than a sale of the real property that secures it. Anyone drafting or negotiating a Sublease may wish to consider the full range of these issues, although at a certain point these issues invite overthinking and verge on a discussion of philosophy rather than practical relationships and what really happens in the real world.

1 See Joshua Stein, *The Perils of Subtenancy: A Roadmap for Recourse When the Sublandlord Defaults Under the Prime Lease; and Some Lessons for Nonrecourse Financing*, 22 ICSC Shopping Center Legal Update, No. 2, at 10 (Summer 2002) (discussing *Tapps of Nassau Supermarkets, Inc. v. Linden Boulevard L.P.*, 704 N.Y.S.2d 27 [Sup. Ct. App. Div. 2000]); *The Perils of Subtenancy and a Roadmap for Recourse When the Sublandlord Defaults Under the Prime Lease*, Retail Law Strategist, April 2002, at 4 (shorter version of same article).

2 As summarized, for example, in the silent lease issues checklists co-authored by Joshua Stein and S.H. Spencer Compton.

4.9 *Holdover*. If Subtenant holds over in even a small part of the space, Overlandlord can treat this as Sublandlord's holdover in the entire Sublandlord's Premises under the Overlease, with attendant hold-over rent penalties. Counsel should assure that Sublandlord understands that risk and the resulting need to have a creditworthy and responsible Subtenant. Sublandlord could mitigate that risk by ending the Sublease term more than a day before the end of the Overlease term, or by requiring Subtenant to deliver an extra security deposit, to assure timely departure, a few months before the end of the Sublease term.

4.10. *Rights of Overlandlord*. Overlandlords have been known to claim they are third-party beneficiaries under Subleases, although they disclaim any liability or obligation. Based on this theory, Overlandlords have been known to assert that if Sublandlord and Subtenant agree to terminate a Sublease, this violates Overlandlord's rights. Overlandlord may express the same concept in any consent to the Sublease. This Sublease contains language by which Sublandlord and Subtenant reserve the right to amend or terminate this Sublease, in an effort to defeat any such Overlandlord theories. Sublandlord and Subtenant should watch for any language in the Overlease or Overlandlord's consent that might be deemed to make Overlandlord a third-party beneficiary, hence having the right to prevent amendment or termination of the Sublease. The parties to the Sublease may want to push back on that. As a reasonable middle ground, the parties might reserve the right to terminate the Sublease but not the right to amend it.

5. OTHER DELIVERIES

For attachments, see the exhibits at the end of this chapter. Revise as necessary. Subtenant will want to see a copy of the Overlease. It is customary to redact economic terms in the Overlease before sending it to Subtenant. That redaction process sounds simple. Once started, though, it must be done perfectly. Hence it incurs significant legal fees as well as delay. Sublandlord may reasonably decide to skip the redaction and let Subtenant see the whole Overlease.

6. SUBLEASE MECHANICS

The most difficult part of negotiating any Sublease will often relate to the various mechanical and logistical steps in transitioning the Subpremises from Sublandlord to Subtenant, as opposed to negotiating the Sub-

lease. These steps and issues include: (i) defining the space, typically in the form of a diagram for which no one wants responsibility; (ii) getting a copy of the entire Overlease and (if desired) redacting it to share it with Subtenant's counsel; (iii) defining what personal property goes to Subtenant and what personal property Sublandlord must remove; (iv) getting everything signed and the necessary checks written and delivered to the right place; (v) getting Overlandlord's attention for the required Overlandlord consent; (vi) getting a draft of Overlandlord's consent, which will often be egregious, and then negotiating it on behalf of both Sublandlord and Subtenant³; (vii) delivering the keys to the Subpremises; (viii) making sure Subtenant knows it has received possession and the keys; (viii) giving any required formal notices of delivery; and (ix) making sure Overlandlord's property management personnel realize Subtenant exists.

7. COMMENCEMENT DATE

Logistical concerns continue after signing the Sublease. If the Commencement Date is not the date of signing, what notices must Sublandlord give? Should the parties sign a Commencement Date letter? In practice, written notice of commencement sounds like a great idea and a simple thing to do. When the time actually comes, though, Sublandlord and its counsel – who are not in the property management business, after all – will either not remember, or take too long, to do it. Sublandlord's signer will probably be unavailable. Sublandlord may lose significant subrent as a result. Sublandlord's counsel would be well advised to prepare the Commencement Date notice when the parties sign the Sublease, with a blank for the actual Commencement Date, so Sublandlord will be able to issue the notice immediately when accurate. This also represents another reason to empower counsel to give notices on behalf of the parties they represent.

3 Ideally, Sublandlord will obtain that document early in the process so it can be fully resolved, and attached as an exhibit to the Sublease, during Sublease negotiations. Overlandlord might not cooperate, refusing to deal with the matter until Sublandlord and Subtenant have signed their Sublease.

OFFICE SUBLEASE⁴

between

_____, **Sublandlord**

and

_____, **Subtenant**

Signing Date: _____, 201____

For space located at

New York, New York _____

⁴ Neither a cover page nor a table of contents is essential.

OFFICE SUBLEASE

THIS OFFICE SUBLEASE (this “Sublease”) is entered into on _____, 201__ (the “Signing Date”) by _____, a _____ (“Sublandlord”); and _____, a _____ (“Subtenant”).⁵

Sublandlord and Subtenant enter into this Sublease based on these facts:

A. Sublandlord is tenant under one or more lease documents, as amended to date, all as described in **Exhibit A**, by and between _____ (with its predecessors and successors in interest, “Overlandlord”) and Sublandlord or its predecessor in interest (excluding any provisions redacted from the copy given to Subtenant, the “Overlease”).

B. In the Overlease, Overlandlord demised to Sublandlord the premises (“Sublandlord’s Premises”) identified as [part of]the _____ floor(s) of the building known as _____ (the “Building”), substantially as shown in **Exhibit B**.

C. Sublandlord wants to sublease to Subtenant, and Subtenant wants to sublease from Sublandlord, [part/all] of Sublandlord’s Premises ([that part,]the “Subpremises”), [consisting of _____ square feet on the _____ floor(s)], substantially as shown in **Exhibit B**.⁶

D. The part of Sublandlord’s Premises, if any, not constituting Subpremises is referred to as the “Reserved Premises.”

E. On the Signing Date, Subtenant is delivering to Sublandlord:

- A check, subject to collection, in the amount of \$_____ to be credited against the first Fixed Subrent due after the Abatement Period (the “Prepaid Fixed Subrent”);

5 To help prevent confusion and mistakes, consider replacing Sublandlord, Subtenant, and Overlandlord with short versions of the parties’ names, such as Jones, Smith, and Bialystok.

6 Subtenant may insist on mentioning square footage. If so, insert language like this: “and containing about _____ rentable square feet of Sublandlord’s Premises, which rentable square footage shall not be subject to survey, remeasurement, or adjustment.” Generally, any reference to square footage just invites trouble.

- A check, subject to collection, in the amount of \$_____, for Sublandlord to hold and apply as security for Subtenant's performance of its obligations under this Sublease (the "Security"); and
- A guaranty in the form of **Exhibit C** (the "Guaranty") signed by _____ (the "Guarantor").

F. This Sublease may use terms before defining them. An Index of Defined Terms follows the signatures.

NOW, THEREFORE, Sublandlord and Subtenant agree:

1. DEMISING OF SUBPREMISES; TERM

1.1 *Sublease of Subpremises.* Sublandlord subleases the Subpremises to Subtenant, and Subtenant subleases the Subpremises from Sublandlord, for the Term.

1.2 *Term.* The "Term" starts on the date (the "Commencement Date") that is the later of (i) _____, 201__ (the "Expected Commencement Date") and (ii) the date Sublandlord [delivers to Subtenant] [has obtained] Overlandlord's written consent to this Sublease, if Overlandlord or the Overlease requires that consent. Regardless of the Commencement Date, the Term expires on _____ (the "Expiration Date").⁷ Sublandlord shall promptly notify Subtenant of the Commencement Date after it occurs.⁸

1.3 *Overlandlord Consent and Effectiveness.* This Sublease shall be of no force or effect unless Overlandlord consents by executing either: (i) the "Consent of Overlandlord" at the end of this Sublease; or (ii) Overlandlord's standard sublease consent, if any, but only if it is unconditional (except requirements on Sublandlord or Subtenant signing) and irrevocable and does not (except as this paragraph or the Overlease already contemplates) require anyone to make a payment or assume any obligation (the "Standard Overlandlord Consent"). The Standard Overlandlord Con-

⁷ Most subleases expire one day before the Overlease. But it could be one hour or one minute before. Subleases usually do not have extension or renewal options. In the rare case where one arises, edit accordingly.

⁸ Subtenant may seek prior notice of the Commencement Date, or set conditions or documentary requirements for it, e.g., delivery of a copy of Overlandlord's consent. These will just delay the Commencement Date and hence cost Sublandlord money. Often, especially if Subtenant plans to do any Alterations, Subtenant will be "not quite ready" to take the space when Sublandlord delivers it, so Subtenant will happily delay commencement of Subrent. If Sublandlord agrees the Commencement Date will occur only when Sublandlord has given Subtenant a copy of Overlandlord's consent, then delete this sentence to avoid any requirement for double notices.

sent may restrict Transfer of this Sublease. Subtenant shall be bound by that restriction. Sublandlord shall promptly submit this fully executed Sublease to Overlandlord for Overlandlord's consent. Sublandlord shall exercise reasonable efforts to obtain that consent but need not make any unreimbursed payments to obtain it, except nominal application fees and processing fees; reasonable attorneys' fees; and any payments that the Overlease expressly requires Sublandlord to make, when and as due. If Sublandlord receives Overlandlord's consent, then Sublandlord shall promptly give Subtenant a copy of it. If Overlandlord does not consent to this Sublease within __ days after the Signing Date, then this Sublease shall automatically be of no force or effect and neither party shall have any more rights or obligations under it. Sublandlord and Subtenant shall each promptly sign the Standard Overlandlord Consent if required by its terms. Notwithstanding anything else in this Sublease, Subtenant shall not enter into possession of the Subpremises, and no Commencement Date shall occur, unless Overlandlord consents to this Sublease. Nothing in this paragraph expands Overlandlord's right to withhold consent to this Sublease beyond Overlandlord's rights under the Overlease.

1.4 *Commencement Date Agreement.* After the Commencement Date, at either party's request, the parties shall promptly execute, acknowledge, and exchange a document, in substantially the form of **Exhibit D**, stating the Commencement Date and the Subrent Commencement Date, and updating the Fixed Subrent Schedule if the actual Commencement Date is later than the Expected Commencement Date.

2. SUBRENT

Subtenant shall pay Sublandlord rent under this Sublease (the "Subrent") in these amounts at these times, prorated daily for partial periods:

2.1 *Fixed Subrent.* Except in any Abatement Period, Subtenant shall pay Sublandlord "Fixed Subrent" for the Subpremises for each period in the Term in the amounts shown on the Fixed Subrent Schedule below. If the Commencement Date occurs later than the Expected Commencement Date, then the parties shall by written agreement update the Fixed Subrent Schedule, so the first "Start Date" for Fixed Subrent matches the actual Commencement Date and all other dates (except the Expiration Date) are extended by the same amount of time. The "Fixed Subrent Schedule" is as follows:

Start Date	End Date	Annual	Monthly

2.2 *Fixed Subrent Abatement.* The “Abatement Period” means the period from the Commencement Date until the earlier of (i) _____, 201__⁹; and (ii) the date when Sublandlord gives Subtenant an accurate written notice of a monetary or other material default under this Sublease. Fixed Subrent otherwise payable in the Abatement Period shall be entirely abated. The Abatement Period shall have no effect on any other obligation of Subtenant under this Sublease.¹⁰ Beginning on the day after the Abatement Period (the “Subrent Commencement Date”), Fixed Subrent shall begin to accrue and Subtenant shall start to pay Fixed Subrent as this Sublease provides.

2.3 *CPI Increases.* On _____ of each year, annual Fixed Subrent (before giving effect to any Abatement Period) shall be adjusted as described in Overlease Section _____, using as [the Base Year] calendar year 201__.¹¹ Sublandlord shall calculate that adjustment using Overlandlord’s statements of the [Price Index] under Overlease Section __. Sublandlord shall promptly give Subtenant copies of those statements, deleting dollar figures for Sublandlord’s Rent. If Overlandlord fails to provide those statements in a timely manner satisfactory to Sublandlord, then Sublandlord shall obtain similar information from other reliable sources, and adjusted Fixed Rent accordingly.¹²

9 Sublandlord prefers a fixed date to try to incentivize Subtenant to limit and speed up negotiations. More often the Abatement Period will end a certain number of days or months after the Commencement Date.

10 Consider adding this language, largely of theoretical value only: “If Sublandlord terminates this Sublease or re-enters the Subpremises because of Tenant’s default, then Subtenant shall pay Sublandlord an amount equal to the Fixed Subrent that would have been due but for the Abatement Period, in addition to any other amounts Sublandlord can recover.” In the unlikely event that Subtenant pays all damages due for the Sublease termination, Sublandlord is not really entitled to this payment and should be willing to excuse it.

11 The CPI formula in the Overlease can sound right but be wrong. This happens with some regularity. Scrutinize the formula and confirm it works.

12 This paragraph is optional.

2.4 *Timing of Fixed Subrent Payments.* Subtenant shall pay Fixed Subrent in advance, subject to any Abatement Period and credit for Pre-paid Fixed Subrent: (i) for the first full calendar month of the Term, on the Signing Date, (ii) for the period from the Subrent Commencement Date to the end of that month, on the Subrent Commencement Date; and (iii) for the second full calendar month of the Term and for each following month of the remaining Term, on the first day of that month. Subtenant shall make those payments without notice, demand, abatement, deduction, counterclaim, or setoff. If the Subrent Commencement Date occurs on a day other than the first day of a calendar month or this Sublease expires or terminates on a day other than the last day of a calendar month, Sublandlord shall prorate Subrent (and any other obligation of Subtenant under this Sublease, including those incorporated by reference) daily.

2.5 *Additional Subrent.* Subtenant shall pay or reimburse Sublandlord, as “Additional Subrent,” an amount equal to (or, where indicated, part of) the payments described below, prorated for the Term. The parties shall try to have Overlandlord bill Subtenant directly for any Additional Subrent.¹³ If Subtenant’s failure to pay any direct bill from Overlandlord causes Sublandlord any liability or loss, then Subtenant shall indemnify Sublandlord regarding that liability or loss, including payment of reasonable attorneys’ fees. To the extent that Overlandlord does not directly bill for any Additional Subrent, Sublandlord shall deliver to Subtenant an invoice with reasonably detailed supporting documentation, including any available invoices from Overlandlord and the date that Sublandlord’s payment is due to Overlandlord. Subtenant shall pay Sublandlord that Additional Subrent by the later of (i) 10 business days before Sublandlord’s payment is due to Overlandlord; and (ii) 15 days after delivery of that invoice. Sublandlord may require Subtenant to pay Additional Subrent during or after the Term. Sublandlord’s failure to render an invoice for, or collect, Additional Subrent shall not limit Subtenant’s obligations or prejudice Sublandlord’s right to bill later. This Section shall survive the expiration or earlier termination of this Sublease. Subtenant shall pay Additional Subrent to Sublandlord as follows:

2.5.1 *Escalations.* Subtenant shall pay an amount equal to Subtenant’s Contribution Share times Escalations. “Escalations” means any increases, only above Subtenant’s Base Year, in Sublandlord’s payments required under the Overlease arising from these matters: (i) taxes (Section

13 Overlandlord may prohibit direct communications with Subtenant. If so, edit throughout accordingly. In practice, once the lawyers are no longer involved, those direct communications often happen anyway because they make sense.

_____); (ii) operating expenses (Section _____); (ii) porter's wage increases (Section _____); and (iii) any other passthroughs of Overlandlord's costs or similar escalations provided for under Overlease Section _____.

2.5.2 *Base Years and Shares.* Subtenant's "Base Year" for measuring each Escalation means the fiscal year(s) under the Overlease (e.g., tax year, operating year, etc.) that includes the [Signing Date] [first] [last] day [of the calendar year in which the Signing Date occurs]. Subtenant's "Contribution Share" means ___%.¹⁴

2.5.3 *Electricity*¹⁵ Subtenant shall pay an amount per annum, in equal monthly installments, equal to the product of (i) Subtenant's Contribution Share times (ii) the Electricity Rent Inclusion Factor ("ERIF") in force from time to time under the Overlease. If Overlandlord converts to submetering, then Sublandlord shall reasonably allocate Landlord's electricity and related charges between the Subpremises and any Reserved Premises. Subtenant shall pay the charges so allocated to the Subpremises. Sublandlord shall pay, without contribution by Subtenant, the charges allocated to the Reserved Premises.

2.5.4 *Electricity.* Subtenant shall pay the sum of \$_____ per annum ("Electricity Reimbursement"), in equal monthly installments. That sum equals the product of (i) _____, the rentable square footage of the Subpremises times (ii) Subtenant's estimated electrical consumption of \$_____ per rentable square foot. The Electricity Reimbursement is intended to reimburse Sublandlord for the actual cost of Subtenant's electricity consumption. Either Sublandlord or Subtenant may, at any time, request that a survey of electrical consumption be performed by an electrical consultant, whose fees the parties shall split. Based on that survey, Sublandlord shall reasonably recalculate Subtenant's Electricity Reimbursement. That recalculation shall be effective prospectively and for six months retroactively. The parties shall make appropriate adjusting payments. Notwithstanding anything else in this paragraph, Subtenant may not claim any offset or reduction against Fixed Subrent or Additional Subrent (except later Electricity Reimbursements)

14 This equals the square footage of the Subpremises divided by the square footage of Sublandlord's Premises. One would not want to express that formula in the Sublease. One should just do the math and fill in the percentage.

15 Delete whichever "electricity" clause does not apply. As another alternative, Subtenant could agree to pay the Contribution Share of Sublandlord's electricity bill.

because of any recalculation of Subtenant's Electricity Reimbursement under this paragraph.

2.5.5 *Electricity.* The parties acknowledge that a properly operating submeter or direct meter serves Sublandlord's Premises. Sublandlord shall [reasonably] allocate [based on Subtenant's Contribution Share] Sublandlord's electricity and related charges between the Subpremises and any Reserved Premises. Subtenant shall pay the charges allocated to the Subpremises. Sublandlord shall pay, without contribution from Subtenant, the charges allocated to the Reserved Premises.

2.5.6 *Other Payments.* To the extent the Overlease requires any payment for both the Subpremises and any Reserved Premises, Sublandlord shall allocate it[in accordance with Subtenant's Contribution Share or] in an equitable manner as Sublandlord determines, consistently applied]. Sublandlord and Subtenant shall each pay its share accordingly.

2.6 *Other Overlease Charges.* "Additional Subrent" excludes, and Sublandlord shall pay, all charges of Overlandlord to the extent they arise from: (i) goods or services provided or work performed for Sublandlord's benefit; (ii) Sublandlord's acts or omissions, including the nature of Sublandlord's use of the Reserved Premises and Sublandlord's breach of the Overlease; (iii) entering into this Sublease; and (iv) items payable by Sublandlord under this Sublease. Subtenant shall pay any charges under the Overlease arising from work performed at its request or arising from its acts or omissions, including its breach of this Sublease.

2.7 *Payment.* Subtenant shall pay Subrent and all other amounts to Sublandlord in lawful money of the United States as Sublandlord instructs from time to time by notice to Subtenant. Sublandlord may require Subtenant to pay Subrent by wire transfer.¹⁶ No payment by Subtenant or receipt by Sublandlord of any lesser amount than the amount this Sublease requires Subtenant to pay shall be deemed other than on account of Subrent and other amounts payable by Subtenant (in the order as Sublandlord determines). No endorsement or statement on any check or letter shall be deemed an accord and satisfaction. Sublandlord may accept any check or payment without prejudice to Sublandlord's right to recover the balance due or to pursue any other remedy. Subtenant shall make all payments without notice, demand, abatement, deduction, counterclaim or setoff.

¹⁶ If Sublandlord intends to do this, it saves trouble and delays later to specify Sublandlord's wire transfer address in the Sublease.

3. SUBLETTING COVENANTS

3.1 *Incorporation of Overlease.* Except where this Sublease states otherwise, or, where the context so requires, otherwise inapplicable or inconsistent to effectuate the parties' intent: (i) this Sublease incorporates by reference all agreements, conditions, covenants, obligations, provisions, remedies, rights, stipulations, and other terms in the Overlease, as if completely repeated in this Sublease (the "Overlease Provisions"); (ii) every Overlease Provision that binds or benefits Overlandlord shall, for this Sublease, bind or benefit Sublandlord; and (iii) every Overlease Provision that binds or benefits Sublandlord (as tenant under the Overlease) shall, for this Sublease, bind or benefit Subtenant. Notwithstanding the previous sentence, the Overlease Provisions shall be subject to these exclusions, exceptions, and additional agreements:

3.1.1 *Defined Terms in Overlease.* Wherever the Overlease refers to a term in the left column of the following table, this Sublease shall be deemed to refer to the term in the right column of the table. All other defined terms in the Overlease shall be deemed appropriately modified[, as necessary in Sublandlord's reasonable judgment,] to reflect the circumstances of this Sublease. To the extent this Sublease defines any term used in the Overlease Provisions and varies from the Overlease Provisions, that definition replaces the Overlease definition. Capitalized terms used in this Sublease and not otherwise defined in or excluded from this Sublease shall have the same meanings they have in the Overlease, as modified in this Sublease, including these modifications (unless the context indicates that a modification should not be made or a modification would have an illogical effect on the provision modified):

Each Reference to:	Shall be Deemed Replaced by a Reference to:
Additional Rent	Additional Subrent
Base Year	Subtenant's Base Year
Expiration Date	Expiration Date under this Sublease
Lease	This Sublease
Landlord	Sublandlord
Sublandlord's Premises	Subpremises only
Sublandlord's Rent	Subrent

MODEL OFFICE SUBLEASE

Tenant	Subtenant
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3.1.2 *Exclusions.* Notwithstanding anything else in this Sublease, this Sublease does not incorporate by reference these Overlease Provisions:¹⁷

3.1.2.1 *Definitions.* These terms defined in the Overlease, and all references in the Overlease Provisions to these terms: _____, _____, _____ and _____.

3.1.2.2 *Certain Items.* These Articles, Sections, and Exhibits of the Overlease: _____; _____; _____; and _____.

3.1.2.1 *Additional Matters.* All references in the Overlease Provisions to these matters. (These are just examples. Tailor as appropriate).

Section	Subject
Throughout	Addresses of parties
	Brokerage
	Conditions to effectiveness of Overlease
	Limitation of Overlandlord’s liability
	Memorandum of Lease
	Nondisturbance by holders of senior estates
	Overlandlord’s and Sublandlord’s initial fixturation, including development of plans and specifications, and any payments by Overlandlord or Sublandlord for that work (but the general Overlease Provisions on alterations are incorporated by reference)

17 One can identify specific terms, or depending on circumstances refer generically to, e.g.: “any provisions on rights of renewal and extension, expansion, contraction, termination and partial termination, first refusal and first offer, security deposits, signage, rights to any name or intellectual property of Overlandlord or Sublandlord, rights to restrict Overlandlord from naming or leasing space in any structure, rights to place exterior antennas, parking rights, rights to lease storage space, dumbwaiter rights, roof rights, generator rights, interconnecting stairwell rights, tenant improvement or other allowances, obligation of Overlandlord or Sublandlord to construct improvements, rent abatements or “free rent periods,” rights to arbitrate rent, to audit or review Operating Costs, to apply for or to demand filing of tax abatements, or to exercise self-help remedies.”

	Overlandlord's consent to any assignment, subletting, or other transfer of the Overlease or any interest in it
	Overlease Term
	Rentable square footage of Sublandlord's Premises
	Representation or warranties by Overlandlord
	Sublandlord's free rent or rent abatement
	Sublandlord's options, if any, including options to extend or cancel the Overlease or expand Sublandlord's Premises
	Sublandlord's rent
	Sublandlord's security deposit or letter of credit, if any, delivered to Overlandlord, unless this Sublease expressly requires a similar delivery by Subtenant, in which case this Sublease shall govern the amount and the Overlease Provisions shall govern administration
	Sublandlord's repair and maintenance obligations, including any obligation to maintain and repair structural and nonstructural parts of the Building and common areas

3.1.2.2 *Other.* This Sublease does not incorporate by reference any other terms of the Overlease that, by their nature or purpose, are [in Sublandlord's reasonable judgment] inapplicable or inappropriate to the subleasing of the Subpremises.

3.1.3 *Interaction of Sublease and Overlease.* Wherever this Sublease conflicts with an incorporated Overlease Provision, this Sublease governs. Wherever reasonably possible, those conflicts shall be resolved by treating Subtenant's obligations as cumulative. Any reference in this Sublease to a section in the Overlease refers to that section in the oldest document listed in **Exhibit A** containing such a section, as modified by later documents listed in **Exhibit A**.

3.2 *Compliance with Overlease.* Subtenant agrees, solely for Sublandlord, to be bound by, and to fully comply with all obligations of Sublandlord under the Overlease (to the extent incorporated by reference into this Sublease), except those obligations this Sublease requires Subland-

lord to perform, such as payment of Sublandlord's Rent. Subtenant shall do nothing that violates the Overlease.

3.3 *Abatement Rights.* Subtenant may not assert against Sublandlord any right to abate rent under the Overlease. If, however, any such right becomes relevant for the Subpremises, then Sublandlord shall use reasonable efforts to pursue it. Subtenant shall be entitled to an abatement against Subrent equal to the lesser of (i) the dollar amount of abatement that Sublandlord actually obtains to the extent fairly allocable to the Subpremises, based on the circumstances or (ii) Subtenant's Subrent for the affected Subpremises for the abatement period.

3.4 *Payment of Sublandlord's Rent.* If Subtenant complies with its payment obligations (including payment of all Subrent when and as due) and material nonmonetary obligations under this Sublease, Sublandlord shall pay Overlandlord all rent the Overlease requires ("Sublandlord's Rent") within cure periods. This does not limit any express obligation of Subtenant to pay any amount.

3.5 *Rights and Benefits Under Overlease.* To the extent they apply to the Subpremises, Subtenant shall have all rights, privileges, and benefits of Sublandlord under the Overlease Provisions, to the extent Subtenant's exercise of those rights, privileges, and benefits does not violate the Overlease.

3.6 *Overlandlord's Performance.* Wherever the Overlease Provisions require delivery of any benefit or service that Overlandlord provides or require Overlandlord to perform any obligation, or to the extent Overlandlord agrees to provide Subtenant with any services beyond those this Sublease requires (all, collectively, "Overlandlord Services"), Subtenant shall receive Overlandlord Services directly from Overlandlord. Overlandlord Services could include additional cleaning; after-hours heating, ventilation, and air-conditioning; freight car service; and loading dock security services. Sublandlord shall have no liability to Subtenant, and Subtenant's obligations under this Sublease shall not be reduced, restricted, diminished, or deferred, if Sublandlord fails to provide any Overlandlord Service, unless both: (i) Subtenant is not in default under this Sublease; and (ii) Sublandlord's failure results from Sublandlord's default under the Overlease. Subtenant shall have no direct recourse against Overlandlord. Sublandlord shall, for Subtenant's benefit, on Subtenant's written request, diligently endeavor to enforce Overlandlord's obligations to provide Overlandlord Services. Subtenant shall indemnify Sublandlord for any costs associated with Subtenant's obtaining Overlandlord Services. If

Overlandlord refuses to deal directly with Subtenant for Overlandlord Services, then Sublandlord shall have no liability to Subtenant but shall without charge act as an intermediary in those communications. Subtenant shall reimburse all reasonable costs and expenses Sublandlord incurs in enforcing or attempting to enforce Overlandlord's obligation to provide Overlandlord Services, subject to equitable proration to the extent the claim also relates to Reserved Premises. Subtenant may not require Sublandlord to perform any obligation of Overlandlord under the Overlease or otherwise. Sublandlord shall have no responsibility for Overlandlord's failure to provide Overlandlord Services except as this Sublease expressly states.

3.7 *Preservation of Overlease.* So long as Subtenant is not in default beyond notice and cure periods, Sublandlord shall: (i) preserve the Overlease and keep it in full force and effect as it relates to the Subpremises; (ii) not agree to any Overlease amendment that would materially adversely affect Subtenant; (iii) not, without Subtenant's written consent, exercise any right to terminate the Overlease (including any right to treat it as terminated in any bankruptcy or insolvency proceeding of Overlandlord), except for casualty or condemnation; (iv) exercise any renewal options under the Overlease before the deadline, if the renewal term would include any part of the Term; and (v) perform all its obligations under the Overlease, except any contested in good faith. If Sublandlord enters into any Overlease amendment, then Sublandlord shall promptly give Subtenant a copy with terms that do not affect Subtenant deleted. The definition of "Overlease" shall be deemed modified accordingly. Sublandlord shall have the sole right to exercise any rights, privileges, and remedies under the Overlease.

3.8 *Sublandlord's Consent to Certain Matters.* Notwithstanding anything else in this Sublease or the Overlease, Subtenant must obtain Sublandlord's consent for each of these matters:

3.8.1 *Transfers.* Sublandlord's prior written consent shall be required, and Sublandlord may withhold its consent for any reason or no reason (or require payment as a condition to its consent),¹⁸ if Subtenant desires to subsublet any or all of the Subpremises, assign this Sublease, otherwise transfer or convey its estate in whole or in part, or allow anyone

18 For a large Sublease, Subtenant might ask Sublandlord to agree to: (a) withhold or condition its consent only to the extent Overlandlord may do so under the Overlease; and (b) automatically consent to any Transfer Overlandlord approved. Given Sublandlord's exposure to Transferee credit risks, Sublandlord should resist these requests.

except Subtenant to use or occupy any or all Subpremises (any of those, a “Transfer”). The term “Transfer” also includes any transaction (including a transfer of more than 50% of the direct or indirect ownership interests in Subtenant) that is in substance in whole or in part a transfer of this Sublease or would (if it involved Tenant rather than Subtenant) be deemed an assignment of the Lease (or require Overlandlord’s consent), under the Overlease. Any Transfer also requires Overlandlord’s approval to the extent the Overlease (or Overlandlord’s consent to this Sublease) requires. This paragraph supersedes any Overlease Provisions by which Overlandlord consents to any Transfer. Any Subtenant’s Transfer that violates this paragraph shall constitute a default and shall be void, conferring no rights on anyone. Subtenant shall pay Overlandlord any amounts the Overlease requires because of Subtenant’s Transfer.

3.8.2 *Alterations.* Subtenant shall make no material alteration, improvement, decoration, or other physical change (an “Alteration”) to the Subpremises without both: (a) Sublandlord’s written consent, not to be unreasonably withheld; and (b) Overlandlord’s approval to the extent the Overlease provides. Sublandlord may withhold its consent for any reason or no reason to: (i) any Alteration located in or visible from public areas on any floor that includes any Reserved Premises, except Subtenant’s reasonable business sign and logo, if it complies with the Overlease and is performed in a manner reasonably satisfactory to Sublandlord; or (ii) any Alteration that the Overlease would require Sublandlord to remove at the end of the Overlease unless Subtenant agrees in writing to remove it at the end of the Term (or earlier termination of this Sublease) and provides assurances of removal as Sublandlord reasonably requests.

3.9 *Overlandlord Consent.* Wherever the Overlease requires Overlandlord’s consent to anything (except Alterations, which are addressed separately), including any consent the Overlease Provisions would require if the matter arose under the Overlease, Subtenant shall obtain both Sublandlord’s and Overlandlord’s consent. [If Overlandlord consents to anything that needs Overlandlord’s consent but this Sublease does not otherwise mention, then Sublandlord shall not unreasonably withhold consent.]

3.10 *Expenses for Consent.* Whenever this Sublease requires Subtenant to obtain Sublandlord’s or Overlandlord’s consent, Subtenant shall promptly reimburse their reasonable expenses in reviewing that matter and granting or withholding consent, including reasonable fees of attorneys and other advisers.

3.11 *Overlandlord Notices.* Each party shall immediately give the other a copy of any notice from, or any other written communication with, Overlandlord, to the extent it both affects the other party and relates to any requested approval or consent, calculation of Subrent, an alleged default, or exercise of Overlandlord's remedies. [If the Overlease entitles Sublandlord to do so, then at Subtenant's request Sublandlord shall ask Overlandlord to simultaneously give Subtenant a copy of any notice to Sublandlord under the Overlease.]¹⁹

3.12 *Representations and Warranties.* Sublandlord represents and warrants: (i) Sublandlord has given Subtenant a full and correct copy of the Overlease, except any redacted provisions; (ii) the Overlease is the entire agreement between Overlandlord and Sublandlord on Sublandlord's Premises and is in full force and effect; (iii) neither Sublandlord nor Overlandlord is in default under the Overlease beyond applicable cure periods, and to Sublandlord's knowledge nothing has occurred that, with notice or passage of time, would constitute such a default; (iv) Sublandlord has completed and paid for any Alterations to the Subpremises for which Subtenant started on-site work; (v) no pending dispute or claim has been asserted in writing between Sublandlord and Overlandlord[, Sublandlord does not now intend to assert any such claim, and Sublandlord knows of no basis to do so]; and (vi) Sublandlord has not received written notice that any Alteration Sublandlord performed does not comply with the Overlease, law, or code. To the extent the Overlease Provisions include any representations and warranties: (a) Sublandlord confirms it has no actual knowledge of any material breach; and (b) if any such breach by Overlandlord occurs, then Subtenant shall have no claim against Sublandlord except to the extent of an equitable allocation of any resulting payment, settlement, or rent offset from Overlandlord. Subtenant represents and warrants that it has reviewed and is fully familiar with the Overlease and the Subpremises. Except as this Sublease states, neither party makes any representation or warranty on anything.

4. INTERACTION OF ESTATES; EFFECT ON OVERLANDLORD

4.1 *Priorities.* This Sublease is unconditionally subject and subordinate to: (i) the Overlease and all Overlease Provisions, as amended from time to time in compliance with this Sublease; and (ii) all present and future estates and interests to which the Overlease is expressly subject and subordinate, including any underlying ground leases and mortgages

¹⁹ Sublandlord might not like this idea.

affecting Overlandlord's estate, all as amended from time to time. If, under the Overlease, Overlandlord or its ground lessor(s) or mortgagee(s) request(s) additional documentation (in compliance with the Overlease) to confirm that subordination, then Subtenant shall promptly sign and acknowledge it.

4.2 *Attornment.* If the Overlease terminates and this Sublease otherwise remains in full force and effect, then Subtenant shall, at Overlandlord's option, attorn to and recognize Overlandlord as landlord under this Sublease (as Sublandlord and Subtenant may have amended it), and shall, promptly on Overlandlord's request, sign and deliver all instruments necessary or appropriate to confirm that attornment and recognition, all as the Overlease requires. If Subtenant's possession of the Subpremises is not disturbed and Overlandlord recognizes this Sublease, Subtenant waives any right to terminate this Sublease, surrender possession of the Subpremises, or assert any claim against Sublandlord because the Overlease terminates.

4.3 *No Effect on Overlease, Overlandlord.* Notwithstanding anything else in this Sublease, including Overlandlord's consent to this Sublease, unless and until an attornment occurs between Overlandlord and Subtenant: (i) Overlandlord shall have no obligations of any kind to Subtenant; (ii) the Overlease remains in full force and effect between Overlandlord and Sublandlord; and (iii) this Sublease does not create any privity or contractual or landlord-tenant relationship of any kind between Overlandlord and Subtenant.

4.4 *Overlease Termination.* If the Overlease terminates for any reason, then the Term shall automatically terminate one minute before that termination unless Overlandlord elects or agrees otherwise in writing. Sublandlord's and Subtenant's obligations under this Sublease shall automatically and immediately cease and terminate on any such expiration or earlier termination of the Term, but this shall not limit (i) either party's obligations and liability that accrued before termination, (ii) Subtenant's obligations to vacate the Subpremises and return the Subpremises to Sublandlord as this Sublease requires, or (iii) any obligations under this Sublease that expressly survive termination.

5. LEASING COVENANTS

5.1 *Beginning and End of Term.* Except to the extent, if any, that this Sublease states otherwise: (i) Subtenant accepts the Subpremises "as is" on the Signing Date (subject to reasonable wear and tear from then

through the Commencement Date) except that Sublandlord shall deliver the Subpremises to Subtenant, substantially as shown in **Exhibit B**, vacant and in broom clean condition on the Commencement Date; and (ii) Sublandlord need not perform any Alterations or space preparation for Subtenant. Subtenant shall return the Subpremises to Sublandlord in the same condition in which Subtenant received the Subpremises, subject to reasonable wear and tear. At Sublandlord's option, Subtenant shall also comply with all Overlease requirements on delivery of Sublandlord's Premises to Overlandlord at the expiration of the Overlease. [Notwithstanding anything else in this paragraph or in the Overlease, Subtenant need not remove or restore any Alteration installed with Sublandlord's consent or by Sublandlord, unless that removal or restoration was a condition to Sublandlord's consent or agreed on in writing.] [To the extent Subtenant performs any Alteration, whether or not material or Sublandlord consents to it, Subtenant shall on or before the Expiration Date restore the Subpremises to its condition at the Commencement Date, substantially as it existed when delivered to Subtenant, subject to normal wear and tear.] At the end of the Term Subtenant shall remove from the Subpremises all of Subtenant's furniture, belongings, personal property, trash, debris, and all other movable items of any kind and leave the Subpremises vacant and in broom clean condition and otherwise in the condition the Overlease Provisions require. To the extent Subtenant does not do that, Subtenant shall, on demand, reimburse Sublandlord for all costs and expenses of disposal and cleaning, including a reasonable allocation of Sublandlord's staff time. Subtenant's obligations under this paragraph shall survive the end of the Term.²⁰

5.2 *Holdover.* Subtenant shall have no right to hold over in the Subpremises for any reason. If Subtenant does not surrender the Subpremises when this Sublease expires or terminates, Subtenant shall be in default. In addition to any other rights or remedy Sublandlord may have for that default, Subtenant shall pay Sublandlord for each whole or partial month in which Subtenant holds over a sum equal to (i) [200%] _____% of the monthly Subrent payable in the last month of the Term; plus (ii) all Additional Subrent payable under this Sublease during that holdover period. This does not give Subtenant any right to hold over. Subtenant shall indemnify, defend, and hold harmless Sublandlord from and against any liability or loss caused by Subtenant's holdover or delay in surrendering

20 Subtenant should resist any obligation to deliver the Subpremises at the end of the Term in any condition better than vacant and broom-clean. Obligations going beyond that standard just cause potential disputes with no practical benefit to anyone, subject however to consideration of Sublandlord's end-of-term obligations under the Overlease.

the Subpremises, including any liability Sublandlord incurs: (a) to Overlandlord under the Overlease; or (b) to any succeeding person entitled to occupancy. If the Subpremises consists of only part of Sublandlord's Premises, Subtenant's holding over could make Sublandlord a holdover for all Sublandlord's Premises. Subtenant's indemnity obligations under this paragraph shall include and extend to all liability that Sublandlord incurs to Overlandlord as a result. Subtenant's obligations under this paragraph survive the expiration or termination of this Sublease.

5.3 *Quiet Enjoyment.* So long as Subtenant pays the Subrent and performs its obligations under this Sublease, within notice and cure periods, Subtenant shall peaceably have, hold, and enjoy the Subpremises in the Term, subject to the Overlease and this Sublease.

5.4 *Insurance.* Starting on the Commencement Date, Subtenant shall provide, for the Subpremises in the Term: (a) all insurance the Overlease Provisions require; and (b) whether or not the Overlease Provisions require it, \$_____ in combined single limit liability coverage for bodily injury and property damage, which number Sublandlord may reasonably increase from time to time for inflation. Subtenant shall give Sublandlord, as a condition to taking occupancy, and at least 10 days before expiration of each policy, certificates of that insurance. Those certificates shall: (i) designate Sublandlord and Overlandlord as additional insureds; and (ii) state that Subtenant's insurance will not be cancelled or terminated without 30 days' prior written notice to Sublandlord. [Sublandlord approves the proposed coverage stated in Subtenant's initial certificate of insurance attached as **Exhibit E.**] Sublandlord has no obligation to maintain insurance in the Term. If Sublandlord chooses to do so, it shall not benefit Subtenant. Subtenant's insurance shall be primary and Sublandlord's non-contributory. Subtenant shall also provide worker's compensation insurance as law requires, with waiver of subrogation for Sublandlord and Overlandlord.

5.5 *Indemnity.* Subject to any waiver of subrogation requirements in the Overlease Provisions, Sublandlord and Subtenant shall each indemnify and hold each of the persons or entities comprising the other, and all their trustees, principals, partners, officers, directors, shareholders, employees, agents and servants, harmless from and against any loss, liability or expense, including reasonable attorneys' fees, incurred or suffered by the other party (including, in the case of Sublandlord, any liability of Sublandlord to Overlandlord under the Overlease) on account of the indemnifying party's failure to perform its obligations, or because of a material breach by the indemnifying party of any representation or

warranty made by it, under this Sublease (including the Overlease Provisions) or the indemnitor's negligence or intentionally wrongful acts or omissions. The provisions of this paragraph shall survive the end of the Term.

5.6 *Default; Remedies.* Notwithstanding anything else in this Sublease, if Subtenant defaults in performing any obligation under this Sublease or commits a default under this Sublease, including the Overlease Provisions, then Subtenant shall remedy that default within the applicable cure period (if any), which shall automatically start to run against Subtenant when it commences to run against Sublandlord provided that, in the case of Subtenant's default under the Overlease, Sublandlord gives Subtenant, reasonably promptly after receipt, a copy of Overlandlord's notice of default. If Subtenant fails to perform its obligations under this Sublease (including any Overlease Provisions), then Sublandlord may exercise against Subtenant all remedies in the Overlease Provisions or available at law or in equity.

5.7 *Disputes.* If any dispute arises over this Sublease: (a) if that dispute is heard in the Commercial Division, New York State Supreme Court, then the parties agree to application of the Court's accelerated procedures, Uniform Rules for the Supreme and County Courts (Rules of Practice for the Commercial Division § 202.70(g), Rule 9); (b) the parties shall promptly enter into and submit to the court, with a request to be "so-ordered," a Stipulation and Order for the Production and Exchange of Confidential Information as promulgated by the New York City Bar Association Committee on State Courts of Superior Jurisdiction; and (c) the parties waive jury trial.

5.8 *Additional Covenants.* Sublandlord and Sublandlord's designees shall have access to the Subpremises on reasonable oral notice as Sublandlord reasonably requires, subject to Subtenant's reasonable instructions. Subtenant shall pay all rent, occupancy, and other taxes assessed, imposed, or otherwise payable on this Sublease, the Subrent, Subtenant's subleasehold estate, and any personal property of any kind, owned by or placed in, on, or about the Subpremises by Subtenant. If any governmental authority imposes any transfer tax on creation or Transfer of this Sublease (a "Transfer Tax"), then the party with primary legal obligation to pay it shall do so. If any law would limit, control, or "stabilize" the Subrent or extend the Term beyond the agreed Term, then Subtenant waives any rights or benefits under that law.

5.9 *Directory Entries.* Sublandlord shall exercise reasonable efforts to cause Overlandlord to allow Subtenant entries in the lobby directory for the Building as Subtenant reasonably requests consistent with the Overlease. If the Overlease limits those entries then Subtenant shall not be entitled to more entries than Subtenant's Contribution Share times the number of entries the Overlease allows Sublandlord. Subtenant shall pay any fees or charges Overlandlord imposes for Subtenant's directory entries.

5.10 *Matters Affecting Guarantor.* If Guarantor: (i) dies (or becomes disabled), if a natural person; (ii) fails to perform any obligation under the Guaranty, including delivery of any required document or information, and does not cure that failure within ___ days after notice to Subtenant or Guarantor; (iii) purports to revoke, rescind, cancel, or limit the Guaranty; (iv) asserts in writing that the Guaranty is partially or wholly unenforceable; or (v) becomes bankrupt or insolvent, makes an assignment for the benefit of creditors, admits in writing that it is unable to pay its debts when due, or is otherwise the subject of any similar proceeding, then within __ days Subtenant shall cause a replacement **Guarantor**, satisfactory to Sublandlord, to execute and deliver to Sublandlord a replacement Guaranty in the same form.

6. MISCELLANEOUS

6.1 *Attorneys' Fees.* If this Sublease is the subject of any litigation (including litigation to enforce an indemnity and in bankruptcy or similar proceedings), then the prevailing party shall be entitled to recover all costs incurred, including reasonable attorneys' fees. If Sublandlord or Subtenant represents itself in that litigation, it shall be entitled to reimbursement of fees based on its standard hourly billing rates (including the value of the time of attorneys in any in-house law department based on prevailing rates of outside law firms for attorneys of equivalent experience) as if it were outside counsel.²¹

6.2 *Confidentiality.* The parties shall treat this Sublease and the Overlease as confidential, exercising the same measures they would for their own information they wanted to keep confidential. Nothing in this paragraph limits disclosure to a party's accountants, attorneys, investors, lenders, or other advisers for proper business purposes or as law requires. Any party legally required to disclose this Sublease or the Overlease shall try

²¹ Some clients have strong views for or against attorneys' fees clauses.

where reasonably possible to give the other party notice and a chance to object. This paragraph survives the end of the Term.

6.3 *Execution.* This Sublease shall not be effective in any way or create any obligation of any kind unless and until both parties sign and deliver it. Delivery of any draft(s) imposes no obligations on anyone. This Sublease may be executed in counterparts.

6.4 *Further Assurances.* Each party shall execute and deliver any further documents, and perform any further acts, as reasonably necessary to achieve the parties' intent as expressed in this Sublease. Each party shall deliver reasonable estoppel certificates within 10 days after request.

6.5 *Interpretation.* Although Sublandlord or Subtenant prepared the first draft of this Sublease, the party preparing this Sublease has tried to prepare a balanced and reasonable document that equitably serves both parties. This Sublease shall not be construed against whichever party drafted it. Wherever either party agrees not to unreasonably withhold consent to any matter, it shall also not unreasonably condition or delay its consent. The word "include" and its variants shall be interpreted as if followed by the words: "without limitation."

6.6 *Late Payments.* If Subtenant fails to pay any Subrent when and as this Sublease requires, then without limiting Sublandlord's remedies, Subtenant shall pay Sublandlord interest on that late payment at a rate equal to the prime or equivalent rate published in The Wall Street Journal or, if unavailable, a similar third-party source reasonably designated by Sublandlord, plus 4% per annum.²²

6.7 *Merger and Third Parties.* This Sublease contains the entire agreement between the parties. It may not be changed orally. It binds the parties' successors and assigns. If Sublandlord assigns the Overlease, Sublandlord shall simultaneously assign this Sublease and transfer the Security to the same assignee and require it to assume Sublandlord's obligations. On that assignment, transfer, and assumption, Sublandlord shall [not] be released from liability. Except as the parties expressly agree otherwise in writing: (i) Sublandlord and Subtenant do not intend to confer any benefit or enforcement right on anyone except Sublandlord and Subtenant; and (ii) no one except Sublandlord and Subtenant shall have any right to enforce, or prevent the parties from agreeing to amend or termi-

²² If Sublandlord pays a higher default interest rate under the Overlease, then insert that number as the interest rate.

nate, this Sublease. Notwithstanding anything in the Overlease, Overlandlord's consent to this Sublease, or any other document or agreement, Sublandlord and Subtenant expressly reserve the right to modify, cancel, or terminate this Sublease, on any terms they agree.

6.8 *Notices.* All notices under this Sublease shall be in writing (unless stated otherwise) and given, and shall become effective, in accordance with Overlease Provisions on notices. The notice addresses of the parties (including required copies to counsel) are in **Exhibit F**, subject to change by notice. Any attorney for a party may give any notice for that party.

6.9 *Representations; Brokerage.* Each party represents that: (a) this Sublease: (i) has been duly authorized, executed, and delivered by it; (ii) is its legal, valid, and binding obligation; and (iii) does not violate any agreement or order to which it is party or subject; and (b) it has not dealt with any broker or agent for this Sublease except _____. (the "**Broker**"). _____ shall compensate Broker.

7. SPECIAL COVENANTS²³

7.1 Sublandlord's Work.

7.1.1 *Sublandlord's Obligations.* Sublandlord shall, at its expense, with reasonable diligence, build out the Subpremises substantially in accordance with the diagram and specifications attached as **Exhibit G** (collectively, "Sublandlord's Work"), all in compliance with the Overlease.

7.1.2. *Subtenant's Obligations.* Subtenant shall pay for the actual incremental cost (including allocable general contractor's general conditions, insurance, overhead and profit; Overlandlord's charges, if any; incremental design charges; and any other costs, charges, and expenses that Sublandlord would not otherwise have incurred, net of actual savings achieved) (the "Incremental Cost") that Sublandlord incurs because of these elements of Sublandlord's Work: (i) dividing rooms _____ (previously a single conference room) into ____ separate offices, including installation of partition wall and a second door; (ii) installing a pantry in office _____, including utility lines, built-ins, and special finishes; and

23 These special covenants are deal-specific but often seen. Delete all except as they apply to a particular Sublease. Conform other provisions as appropriate, e.g., Commencement Date and Subrent Commencement Date.

(iii) any changes in Sublandlord's Work that Subtenant requests and Sublandlord approves.

7.1.3. *Certification of Incremental Cost.* Sublandlord shall instruct Sublandlord's design consultant engaged from time to time (now _____) ("Design Consultant") to certify to Sublandlord and Subtenant the Incremental Cost,²⁴ based on actual charges by the general contractor, subcontractors, Overlandlord, the Design Consultant, and other third parties. Subtenant shall reimburse Sublandlord for that Incremental Cost, as Additional Subrent, within 10 days after receipt of an invoice and Design Consultant's certification.²⁵

7.1.4. *Progress Reports and Notice.* Sublandlord shall periodically inform Subtenant of progress of Sublandlord's Work. Sublandlord shall try to notify Subtenant 20, 10, and five days before the date (the "Substantial Completion Date") when Sublandlord achieves substantial completion of Sublandlord's Work. Sublandlord shall notify Subtenant of the Substantial Completion Date promptly after it occurs. After the Substantial Completion Date, Sublandlord shall reasonably promptly complete any punchlist work for Sublandlord's Work.

7.1.5. *No Warranty.* Sublandlord does not make, and shall not be deemed to make, any representation or warranty on, and shall have no liability for any defect or fault, latent or patent, in, Sublandlord's Work. At Subtenant's request, to the extent reasonably necessary for specific claim(s) actually then capable of assertion against Sublandlord's contractors, Sublandlord shall assign to Subtenant, or at Sublandlord's option shall seek to enforce for Subtenant's benefit and at Subtenant's expense, any warranties Sublandlord actually received for Sublandlord's Work, subject in each case to their terms, and only to the extent necessary for a particular claim based on identified breaches.

7.2. *Separation of Subpremises.* On or before the Commencement Date, or as soon thereafter as is legal and reasonably feasible, Sublandlord shall, at its expense and in compliance with law: (i) install a temporary wall to block access from the Subpremises to the Reserved Premises; and (ii) perform any work legally required to make the Subpremises a separately demised legal premises and a separate legal occupancy.

24 It sounds entirely fair and reasonable for Subtenant to bear this Incremental Cost but, as a practical matter, will Design Consultant be able to calculate it? Ask.

25 Sublandlord could instead "reasonably determine" the Incremental Cost.

7.3 *FF&E*. [On the Signing Date, Subtenant is buying from Sublandlord, and Sublandlord is selling to Subtenant (effective on the Commencement Date), the fixtures, furnishings and equipment at the Subpremises identified or described in **Exhibit H** (the “**FF&E**”). The price for the FF&E is \$_____, receipt of which (by check subject to collection) Sublandlord acknowledges. Of this amount, \$_____ is allocable to tangible personal property. On account of the transfer of that tangible personal property, Sublandlord is collecting from Subtenant ___% sales tax in the amount of \$_____, which sales tax Sublandlord shall promptly remit to the appropriate tax authority.]²⁶ [Sublandlord shall leave in the Subpremises, and conveys and transfer to Subtenant on the Commencement Date, all FF&E for Subtenant’s use at no additional charge. No consideration is allocable to FF&E.] Sublandlord delivers the FF&E to Subtenant in its then-current condition on the Commencement Date. Sublandlord shall disconnect the FF&E from Sublandlord’s systems serving the Reserved Premises. Subtenant shall be solely responsible for the FF&E after the Commencement Date for all purposes. Subtenant shall pay for any equipment, inventory, or work to connect or reconnect any systems, including the FF&E, for Subtenant. Subtenant shall (and Sublandlord shall have no obligation to) maintain, repair, operate, and replace the FF&E, and maintain any FF&E service contracts. Only after any FF&E has been disconnected from the Reserved Premises, Subtenant may remove or replace any FF&E without Sublandlord’s consent. **SUBLANDLORD MAKES NO REPRESENTATION OR WARRANTY ON THE FF&E, AND SPECIFICALLY DISCLAIMS ANY IMPLIED WARRANTY OF MERCHANTABILITY OR FITNESS FOR ANY PARTICULAR PURPOSE.** Sublandlord does, however, represent and warrant it owns the FF&E subject to no lien, encumbrance, or equipment lease.

7.4 *Doors*. The present configuration of the Subpremises requires Subtenant to enter the Subpremises through the Reserved Premises or requires Sublandlord (or another subtenant of Sublandlord) to pass through the Subpremises to enter the Reserved Premises. Sublandlord shall promptly (and in any event within __ days after Overlandlord’s written consent to this Sublease and to the work described in this paragraph), at Sublandlord’s expense, rearrange and reconfigure the doorways to Sublandlord’s Premises so the Reserved Premises and the Subpremises each has direct access to common corridor space, and neither has direct access to the other. Sublandlord shall perform that rearrangement and reconfigu-

26 Preceding bracketed language represents one way to handle. The next bracketed language represents a better, and probably more typical, way.

ration in a reasonable manner that reasonably minimizes interference with Subtenant's business or usability of the Subpremises. Sublandlord shall try to comply with Subtenant's reasonable requests on door placements.

7.5 Reoccupancy. Sublandlord may re-occupy the Subpremises after the Term. Sublandlord configured and fixtured the Subpremises accordingly. Without limiting any other right of Sublandlord to disapprove an Alteration, Sublandlord may disapprove it if Sublandlord determines it would materially interfere with Sublandlord's plans for the Subpremises, or otherwise materially diminish the utility of the Subpremises to Sublandlord, after the Expiration Date.²⁷

7.6 Nondisturbance/Recognition. Sublandlord and Subtenant shall reasonably seek to have Overlandlord give Subtenant nondisturbance/recognition protection. Neither shall have any obligation to spend money or start litigation for that purpose. Failure to obtain that protection shall not limit either party's rights or obligations under this Sublease.²⁸

7.7 Dispute Resolution. Wherever the Overlease provides a dispute resolution procedure or a procedure to determine any matter relevant to this Sublease, if any dispute arises with Overlandlord that relates [solely] [or in substantial part] to the Subpremises, Sublandlord shall consult with Subtenant in exercising Sublandlord's rights under or otherwise complying with that procedure under the Overlease. If Sublandlord acted in good faith, the outcome of that procedure shall bind Subtenant. Subtenant shall have no separate right to invoke that procedure as between Sublandlord and Subtenant. If Subtenant's Contribution Share exceeds 50%, then: (a) Sublandlord may require Subtenant to act for Sublandlord in that dispute resolution procedure, at Subtenant's expense; and (b) the outcome shall bind both parties. Subtenant shall have no other right to participate in or be consulted on any dispute resolution under the Overlease.

7.8 Security. If Subtenant defaults under this Sublease beyond applicable cure periods, then Sublandlord may apply the Security to cure that default. Subtenant shall replenish the Security, to the extent so applied, within five days. After the Term expires, Sublandlord shall within 30 days refund to Subtenant the Security less amounts applied to cure Subtenant's

27 This paragraph is optional. Without this language, it might not be "reasonable" for Sublandlord to withhold approval because of the considerations suggested here. Any such ground for disapproval might be idiosyncratic and personal to Sublandlord.

28 If Subtenant wants to take a harder line, the term sheet should say so and the parties should deal with Overlandlord nondisturbance early in the process.

defaults. Sublandlord shall deposit the Security in an interest-bearing account of a banking organization with a place of business in New York State, all in compliance with New York General Obligations Law Section 7-103. Sublandlord shall promptly notify Subtenant of the name and address of the banking organization in which Sublandlord deposits the Security. Sublandlord shall be entitled to receive, as administration expenses, a sum equivalent to one percent per annum on the Security, which shall be in lieu of all other administrative and custodial expenses. The balance of the interest paid by the banking organization shall be the money of Subtenant and shall either be held in trust by Sublandlord, until repaid or applied for the use or rental of the Subpremises, or annually paid to Subtenant. Subtenant certifies that: (i) the taxpayer identification number below Subtenant's signature is Subtenant's true and correct taxpayer identification number, and (ii) the Internal Revenue Service has not notified Subtenant that Subtenant is subject to backup withholding. If the Security exceeds \$_____, then Subtenant may substitute a letter of credit for the Security, but only if: (i) that letter of credit and its issuer comply with Sublandlord's reasonable requirements; and (ii) the parties enter into an ordinary and customary amendment to this Sublease to address the letter of credit.²⁹

7.9 *Reduction of Security.* If as of _____, 201____, Subtenant is not in default (and has never been in default beyond cure periods) under this Sublease, the Security shall be reduced to \$_____ and Sublandlord shall accordingly refund \$_____ of the Security to Subtenant. The Security shall thereafter remain \$_____ for the rest of the Term.

7.10 *Subtenant's Pending Sublease.* Subtenant has notified Sublandlord that Subtenant is trying to sublease Subtenant's existing premises at ____ ("Subtenant's Old Premises"). If, as of _____ (the "Termination Deadline"), Subtenant has not yet subleased Subtenant's Old Premises and obtained all necessary consents to that subleasing, then unless Subtenant has taken possession of the Subpremises, Subtenant may terminate this Sublease by notice to Sublandlord (the "Termination Notice"). If Subtenant gives a Termination Notice, then: (i) this Sublease shall automatically terminate; (ii) Sublandlord shall refund the Security; and (iii) after that refund, neither party shall have any further rights or obligations under this Sublease. The Termination Notice, if given, must be actually received by Sublandlord and its counsel by 5:00 p.m. on the Termination Deadline. Time shall be of the essence on Subtenant's giving the Termination Notice. After 5:00 p.m. on the Termination Deadline, or if Subtenant

²⁹ For letter of credit language, please see the author's model commercial lease.

takes possession of the Subpremises before the Termination Deadline, Subtenant shall have no right to deliver a Termination Notice.³⁰

7.11. *Early Access.* Subtenant may, without paying Subrent, enter the Subpremises between the Signing Date and the Commencement Date only to install communications equipment, a computer network, and furniture, and to perform any Alterations the Overlease and this Sublease allow (but not to conduct business), all in compliance with and subject to this Sublease as if the Commencement Date had occurred.

No Further Text on This Page.

30 This paragraph represents an extraordinarily bad idea and something Sublandlord should avoid accepting, unless market conditions leave no choice. Sublandlord should try to collect an option fee for holding the space available for Subtenant.

MODEL OFFICE SUBLEASE

IN WITNESS WHEREOF, Sublandlord and Subtenant have executed this Sublease as of the Signing Date.

[Signatures]

CONSENT OF OVERLANDLORD

Overlandlord consents to the Sublease. Overlandlord shall have no obligations to Subtenant by reason of this Sublease.³¹

[Signature]

31 This paragraph represents wishful thinking. Overlandlord will generally have its own form of consent, sometimes more extensive than the Sublease itself. As a practical matter, Sublandlord should find out Overlandlord's requirements early in the process, and tailor the Sublease and Sublease approval process to match those requirements.

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EXHIBIT A³²

Description of Overlease and All Amendments

(All documents are dated as of _____201__, unless otherwise indicated.)

1. _____

2. _____

3. _____

32 The parties may prefer to attach a copy of the Overlease for convenient reference. Also, if Sublandlord redacted parts of the Overlease the parties may want an unambiguous record of what Subtenant saw.

EXHIBIT B

**Diagram of Sublandlord's Premises, Subpremises, and
Reserved Premises**

EXHIBIT C
Guaranty, Form of

EXHIBIT D
Commencement Date Agreement³³

[Sublandlord’s Letterhead]

To: [Subtenant]_____

Sublease (“Sublease”), dated as of _____, 201__, between ___
_____ (“Sublandlord”) and _____ (“Subtenant”)

Ladies and Gentlemen:

Please refer to the Sublease. Terms used but not defined here are defined in the Sublease. This letter confirms we agree:

1. The Commencement Date of the Sublease is _____.
2. The Subrent Commencement Date of the Sublease is _____.
3. The Expiration Date of the Sublease will be _____.
4. Because the Commencement Date occurred after the Expected Commencement Date, the parties update the Fixed Rent Schedule as follows:³⁴

33 This confirmation letter is different from Sublandlord’s notice of delivery and commencement. That notice does not require a countersignature. In comparison, this form of letter requires the parties to mutually confirm dates after the fact.

34 Omit if the Commencement Date occurred on the Expected Commencement Date.

Start Date	End Date	Amount	Monthly

5. We confirm and ratify the Sublease.

Please sign below to confirm you agree.

SUBLANDLORD

By: _____

Name: _____

AGREED TO AND ACCEPTED AS OF _____, 201_.

SUBTENANT:

By: _____

Name: _____

EXHIBIT E³⁵

Subtenant's Initial Certificate of Insurance

³⁵ This is not a standard exhibit for a Sublease. Sublandlord or Subtenant, or both, may care a lot about insurance. If Subtenant's initial certificate of insurance is an exhibit to the Sublease,

EXHIBIT F
Addresses for Notices

Sublandlord:

With a copy to:

Subtenant:

With a copy to:

EXHIBIT G

Sublandlord's Work Diagram and Buildout Specifications

EXHIBIT H
Fixtures, Furnishings, and Equipment

CHAPTER THIRTY-ONE

LEASE RENEWALS: HOW TO GAIN THE UPPER HAND

Marisa L. Manley, Esq.

[31.0] I. INTRODUCTION**[31.1] A. Tenant Renewal Strategy**

Why do landlords make much better offers to brand-new tenants than to renewal tenants?

One might imagine that when a company has proven itself to be a good tenant and paid rent on time throughout the term of its lease, a landlord would make a solid renewal offer. In fact, the odds are overwhelming that a renewal tenant will get an offer inferior to terms prevailing in the market. Landlords commonly make their best offers to brand-new tenants, not renewal tenants. The difference can result in costs to a renewing tenant up to 30% higher than those offered new incoming tenants.

Furthermore, if a tenant's renewal strategy is to improve on the current lease, the likely result is a deal inferior to what other tenants new to the building are getting and inferior to what the tenant could achieve at another, competing location. This is true in both rising markets and "tenants' markets." The renewal tenant would be burdened with above-market occupancy costs, and if the tenant ever found it desirable to sublease some of its space, it would be more difficult and costly to do so.

Fortunately, it is possible for a renewal tenant to secure advantageous lease terms. For example, in a market highly favorable to tenants, a major broadcasting company negotiated an early lease renewal. Building ownership found this tenant highly desirable and sought to have it increase its total occupancy in this building. Nonetheless, and by ownership's own admission, it initially sought lease terms that would result in costs 20% higher than costs incurred by incoming tenants new to the building. Despite ownership's approach, and because of how the tenant managed the lease renewal process, it secured terms substantially better than the landlord's initial offer and more favorable than those being offered to incoming tenants. This tenant, with a substantial period left on its original lease, received additional landlord money for its installation, an extended rent holiday, favorable early termination rights, favorable escalation formulas, and a favorable base rent.

[31.2] B. Why Landlords Make Inferior Renewal Offers

When tenants consider whether to renew or move out, they tend to focus on the costs and disruptions of moving out, and landlords know it. There are moving costs and the costs of rewiring new offices for tele-

phones, computers, and other equipment. Retail tenants are concerned about losing business because some customers might find a competitor more convenient after a move. Some employees might be lost because the new location isn't convenient for them. Management usually has more pressing matters than real estate on which to focus. Finally, inertia always favors staying put.

For these reasons, many tenants don't want to bother aggressively shopping the market for alternatives to their current location. Consequently, they might not be aware of the degree to which their landlord is making an inferior offer.

[31.3] C. How Tenants Can Strengthen Their Bargaining Positions

Four strategies will help a tenant maximize its bargaining leverage. A well-advised tenant will (1) understand its options in the marketplace, (2) use lease audits to monitor landlord behavior, (3) understand the costs a building owner will incur if the tenant moves, and (4) use time to the tenant's advantage.

Ironically, the best way to avoid moving is to plan for the possibility of a move. First, a tenant should determine what alternatives are available in the current market. This means working with a real estate advisor who can comprehensively survey the marketplace, and provide detailed information about locations, building configurations, building systems, and other tenants in each building under consideration. The only way to gain an adequate understanding of non-rent costs and lease terms is to negotiate with a landlord and determine the value of concessions it's willing to make. Understanding the value of options in the marketplace will help a tenant determine whether it might be worthwhile to move.

A tenant will be in a stronger bargaining position for a renewal if fully informed about how the landlord has handled the tenant's money during the prior lease term. This information doesn't appear in a tenant's bills. A lease audit is required, which means having an independent lease auditor examine a landlord's general ledger, invoice files and vendor contracts, to see that the landlord has properly billed the tenant in accordance with negotiated lease terms.

After an audit, the tenant will become aware of the extent of mark-ups on services, the nature and extent of management costs associated with services provided, the nature of the landlord's accounting practices and

whether they are prone to costly errors, and the landlord's interpretations of the lease that may be questionable, thus leading to unnecessarily high costs for the tenant. If a lease audit were to turn up serious adverse findings, the tenant might conclude that it doesn't make sense to continue doing business with the landlord.

For a lease audit to be most helpful in preparing for renewal negotiations, a tenant must plan on conducting the audit at least 24 months before its lease expires. This will allow time to gain access to the building owner's books and records, and for necessary analysis and discussions. Tenants interested in gaining this information should be advised to remember that, under most leases, there is a limited time allowed for auditing the bills relating to any lease year, and that the start of an audit must usually occur within a short time after a landlord renders its annual billing or reconciliation.

A tenant should also be informed about the costs a *landlord* would incur if the tenant were to move out. Even in a strong leasing market, space a tenant vacates may remain empty, not generating income for several months. In a weak market, the vacancy period could be much longer. A landlord will incur substantial costs to market the space. Moreover, a landlord would most likely have to demolish the existing installation and give a new tenant a work letter covering at least part of the cost of a new installation. The landlord might have to offer free rent to a new tenant. The brokerage commission for a new tenant is often a bit higher than it is for a renewal tenant. So, while a tenant naturally focuses on the costs it will incur in a move, a wise tenant will also seek to understand the costs a landlord will incur should the tenant move out. The costs a landlord would incur must be estimated, to suggest the value of concessions that might be expected.

To maximize the value of a lease renewal, a tenant must have adequate time. A tenant must start early enough so that, if it becomes apparent the tenant's current landlord won't agree to market rate terms, there will still be time to negotiate with another prospective landlord (or if necessary more than one), complete a build-out, and manage a move to a new location.

[31.4] II. OVERVIEW OF THE RENEWAL NEGOTIATION PROCESS

The time a tenant requires to manage effectively the process of negotiating a lease renewal—even if the tenant is 100% committed to remaining

at its existing location—must be calculated backward from the desired move-in date at a new location.

For leases of roughly 20,000 to 100,000 square feet, under normal conditions—and assuming no unusual build-out requirements and no unusual transaction complications—the minimum time a tenant needs to manage the lease renewal process is typically 18 months from an initial search for alternative sites to move-in.

Here's a quick overview of the process:

[31.5] A. Site Surveys

Allow six months or more and expect this process to continue as other phases proceed.

[31.6] B. Preliminary Financial Analysis

Overlapping the site survey process, perform an analysis of key rent and non-rent financial terms at competing locations, including the preferred current location. Anticipate that this process will start fairly early during site inspections and continue during lease negotiations until all scenarios for all alternatives have been analyzed. Allow five months or more for this process.

[31.7] C. Select Architectural/Engineering Team

This should begin early in the site search process. Part of the lease renewal process involves analyzing the current location's building systems and electrical capacity, loss factor, efficiency of the floor plate, and other physical factors. The tenant will want to determine what changes to its existing build-out will be required to make the facility suitable for use during the next lease term. Each of these systems or features involves costs that must be compared to all alternative locations and factored into the renewal negotiations. Once the architectural/engineering team has been incorporated in the process, that team should provide data for each location that will assist in the analysis.

Many tenants simultaneously hire a telecommunications consultant or involve their internal information technology staff in the site selection process to assure (for example) that the building has or can accommodate suitable wiring, and can provide sight lines to transmission towers where relevant.

[31.8] D. Secondary Financial Analysis

Financial analysis at this stage includes more detailed information. The activity typically continues for four to five months and encompasses initial offers, landlord counteroffers, evolving architectural and engineering data, as well as other steps.

[31.9] E. Submit Preliminary Offers for Preferred Locations (or Request Landlord Proposals)

Perhaps around month eight, at the preliminary stage of negotiations, it is customary for a tenant to submit offers on multiple locations—typically two or three where the preliminary analyses indicate a potentially good fit operationally and economically.

[31.10] F. Negotiate Financial Terms for Preferred Alternative Locations

Offer and counteroffer typically are initial exchanges that indicate each party's sensitivity to key issues. Additional exchanges are needed to determine the final best taking terms. A tenant must proceed to this stage with information about potentially viable alternatives before it can truly assess total likely lease costs, and this is still before taking into account non-rent operational and business terms that will only be disclosed in the landlord's draft lease. A tenant seeking to maximize value in a lease renewal may wish to have in hand results of negotiations from two or three such likely alternative locations before making a formal offer to renew at its current location.

[31.11] G. Preliminary Lease Negotiations

Savvy tenants understand that many key financial terms are contained not only in the so-called term-sheet or other similar document, but are embedded in the lease that will govern their long-term relationship with the building. Key examples of these non-rent business and financial terms include:

- operating expenses;
- real estate taxes;
- utility costs;
- maintenance obligations;

- extent of services landlord must provide;
- building systems;
- workletter issues;
- signage; and
- ability to terminate.

Often it is non-rent costs and operational lease terms, and not the basic financial terms such as base rent, that determine which location and lease arrangement will make the most sense over time.

A tenant that wishes to assess the financial and operational impact of such terms must analyze the landlord's draft lease. Depending on market conditions and norms, the tenant can either enter into preliminary lease negotiations at multiple locations in which it has a serious interest, or secure from building ownership for each such location a copy of the landlord's draft lease, not modified to show terms particular to the current transaction. Anticipate that lease analysis and negotiation will consume three to four months.

By month 10 or 11 of the renewal process, a tenant should have a good understanding of available options outside the preferred location and should be prepared to engage fully in negotiations with existing ownership.

Using information gained from site searches, financial analysis, and preliminary lease analysis and negotiations, the renewing tenant now has robust market knowledge to use in negotiations with its current landlord. It can either make an offer to its current landlord or analyze an offer that it has received from another landlord in light of its current market knowledge. The tenant is in a position to assess true life-cycle costs—on a relative basis—at competing alternative locations.

At this point, the renewing tenant must continue to manage the process carefully: Seek a firm commitment from existing ownership and, failing such a commitment, be prepared to move to an alternative location if necessary.

A tenant must always seek a final commitment in sufficient time that if the existing landlord's best offer is not competitive, the tenant has time to complete a build-out and move to a new location. If a tenant secures an

acceptable commitment from the landlord during months 10 to 12, negotiations at other locations will cease and the renewal negotiation process will be essentially complete. If, however, a renewing tenant does not secure an acceptable commitment from existing ownership, the tenant is still well-positioned to conclude negotiations at an alternative location—not as a “desperation solution”—so it can maximize the value it receives.

[31.12] H. Final Lease Negotiations

Depending on whether the tenant renews at its current location or at a new one, final detailed lease negotiations for an uncomplicated lease may take another nine to 12 weeks. By the date of lease execution, it is likely that the tenant will be at months 12 to 14.

[31.13] I. Preparation for a Move

If a tenant must move to a new location (or requires extensive alterations at a current location), it will proceed through the following steps:

- Schematic design
- Design development
- Preparation of working drawings
- Construction

If this process is effectively managed, the tenant can complete an on-time, cost-effective move-in to a new location within 18 months from the start of market surveys.

Now that we’ve reviewed why even a tenant wholly committed to remaining at its current location must allow at least 18 months for the process under normal circumstances, let’s review key aspects of the lease renewal process where a tenant can gain significant advantage.

[31.14] III. THE ADVANTAGE OF EARLY RENEWALS

As the previous discussion suggests, when a tenant begins the process early—and develops viable alternatives—the tenant has the bargaining advantage because the tenant has ample time to walk away from an unsatisfactory negotiation, begin negotiations with another landlord, walk away from that if necessary, pursue yet another negotiation, and so on. As time

slips away, however, and the tenant's lease expiration approaches, fewer alternatives can be pursued, and the landlord is likely to gain the upper hand.

There are often situations in which it makes sense for a tenant to begin negotiations with the landlord well in advance of its current lease expiration date. The aim might be an early commitment for terms that take effect at the end of the current lease or a current commitment that results in changed lease terms for the duration of the current lease and some extended period. In an early lease renewal, the landlord gets a current commitment for continued cash flow. This may be particularly attractive to a landlord seeking refinancing, a landlord concerned about a downturn in the market, a landlord with a high vacancy rate, and other situation-specific circumstances.

Tenants most likely to benefit will be those for whom a disruption in business operations would be a serious issue, those who can secure substantially more favorable terms through an early lease renewal, those seeking to expand or contract before a current lease expires, and those with special requirements (e.g., tenants that must make costly decisions about capital expenditures for their operations).

A tenant contemplating an early lease renewal will be well advised to consider all the same issues associated with any other renewal—how price and terms compare to other options—and must also analyze how the remaining costs at the current location will be handled. For instance, if an early renewal is desired and cannot be negotiated, the tenant must determine if ownership at a new location will absorb some or all of the remaining costs and whether total net costs at a new location will justify an early move. The tenant must also be advised on whether a move from the current premises could constitute abandonment, and a technical default under the lease even if rent is timely paid, and the prospects and procedures for subleasing the space or negotiating a buy-out if this is desired.

Familiarity with the variety of ways an early lease renewal can be structured, the alternatives to early lease renewals, and the possible resulting benefits will give a tenant additional tools for controlling occupancy costs.

[31.15] IV. EIGHT KEY ISSUES TO ADDRESS IN NEGOTIATING A LEASE RENEWAL

Often a tenant assumes that if things went reasonably well during the previous lease term, a renewal will involve little more than updating base rents and perhaps a few other terms. But much will have changed. For instance, a tenant's business may be larger or smaller and its growth prospects may be dramatically different than at the start of the lease term. The tenant might have taken more space and become a large tenant but still be living under a lease that is primarily suitable for a much smaller tenant. In addition, the building systems, unless replaced as part of a landlord's capital program, are probably many years older than when the lease was signed, and higher operating expenses are likely. The infrastructure considered appropriate for an office building may have changed during the past lease term.

Here's a summary of eight key lease issues every tenant should address during a lease renewal negotiation:

1. *Base Years.* Typically, a renewing tenant operating under a modified gross lease will want to reset the base years so it pays increases over a current base year for operating expenses, CPI (Consumer Price Index), porter's wage or other escalation formula as agreed upon. The same is true of real estate taxes and utility costs when a tenant pays increases over some base amount for these costs. Exceptions to the rule of seeking a new base year exist when it is more advantageous for a tenant to retain an existing escalation formula and the cost of switching to new base years would be accepting a less advantageous escalation formula that is prevalent in the current market.

For instance, if a tenant under an existing lease pays a proportionate share of increases in the building's actual operating expenses, and if those expenses have been moderate, and if the economy supports a reasonable belief that moderate operating expenses are likely to continue, a tenant is likely to be better off with old base years and a favorable escalation formula rather than insisting upon new base years and accepting with them a current market escalation formula which may involve significant, fixed increases each year during the term (e.g., 3% of base rent cumulating annually or higher). In this situation, a renewing tenant that negotiates effectively will have an advantage not available to an incoming new tenant.

Another base-year related issue to consider in connection with a lease renewal is whether building ownership has added staffing or services not formerly provided that should be included in the base year compilation. For instance, after 9/11, many building owners substantially increased security at their buildings—often adding more than a dollar per square foot to operating expenses. Costs of security increased both to provide for additional personnel and to pay for security systems—such as metal detectors and enhanced computer systems. If these costs are not reflected in the new base year compilation, your tenant-client will pay not only for increases in the cost of security—but for the full cost. Accordingly, in negotiating for a new base year it is important to review types of charges included in the compilation to assure that all current costs are fully provided for.

2. *Escalation Formula.* Operating expenses or the surrogate formula agreed upon by landlord and tenant continue, over time, to be a major cost of a long-term lease and should be aggressively negotiated in connection with any renewal. A tenant seeking to renew that has regularly performed escalation reviews will be particularly well-informed on this point. For instance, if a landlord has recently made significant capital improvements, the value of those improvements is likely to be reflected in the current base rent and should be explicitly excluded from operating expenses. Examples of this type may include lobby upgrades, common area upgrades, building system upgrades, and elevator upgrades.

A tenant that has regularly audited its landlord's billings will know to what extent ownership has included questionable costs in operating expenses and will be in a position to demand specific changes. By way of example, a well-known and highly regarded building owner regularly billed all tenants in all buildings for the services of an on-staff locksmith. When questioned on this point, the owner acknowledged that the locksmith worked full time at a single building and performed services primarily for a single large tenant. When services were occasionally performed for other tenants, these services were billed separately. Because this tenant audited the landlord's billings on a regular basis, it was well prepared to address these and other non-rent financial issues during its renewal negotiations.

When dealing with other types of escalation formulas, similar issues arise. For instance, if the lease calls for CPI increases, be sure that the increases are based on a CPI index that still exists and not one that the BLS (Bureau of Labor Statistics) has eliminated. For instance, a Fortune 10 company signed a lease that called for using a Washington, D.C., area

index, but that particular index no longer existed because the BLS had consolidated it with a new aggregate index that included dissimilar rural areas and had different components. The tenant did not notice this during its renewal negotiations. Subsequent determination of a correct substitute index caused ongoing friction between landlord and tenant and had the potential to result in substantial excess costs for the tenant.

Similar issues arise in dealing with something like a porter's wage index. This, of course, is most common in and around New York City, and is based on a union contract. The contract is negotiated every three years, and has changed with its last several iterations—with benefits being added and a new category of employee being created. Any tenant renewing under a porter's wage lease who determines that a negotiated porter's wage formula will be more beneficial than other types of formulas should address this type of issue in any renewal negotiation.

3. *Real Estate Taxes.* In addressing real estate tax issues during a negotiation for a lease renewal, a tenant will first address the base year question, then should look carefully at how taxes are defined. To the extent that a tenant is exposed to costs not traditionally included in the definition of real estate taxes, such as special assessments and business improvement district fees, the tenant should assess the effect these have had during the preceding lease term and, based on current local conditions, what effect they may have during the coming lease term.

A tenant must also determine whether changes in the use of the property or the jurisdiction's tax practices could unnecessarily increase its taxes during a new follow-on lease term.

For instance, an engineering firm was the major tenant in a Class A suburban building. During much of its lease term, the real estate market was depressed and the building experienced a high vacancy rate. Close to the end of its lease term, demand in the real estate market increased and ownership moved forward with plans to develop a second office building on adjacent acreage, which was part of the same tax lot. This tenant faced a significant issue during its renewal negotiations—negotiating an appropriate percentage share of both real estate taxes and operating expenses taking into account this as-yet-unbuilt additional property. A tenant that assumed that its lease negotiation would be a straightforward matter of simply negotiating new base rents would likely face excessive real estate taxes and other such costs as compared to its occupancy and the benefits it receives.

4. *Work Letter.* A tenant contemplating a renewal must carefully consider the work that will be needed for the interior installation that it desires. Most tenants, at the end of a five-, seven-, ten-year or longer initial lease term, will at a minimum want new paint and carpet. Very often the organization's operational needs will have changed, and significant changes in the layout and circulation patterns of the space will be beneficial. Lighting currently in use in the space may be harsh compared to newer alternatives, and older bulbs may be significantly more expensive to operate. Although a tenant may think in terms of moving or adding walls, how to accommodate additional staff, and a new set of space standards that will be more efficient—along with these highly visible changes will come less obvious but very expensive changes in the lighting grid, and electrical and HVAC distribution systems. A tenant that wishes to maximize the value it receives in a lease negotiation will have developed reasonably detailed plans and have reliable initial cost estimates for this work before proceeding.

A landlord may look at an installation, assess it as being in “reasonably good condition,” decide the tenant does not need anything more, and predicate its negotiations on an “as-is” condition of the premises. But the appearance of the premises often has little to do with functionality.

For example, the subsidiary of a major financial services company wished to renew at its existing location. Its building was conveniently located and attractive; face rents were lower than at other nearby buildings. The tenant knew, however, that it would have to substantially reconfigure its premises to make them cost-effective. As configured, they were highly inefficient. Much of the premises was used by programmers. Lighting in this area was so poor for the tasks to be performed that the staff kept the lights off all day and worked in semi-darkness. Other staff, located at sheet-rock workstations, did not have enough desk surface area. They frequently put sensitive documents on adjacent ledges, where they could spill onto the floor and were visible to passersby. One conference room, frequently used for staff meetings, also functioned as a corridor from one part of the premises to another. Offices built for former executives were grandiose and not suitable for their intended use. Despite these significant problems with the existing installation, the landlord would discuss a renewal only on an as-is basis, while giving incoming tenants at comparable rents between \$20 to \$30 per square foot for build-out.

As the tenant explored the cost of reconfiguring the existing installation while remaining in the premises, it discovered a fact common to such in-place upgrades: it would easily cost 20% more to reconfigure the exist-

ing installation than to build from scratch at a new location. In this case, because the installation desired was relatively simple, that meant an additional cost of \$8 to \$10 per square foot, which translated to about \$1.50 per square foot per year in higher rent over the lease term. When a tenant understands cost factors such as this, it is in a much better position to objectively assess the value of a renewal and use this information in lease negotiations to achieve the most cost-effective solution.

5. Building Infrastructure. Building infrastructure, particularly flexible, cost-effective HVAC systems, the availability of adequate electrical capacity at reasonable cost, and broadband telecommunications capability, have become increasingly important to most tenants' business operations and have a significant value in lease negotiations.

This means that a renewing tenant should assess the infrastructure at its building compared against other options available in the marketplace. If a tenant occupies a building with a central HVAC plant with significant costs for overtime use, and if many buildings in that market offer tenants tenant-controlled HVAC systems with substantially lower costs, the landlord will be under competitive pressure to provide an alternative to costly overtime HVAC when faced with a savvy tenant. The tenant may seek to have the landlord install supplemental HVAC systems for part of its space, have the landlord agree to favorable long-term rates for chilled water or condenser water, or provide extended hours for use of the base building system at no additional cost. For a mid-sized tenant with substantial overtime or supplemental HVAC needs, proper negotiation of terms like this can result in savings of tens of thousands of dollars each year during the lease term. Other solutions are possible depending on the nature and extent of a tenant's needs.

Increased technological needs are just one issue to consider in connection with an assessment of building infrastructure and how it may affect a tenant's negotiation for a lease renewal.

For instance, a multinational firm sought to renew its lease of a single-tenant suburban building. The tenant had extensive supplemental and overtime HVAC requirements. The firm obtained an engineering analysis, which demonstrated that the existing HVAC units, which the tenant was responsible for maintaining, had substantially exhausted their useful lives. In addition, the HVAC control system in use was obsolete. It was increasingly difficult to get parts and to find technicians skilled in the repair of such systems. Because the tenant was fully prepared with this information, the nature and condition of the HVAC system and its controls

became a significant issue during renewal negotiations. The landlord agreed to accept additional responsibilities and absorb costs that under the existing lease would have been the tenant's responsibility. This aspect of the renewal negotiations saved the tenant at least \$400,000 during its renewal term.

6. *Building Services.* In addition to assessing physical infrastructure, a renewing tenant must assess a wide range of building services to determine adequacy for current needs and comparability to what is generally available in the market.

Many older buildings gave tenants little choice as to how HVAC systems would be zoned, and everyone was served by standard hours of operation. Newer buildings or those with upgraded infrastructure allow substantially more flexibility in zoning HVAC systems and may provide 24-hour HVAC service at no additional cost to the tenant, except for the actual cost of utilities consumed when the service is used. A related building service issue is the performance of the existing building HVAC system in terms of temperature, humidity and hours of operation. A tenant that has experienced significant discomfort may negotiate to have building ownership install and maintain supplemental HVAC equipment (tenant pays for use), to extend the daily or seasonal hours of HVAC operation, to agree to an earlier start-up time for heat during the heating season, and similar matters. Some landlords are more receptive to changes of this nature, which do not affect the face rental rates, and thus do not affect refinancing negotiations, than to other ways of accomplishing a similar result.

Other significant service issues to be assessed and negotiated at the time of a lease renewal are the general performance of the cleaning contractor, adequacy of the HVAC specification including temperature and humidity standards and dates of operation, and performance of the cafeteria vendor. Security is another building services issue to be addressed during renewal negotiations; to maintain comparability with other options in the market, a tenant may seek to have a landlord agree to provide manned, on-site security during off-hours, card-key access to building entrances, camera surveillance of common areas and similar matters. Landlords may be receptive to such requests because they tend to enhance the value of the building as a whole.

7. *Sublease Rights.* Negotiating adequate sublease rights, of course, should be part of every lease negotiation, whether a new lease or a renewal. A renewing tenant that may be inclined to substantially rely on

the existing lease document and merely modify basic economic terms should consider carefully its current needs for an exit strategy, whether its corporate relationships have changed or may change—e.g., through merger or acquisition—and how these and similar issues should affect the sublease rights it agrees to.

A renewing tenant that has grown since entering into a lease may seek substantially stronger sublease rights, including the ability to sublease only a portion of the premises, limit the landlord's right to take back the space, or retain all or some of the net profits from a sublease. A renewing tenant should assure that it will have a relatively free right of transfer to all affiliated companies and that a successor, through purchase or otherwise, will have the right to assume the lease. Any tenant seeking a renewal should look carefully at procedural aspects of sublease clauses. If a tenant compromised during initial lease negotiations, it should now assess whether the landlord should have a duty to be reasonable, and whether the lease contains meaningful guidelines as to what is reasonable, whether there are clear and reasonable time limits on the landlord's right to deny a proposed sublease, whether the lease permits the tenant to submit a term sheet as the basis for gaining sublease approval or whether it must submit the sublease in its entirety, and similar matters. Failure to address sublease procedures can result in a situation where impractical procedures substantially negate sublease rights that might otherwise have significant value for the tenant. Substantially similar issues arise in connection with negotiating rights to assign during a new lease term. These are all issues that older leases often cover in a way that does not meet current standards and expectations of major tenants.

8. *Utilities, Capacity, and Pricing.* The need for and provision of electricity has changed significantly during the last few years and continues to change. A renewing tenant should therefore look at this issue in terms of current and expected needs, no matter what the existing lease now says.

The lease should stipulate the minimum capacity of electricity that will be available to the tenant, in the premises throughout the lease term. It is typical to specify this capacity in watts-per-square-foot, and preferable to specify in watts-per-rentable-square-foot (demand load), as this maximizes the electricity actually available to the tenant to use. A tenant in a multi-tenanted building seeking additional power in connection with a lease renewal should specify that the landlord will deliver the power to the premises. Otherwise, the tenant may need to pay substantial sums to install risers or other distribution systems to bring the electricity to its space.

Payment for electricity is another matter to be negotiated in a lease renewal. If a tenant accepted a so-called rent inclusion formula in its original lease, it may want to insist at this time upon submetered or directly metered electricity, as this is likely to substantially reduce costs. For one renewing tenant with substantial laboratory requirements and above-standard electricity needs, for example, it made sense to retain rent inclusion electricity for basic office use and the landlord agreed to provide all supplemental service (above four watts-per-square-foot in this case) on a submetered basis at cost. Through this arrangement, the tenant expected to save 30% or more on its total electricity costs.

With the advent of alternative electrical providers, a tenant may wish to reserve the right to select its own provider of electricity, and to refuse the landlord's selection of an electrical provider if that new provider cannot provide service of comparable scope and quality to the tenant's existing electrical provider.

[31.16] V. NEGOTIATING A RENEWAL OPTION

The discussion so far has considered the issues in negotiating a renewal of an existing lease when either the tenant has no right to renew or the renewal rights provided allow room for negotiation. As another very common element of lease negotiations, a tenant will often seek to secure rights to renew a lease as part of the total agreement when initially negotiating a new lease. Here are key business and strategic issues to keep in mind in such negotiations:

1. *Importance of Renewal Option.* Often a tenant will see a renewal option as an opportunity to lock in below-market rates or otherwise favorable terms. Some landlords resist renewal options for this reason. The benefit of a renewal option may not, however, lie in lower costs at the renewal location, compared to the costs available elsewhere. For some tenants, the most significant benefit of a renewal option is simply the ability to maintain their operations at a current location. In the case of an office tenant, there may be no revenue or identity issue associated with the location as can be the case with a retail tenant, but the ability to stay in the same location may be important for reasons of demographics, continuity of business operations, and other operational issues. For this reason, any renewal option, even if not available on ideal terms, is preferable to none. A renewal option gives a tenant substantial assurance that it will not have to move to accommodate a landlord's desire to re-stack a building, because some other tenant is expanding, because the landlord no longer desires to have tenants of a certain type in the building, or for other rea-

sons that may not be strictly economic, and that therefore could not be overcome by a market-rate offer on the space.

In negotiating a renewal option, fundamental contract considerations apply. In particular, the option must have definite price terms or a court may find that it is unenforceable. For example, a Louisiana tenant entered into a lease of a truck stop and gaming parlor. The landlord and tenant could not agree on a rental rate for the renewal term, so their lawyers drafted a lease clause providing that the tenant had the option for three five-year renewals, with all terms and conditions of the original lease term to continue to apply, except that “the monthly percentage due Lessor shall be negotiable.” The tenant made substantial improvements to the property and operated an apparently successful business there. Despite good-faith efforts to fix a rental rate during and after the conclusion of the initial term, the landlord and tenant could not agree on a renewal rate. When the landlord refused to honor the tenant’s renewal option, the tenant sued to enforce the option and retain its business operations. As so often happens, issues became complicated. The landlord charged that not only was there no enforceable option, but the tenant had breached its lease by opening a second, competitive gaming operation nearby. The landlord’s counsel had drafted the option language and testified that he believed it was enforceable. The court held that the option was not enforceable because it lacked a “certain and determinate price.” Such a price could be set by formula or could be left to third parties to decide, but must be fixed in some way so that once the option was exercised, the rent could be determined from factors or circumstances not within the control of the parties. The court rejected the tenant’s argument that setting a price by negotiation is the equivalent of establishing a price by arbitration or through experts.¹ Because this tenant lacked an enforceable renewal option, it lost a significant capital investment, as well as the ability to continue its business operations at a profitable location.

2. *Fixed-Rate vs. Market-Rate Renewal.* A landlord and tenant negotiating terms of a lease renewal often debate over a fixed-rate or market-rate renewal. In general, a market-rate renewal may be the most advantageous for both sides to the transaction. A market-rate renewal right for the tenant gives the landlord some assurance that it will be able to secure reasonably favorable terms and that the renewal right will not interfere with financing or a possible sale of the property.

1 *T.B. Guillory, Inc. v. N. Am. Gaming Entm’t Corp.*, 741 So. 2d 44 (3d Cir., La. App. 1999).

From a tenant's perspective, a fixed-rate renewal right may seem preferable, but only if the rate agreed upon turns out to be at- or below-market when it is exercised some years after it is negotiated. If the rate is then above-market, the tenant's right has no practical value, and that particular tenant would have been better off with a market-rate renewal right.

In negotiating a market-rate renewal right, a tenant must be sure to structure a definition of "market rate" that includes key non-rent monetary terms available to tenants generally in the relevant market. The relevant marketplace must also be defined, and should be defined with enough specificity and objectivity that it can be ascertained by a third party. The market should not be limited to the building where the renewal will occur or to that landlord's portfolio if it owns multiple buildings in the area.

3. *Definition of Market Value.* At a minimum, terms to be included in a definition of "market rate" when a tenant is seeking to structure a lease renewal should include:

- Base rental rates for comparable new leases
- Creditworthiness of the tenant (assuming the tenant is in fact highly creditworthy and expects to remain so at renewal time)
- Presence or absence of a workletter contribution from the landlord
- Nature of escalation formulas to be employed
- Base years, if any, to be used during the new lease term
- Length of lease term

For any renewal term, the space should be valued for use as office space (or R&D space, as the case may be) and not at the "highest and best use" for the space. As a practical matter, this issue will seldom arise in connection with multi-tenanted urban office space. It may arise in connection with a single-tenant or multi-tenant suburban building, where land use patterns can change more frequently.

Any value attributable to the tenant's existing installation, especially if it is unique or above-standard, should be *excluded* from consideration in determining a market-rate base rent.

4. *Procedure to Set Market Value.* If the landlord and tenant cannot agree on market value, the tenant should insist upon some kind of neutral

arbitration, and not agree that the landlord may unilaterally determine market value, the tenant's only remedy then being to challenge the landlord's determination. In general, baseball-style arbitration is encouraged so that neither side to the transaction has an incentive to inflate/deflate its estimate. Another recommendation is that the lease include qualifying criteria for arbitrators (e.g., no less than 10 years recent and continuous experience in the leasing of similar commercial space in the relevant geographic market). Each party is to select an arbitrator; if the two arbitrators cannot agree upon a base rental figure within the time allotted, the two arbitrators are to agree upon a third—failing which either party may apply to the American Arbitration Association or a local court for the appointment of an arbitrator. In any case, the arbitrators should be required to select only either the base rent figure as determined by landlord or as determined by tenant.

Such a procedure can be cost-effective, as it does not involve lengthy presentation and argument, the time frames involved in the process can be relatively short, and all parties have an incentive from the outset to agree upon a base rent.

5. Time of Exercise. When a tenant has a renewal option for a certain space, the landlord will insist that the tenant exercise or decline the option far enough in advance to give the landlord an adequate time to market the space if necessary. A tenant may prefer to delay exercising its option until as late a date as reasonable so that it can be more certain of its business plans, but the two parties tend to rapidly agree upon a date, often 12 months or so in advance of the beginning of any renewal term. A significant failing of the most commonly seen lease clause of this type is that the tenant does not know what its rent will be until after the option is exercised and the tenant is obligated to remain in the space. Because occupancy costs are significant for most tenants—often the second- or third-largest fixed cost—this is a significant problem. In addition to the fact that a tenant will know what its costs will be only after a commitment is made, many tenants are reluctant to enter into an arbitration proceeding, no matter how carefully structured, for fear that the result will be something not supported by the facts, that costs will get out of control, or that it will lead to animosity with the landlord.

From the tenant's perspective, it is critical to know, before committing to a location, what its costs will be and how these costs compare to alternative locations. Tenants should negotiate renewal provisions that provide for this. One kind of renewal option that provides this essential certainty triggers a discussion period starting 15 to 18 months before the current

lease expiration date. If the landlord and tenant, based on parameters in the lease, cannot agree upon a base rent and other lease terms, either party may elect to arbitrate a base rent rate. The final rental rate must be determined by the arbitrators no later than 13 months before the current lease expiration date and the tenant must elect to proceed—or not—no later than 12 months before the current lease expiration date. (A landlord would argue that a final “opt out” right of this type makes the arbitration a waste of time because the tenant will always be free to renegotiate its outcome.) Landlord and tenant sometimes negotiate as to who will bear the cost of arbitration if the tenant arbitrates, but ultimately does not elect a new lease term.

Beyond strategic considerations of the best time to exercise a renewal option to ensure maximum value and the availability of alternatives, renewal options need to be structured so that the timing of when a tenant may exercise the option is clear and unambiguous. In one case, an Ohio tenant entered into a 30-year lease; the lease also provided for seven additional five-year terms. The lease stipulated that if the parties could not agree on rent for the renewal terms, the rent would be determined by arbitration. The renewal clause stated:

At the expiration of the [initial thirty year] term of this Lease, Lessee shall have the option to again lease the demised premises for seven (7) additional successive five (5) year terms, provided Lessee notifies Lessor by registered mail not less than one year prior to the expiration of the term herein granted of its desire to lease said property for an additional five year term, and thereafter notifies Lessor in the same manner one (1) year prior to the expiration of each said five (5) year term of its desire to again lease said property.

Slightly more than a year before the end of the initial lease term, the tenant notified the landlord of its desire to renew the lease—for two successive terms. When they could not agree on a rental rate, the matter went to arbitration. At the end of the first renewal period, with the rental rate still an issue, the landlord declared the exercise of the option for two terms simultaneously ineffective, and sought to evict the tenant. The court, asked to decide the issue, offered four plausible readings of the language in the lease. The court said the clause could be interpreted to allow the tenant to exercise all seven options at the end of the initial term; or to require the tenant to exercise the options successively, including the exercise of all options successively within the initial term; or to require that

each option be exercised on one day only, the day precisely one year before the end of the then current term; or only during the immediately preceding term, and no less than one year before the expiration date of that term.² With this ambiguity, the court remanded the case for a factual determination of the intent of the parties, and an already-protracted litigation continued. The ultimate issue between the landlord and tenant may have been an inability to agree upon rent, but perceived ambiguity became a costly hurdle that diminished the value of the tenant's renewal and jeopardized its ability to continue doing business at a preferred location.

Costly ambiguity in renewal options takes many forms. As another example, a certain Davis owned a commercial property in Delray Beach, Florida. He negotiated with Kahan to allow Kahan to use the lot for an auto paint and body shop. Because Kahan planned to make a substantial investment in setting up the shop, he negotiated for a seven-year initial term with a seven-year option. Davis felt an auto body shop might be an unsightly use, so he countered with a proposal for a five-year term with a five-year option, required Kahan to store cars inside at night, and imposed other restrictions. The renewal option language the parties agreed upon stated that:

Landlord will grant tenant one (1) five-year option to renew the Lease. On or before May 1997, and Tenant has abided by all the terms of the Lease and is not in default, Landlord—at Landlord's sole option to renew—shall notify Tenant if they desire to honor the option granted in this Lease. If Landlord grants Tenant said option, Tenant will give Landlord 180 days prior written notice from Lease Expiration of Tenant's intent to exercise said option.

When Kahan sought to exercise his renewal option, Davis declined the exercise, advising that the option belonged to him as landlord. Kahan, who had spent more than \$100,000 improving the property, sued. The trial court held that the parts of the renewal option language were in “hopeless and irreconcilable conflict,” and that under the principle of adverse construction, the right to exercise the ambiguous option belonged to Kahan, the tenant, who had not drafted the lease. The decision was affirmed on appeal.³ While Kahan ultimately received a favorable opinion, a sloppy

2 *Four Star Serv., Inc. v. City of Akron*, No. 19124, 1999 WL 980558 (Ohio Ct. App. Oct. 27, 1999).

3 *DHS Corp. v. Affordable Enters. Exch., Inc.*, 734 So. 2d 567 (Fla. Dist. Ct. App. 1999).

renewal option put his substantial investment at risk and added substantial cost to its exercise. Relying on the doctrine of adverse construction may be risky itself in a heavily negotiated lease. Best advice: Make renewal rights clear and unambiguous—as to content and procedure.

What if you miss a renewal option? In many states, an equitable doctrine will excuse a tenant's late exercise of a renewal option if it finds "special circumstances" or even simple negligence. For example, a tenant took over an existing lease that had been substantially modified over time. When the incoming tenant took over, there was just about a year remaining. In addition, there were eight five-year renewal options. The lease required the tenant to notify the landlord of its intent to exercise the first option about six months in advance of the lease termination date, and just about six months after the second tenant took over the lease. The lease provided that "time is of the essence." When the tenant failed to notify the landlord of its intent to renew, the owner promptly sent a notice advising the tenant that since it had not exercised its renewal option, the tenant's lease term would expire at the end of the original lease term in about five months. The tenant immediately sent a notice seeking to exercise its renewal option. When the landlord refused to accept the late exercise of the renewal option, the tenant sued to force enforcement. The court held that an equitable remedy was appropriate because of the hardship the tenant would suffer from a move, even though the landlord had offered alternative sites and relocation assistance. The tenant was allowed to renew, even though no "special circumstances," but only simple negligence, caused its failure to renew on time.⁴

6. *Conditions for exercising a renewal option.* Because many landlords disfavor renewal options, even when a tenant succeeds in negotiating a right to renew, the building owner may seek to limit this right by imposing various conditions. Three conditions building owners commonly use to limit renewal options are (1) claims of tenant default, (2) a requirement that the tenant be in possession of the entire premises, and (3) a requirement that the tenant exercising the renewal option be the original tenant.

To protect your client from losing valuable renewal rights inadvertently or merely through normal business operations, consider the following.

(a) *Tenant not in default.* When a landlord seeks to condition exercise of a renewal option on the tenant not being in default, limit relevant

⁴ *Market Dev. Corp. v. Vill. Green Props., Ltd.*, 2000 WL 33407136 (Mich. Ct. App. Sept. 12, 2000).

defaults to those outstanding at the time of the election, and of which your client has been given written notice. Avoid situations in which building ownership can claim a previous default as the reason for defeating a right to renew a lease.

(b) *Entire premises.* For tenants with sizable premises or premises which may be smaller but consist of non-contiguous units or units on multiple floors, limiting a renewal option to the entire premises may be unnecessarily restrictive. Advise your client to assess potential changes in the way they may use their space, and then seek to negotiate reasonable subdivisions of the premises which the tenant would be entitled to renew even if they do not occupy the entire premises when the exercise date arrives.

(c) *Original tenant only.* At a minimum, seek to extend the right to renew your client's lease to any entity which is a successor to the original tenant or to whom your client may sublease the premises as of right. If your client is creditworthy and will remain on the lease after any sublease or assignment, there is a strong argument that no change in the identity of the tenant should defeat the right to renew the lease.

By avoiding these limitations on renewal rights, your client will retain additional flexibility for its business operations and will enhance the value of its lease.

[31.17] VI. PROTECTING A RENEWAL OPTION

In some jurisdictions, the exercise of an option must be recorded to be effective against third parties. Louisiana case law provides a clear example of this. In 1991, Thompson, the operator of a bar, entered into a five-year lease with Roach. The lease expired August 31, 1996, and contained an option to renew for five years. In early August 1996, Thompson effectively exercised the renewal option. In September, Thompson re-recorded with the Parish Recorder the now-expired lease; the exercise of the option was not recorded. In March 1998, Roach sold the property to Indigo. About two weeks later, Indigo wrote to Thompson advising Thompson of the change in ownership and that Indigo intended to exercise its rights under the lease. Several months later, Indigo wanted possession of the premises and advised Thompson to vacate as he occupied under a month-to-month lease. Thompson refused, believing that he occupied for a five-year term by virtue of his renewal option. Indigo sued and gained possession. The court held that by Louisiana statute, no lease of real property is binding on third parties unless recorded. Recording of an expired lease which contains a renewal right is not sufficient because third parties have

no duty to look beyond the public record. Indigo could have assumed Thompson's lease in connection with the purchase, but did not do so. Indigo's letter to Thompson, advising that Indigo would exercise its rights under the lease, did not imply a lease for fixed duration, but is consistent with the intent to exercise its rights under a "re-conducted" lease—the month-to-month lease which arises when an original lease expires and a tenant remains in possession.⁵ The tenant lost a valuable business location because it failed to protect its renewal option. A tenant should be aware of particular procedures that may be required in jurisdictions where it is negotiating a lease or renewal, and of particular situations—such as an unstable landlord—that may require paying extra attention to this issue.

[31.18] VII. HOLDING OVER NO SUBSTITUTE FOR LEASE RENEWAL

Occasionally, it will be important to remind a client that holding over is no substitute for a lease renewal. The New York courts have emphasized this and arguably added to the cost of holding over. In 1996, Tahari Ltd. sublet from W.R. Grace & Co. the entire 48th floor at 1114 Avenue of the Americas for a term that expired May 31, 2003. In 1993, Kronish, Lieb, Weiner & Hellman, LLP (Kronish) leased the entire 46th and 47th floor, with an option to lease the entire 48th floor starting June 1, 2003. Tahari failed to move out when its sublease expired and litigation between the building owner, Grace, Kronish, Tahari and others followed. In December 2004, with Tahari still occupying the 48th floor, the Appellate Division issued an ejectment order. Kronish follow up with a claim against Tahari for trespass and sought damages for its delayed move-in. The Supreme Court of New York County upheld Kronish's claim.⁶ Accordingly, in New York tenants who hold over may be liable not just for the costs and penalties traditionally associated with holding over—increased rent, and damages for breach of the lease, including consequential damages payable to the building owner—but also damages for trespass payable to an incoming tenant.

5 *Restaurant Indigo, Inc. v. Thompson*, 733 So. 2d 1271 (4th Cir. La. Ct. App. 1999).

6 *Kronish, Lieb, Weiner & Hellman, LLP v. Tahari, Ltd.*, 11 Misc. 3d 1057, 815 N.Y.S.2d 494 (Sup. Ct., N.Y. Co. 2006); see also *White Plains Plaza Realty, LLC v. Town Sports Int'l, LLC*, 79 A.D.3d 1025, 914 N.Y.S.2d 222 (2d Dep't 2010).

[31.19] VIII. A STRONGER LEASE MEANS COST ADVANTAGES OVER COMPETITORS

Although landlords make inferior offers to renewal tenants compared against brand-new tenants, renewal tenants can definitely achieve market-rate terms or better.

The first step is to recognize that renewal tenants face a significant challenge that requires timely attention from top executives. If the renewal process is delayed until there isn't time to develop meaningful alternatives, then a tenant is sure to be stuck with an inferior lease—and above-market costs that could undermine a tenant's ability to control business costs.

Most tenants should begin the renewal process at least 18 months before their current lease expires. Large tenants—the number of square feet qualifying as large will vary from market to market—will need to start earlier, because the larger the requirements, the fewer the options.

The best way to avoid moving is to prepare for a move, because this will put a tenant in the strongest negotiating position. A tenant ready to go elsewhere is a better bet to be taken seriously by a landlord and more likely to get a market-rate proposal.

A tenant should retain an advisor capable of comprehensively surveying a market and aggressively negotiating with landlords to identify good alternatives.

A renewal negotiation should proceed as if one were negotiating a brand-new lease. Take nothing for granted, because a tenant might actually need a new lease to reflect changes in the business, changes in the economy, or changes in the real estate market.

Be especially careful when trying to lock in terms for the next lease renewal.

Monitor the lease to assure timely exercise of renewal rights, and provide protection for renewal rights against changes in ownership and similar matters.

A tenant who does all these things will be in an excellent position over the medium and long term to control occupancy costs and gain advantages over competitors.

CHAPTER THIRTY-TWO

LEASE SURRENDER AGREEMENTS

NEGOTIATING THE EARLY TERMINATION OF COMMERCIAL LEASES AND SURRENDER OF POSSESSION OF THE PREMISES

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[32.0] I. INTRODUCTION

This chapter addresses issues that commercial landlords and tenants should consider in negotiating the early termination of leases and the surrender of possession of leased premises through lease surrender agreements.

One of the more perplexing yet least negotiated aspects of commercial leasing is the early termination of a lease. The terms of a commercial lease are often extensively negotiated by the landlord and tenant based on assumptions that include the lease continuing for the entire negotiated length of time.

The early termination of the lease can undercut many of the underlying assumptions upon which the commercial lease was initially negotiated and affect third parties that occupy the premises as well as parties that provided financing. Questions and issues that arise from an early lease termination include: Should the tenant pay an “early termination fee” to compensate the landlord for the potential loss of rental revenues or for the unamortized portion of a rent-free period, the build-out concession or the brokerage fees? Or, if the landlord requests the early termination, should the landlord compensate the tenant for moving and build-out costs or an increased rental rate at another location (i.e., “buy out” the tenant)? Who are the necessary parties to a lease surrender agreement? Can subtenants stay in the premises even after the tenant has surrendered possession? What would be the consequences of the tenant simply abandoning and unilaterally “surrendering” the premises? Is a lender’s consent required for a lease surrender agreement to be effective as against that lender?

Section II of this chapter provides an overview of general issues and considerations in negotiating commercial lease surrender agreements in New York State. Section III addresses the technical drafting requirements of lease surrender agreements. Section IV covers general issues and problems that arise in negotiating an early termination of a commercial lease through a lease surrender agreement. Sections V and VI discuss potential problems and the enforcement of lease surrender agreements.

Some specific issues covered here include:

- Early termination fee and compensation for costs (Section IV.A.).
- Necessary parties to a lease surrender agreement (Section III.C.).

- Subtenants' rights to remain in the premises (Sections III.C.1. and V.A.).
- Tenant's continuing rental obligations, while the landlord has no duty to mitigate in New York, if tenant abandons the premises (Section II.H.).
- Mortgagee approval of a lease surrender agreement (Sections III.C.2. and V.D.).

[32.1] II. OVERVIEW OF LEASE SURRENDER AGREEMENTS

[32.2] A. Overview

Lease surrender agreements can provide the parties with the opportunity to set forth the conditions and terms of an early termination of a lease and surrender of the premises. In addition to the issues that arise at the original expiration date set forth in a commercial lease, an earlier expiration of a lease arising from a lease surrender agreement raises issues of the costs, liabilities and obligations for the parties (obvious and hidden) such as: the duty to pay rent for the balance of the term after the tenant has vacated the premises, the possible recoupment of rent concessions or partial reimbursement of expenses for improvements to the premises, the application of the tenant's obligation to restore the premises, and the status of other occupants in the premises.

[32.3] B. Reasons for Early Lease Terminations

There are many reasons that a tenant or landlord may need to terminate a lease before the original expiration date set forth in the lease.

Tenants may seek to terminate a lease early in order to relocate or discontinue a business. The need to relocate may reflect a range of a tenant's business needs, such as the contraction of the tenant's business or the expansion of the business without additional space available from the landlord, an offer of significantly lower rental rates at another location, or a substantially more cost-effective location. For example, the other location may be closer to customers or to raw materials; more accessible for employees; provide for a better distribution system, including more effective transportation; or benefit from substantial governmental incentive packages for this particular type of business (e.g., light manufacturing that is job-intensive). In addition, early terminations of commercial leases can

result from a merger or acquisition of the tenant's business or the discontinuation of the tenant's business (e.g., the tenant has decided to go out of business or to close that particular branch).

From the landlord's perspective, the reasons for seeking an early termination of an existing lease may include increasing revenue from higher rental rates in a "boom" real estate market, accommodating the expansion of another tenant, changing the mix of the tenant base, enabling major capital improvements to the premises, creating an assemblage of units within the building, demolishing the existing building to construct a new building, or attracting a buyer for the premises and increasing the sales price. (A buyer might be willing to pay a higher price if the premises were vacant of all occupants—therefore enabling the buyer to choose the tenants and tenant mix, substantially renovate the premises, or demolish the premises and re-build on the land.)

[32.4] C. Definition of Lease Surrender Agreement

For the purposes of this chapter, a lease surrender agreement is defined as an express surrender between the landlord and tenant for the early termination of the lease and surrender of possession of the premises.

The mere surrender of possession of the premises by the tenant does not necessarily constitute a termination of the lease; without an acceptance by the landlord, the mere surrender by the tenant may constitute an abandonment of the premises and therefore not effectuate a termination of the lease. The Court of Appeals has stated that

[A] surrender of "possession" is not always a surrender of a "lease" or of the "estate" thereby created. . . . A surrender of possession, if accepted, is evidence indeed from which a surrender of the estate may be inferred, yet it will not have that effect if the parties otherwise agree.¹

A lease surrender agreement provides express evidence of the landlord's and the tenant's intent and acceptance of the surrender of the lease. There are, however, different methods of surrendering a lease.

¹ *Kottler v. N.Y. Bargain House, Inc.*, 242 N.Y. 28, 35–36, *remititur denied*, 242 N.Y. 568 (1926); see Robert F. Dolan, *Rasch's Landlord and Tenant* including Summary Proceeding § 26:1 (4th ed. 1998).

[32.5] D. Methods of Surrendering a Lease

A tenant can surrender a lease in three possible ways:² (1) an express surrender; (2) a surrender by operation of law; and (3) a surrender pursuant to law.

1. *Surrender by Express Surrender.* “An express surrender of a lease is one voluntarily made by the express mutual agreement of the parties to a lease, and expressly manifests an intention to reconvey the leasehold to the landlord.”³
2. *Surrender by Operation of Law.* “A surrender of a leasehold estate by operation of law occurs when the parties to a lease, without any express surrender, both do some act so inconsistent with the subsisting relation of landlord and tenant as to indicate that they have both agreed to consider the surrender as made.”⁴ For example, when a tenant abandons possession during the term in such a manner as to indicate the tenant’s intention to surrender its lease and the landlord retakes the possession of the premises in such a manner as to demonstrate the intention to reassume dominion and control for the landlord’s benefit, and not for the benefit of the abandoning tenant, then an “agreement” is inferred by law from the conduct of the parties and the “surrender of the lease” is deemed to have occurred by operation of law.⁵
3. *Surrender Pursuant to Law.* A surrender of a leasehold estate may also occur pursuant to the provisions of a particular law. For example, in New York State, under certain circumstances, in the event of a casualty that renders the premises untenable, a tenant may surrender possession of leased premises pursuant to section 227 of the New York State Real Property Law (RPL), which provides that:

2 The second method (a surrender by operation of law) and the third method (a surrender pursuant to law) are also collectively referred to as a surrender by “act or operation of law.” See Dolan, *supra* note 1, § 26:2 and N.Y. General Obligations Law, § 5-703 (GOL), regarding the requirement that a lease surrender agreement be in writing. GOL § 5-703 is discussed in Section III.B. of this chapter.

3 Dolan, *supra* note 1, § 26:2 (citing *Levitt v. Zindler*, 136 A.D. 695, 121 N.Y.S. 483 (2d Dep’t 1910)).

4 *Id.* § 26:6.

5 *Id.*; see *Altamuro v. Capocetta*, 212 A.D.2d 904, 622 N.Y.S.2d 155 (3d Dep’t), *appeal denied*, 85 N.Y.2d 808, 628 N.Y.S.2d 51 (1995); *Queensboro Dodge, Ltd. v. Queens J.K. Mgmt. Corp.*, 284 A.D.2d 383, 725 N.Y.S.2d 398 (2d Dep’t 2001).

Where any building, which is leased or occupied, is destroyed or so injured by the elements, or any other cause as to be untenable, and unfit for occupancy, and no express agreement to the contrary has been made in writing, the lessee or occupant may, if the destruction or injury occurred without his or her fault or neglect, quit and surrender possession of the leasehold premises, and of the land so leased or occupied; and he or she is not liable to pay to the lessor or owner, rent for the time subsequent to the surrender. Any rent paid in advance or which may have accrued by the terms of a lease or any other hiring shall be adjusted to the date of such surrender.⁶

Commercial leases, however, often contain “express agreements to the contrary” (e.g., clauses on “Destruction, Fire and Other Casualty,” which often provide no right or only limited rights for a tenant to cancel the lease in the event of casualty) and in New York State such lease clauses⁷ would include the tenant’s waiver of the provisions of section 227.

This chapter will focus on an express surrender through a lease surrender agreement.

[32.6] E. Terminology for Early Lease Terminations

There are a plethora of words that describe the circumstances pertaining to the early termination of a lease, including: expiration, termination, annulment, cancellation, and surrender. Each of these terms applies to specific circumstances.

Early lease termination terminology, on occasion, is used interchangeably by landlords, tenants, attorneys, the courts and the legislature.⁸ Consequently, understanding the differences and including the appropriate lease termination terminology in the lease surrender agreement can reduce confusion in implementing and enforcing the lease surrender agreement. Identifying the method by which the early termination of the lease is effectuated can help determine the appropriate terminology.

6 RPL § 227.

7 See Chapter 7, *supra*, generally, Section 9 entitled “Destruction, Fire and Other Casualty,” and, specifically, Section 9.5, entitled “Termination Right; Limitation on Restoration” and Section 9.4, entitled “Tenant Waiver.”

8 See Dolan, *supra* note 1, § 23:23 (word “expire” not essential).

For the purposes of this chapter, the term “surrender” is used in two different contexts:

1. “Surrender of possession” of the premises pertains to the tenant’s re-delivery of the possession of the premises to the landlord, but does not necessarily terminate the lease and the obligations of the tenant; and
2. “Surrender of the lease” (also referred to as “surrender of the leasehold estate”) pertains to the tenant’s termination of the lease and surrender of possession of the premises, which merges the estate (e.g., an estate for years) with the immediate estate in reversion or remainder.⁹

[32.7] F. Impact of Business Cycles

From the perspective that the commercial landlord-tenant relationship is a business relationship, many of the business decisions that govern whether to enter into a lease also govern whether to pursue an early termination of a lease. Good business practices include an evaluation by both the landlord and the tenant of the general economic environment and the specific economic issues of a particular lease.

The decision about whether any particular landlord and tenant will negotiate a lease surrender agreement and the terms of such a lease surrender agreement will depend, in part, upon their respective opinions of the real estate market and the financial viability and strength of the parties at the time of the proposed early termination.

In real estate markets classified as “boom” markets (such as the mid- to late-90s when the rental rates per square foot were rising in most real estate markets) the landlord may be more inclined to negotiate a lease surrender agreement in order to benefit from securing a higher rental rate with little risk of loss from the early termination of the lease.

In economic climates with corporate downsizing and decreasing rents in the commercial leasing market, more tenants may seek lease surrender agreements, while landlords may be more concerned about the prospects for re-letting the premises and therefore more reluctant to relieve the tenant of the lease obligations. During “down” business cycles, the landlord may need to balance whether to reject a tenant’s request for an early termination of the lease (to try to avoid the risk that the premises may

⁹ Dolan, *supra* note 1, § 26:1.

remain vacant for a long time and possibly be rented at a lower rental rate) against the business reality that a financially weak tenant may not be able to pay the rent. By rejecting the request for an early termination, the landlord may incur the costs and delays associated with commencing litigation for a judgment for rent and the possession of the premises and possibly further delays—as well as little money—if the tenant’s financial circumstances result in a bankruptcy filing.

[32.8] G. New York State and Other Jurisdictions

The case law, statutes, and practices of each jurisdiction can significantly affect the decision about whether to enter into a lease surrender agreement and, if so, the negotiating positions of the landlord and tenant. For instance, in New York State, the commercial landlord has no duty to mitigate damages after a unilateral vacatur of the premises by the tenant.¹⁰ Therefore, a commercial tenant in New York may be advised to secure a lease surrender agreement to prevent or limit its continuing obligation to pay rent unless the vacatur is in accordance with a provision in the lease or has a basis in law.

[32.9] H. No Duty to Mitigate in New York: Tenant’s Abandonment May Not Terminate Tenant’s Liability

In New York State, abandonment of the premises by a tenant without a lease surrender agreement, and not based on a provision in the lease or the law, generally subjects the tenant to continuing liability under the terms and obligations of the lease. Meanwhile, as noted, the landlord has no duty to mitigate damages under New York law.

The decision in *Holy Properties Ltd., L.P. v. Kenneth Cole Productions, Inc.*,¹¹ by the Court of Appeals of New York, reaffirmed the rule in New

10 *Holy Props. Ltd., L.P. v. Kenneth Cole Prods., Inc.*, 87 N.Y.2d 130, 637 N.Y.S.2d 964 (1995); Christopher Vaeth, Annotation, *Landlord’s Duty, on Tenant’s Failure to Occupy, or Abandonment of, Premises, to Mitigate Damages by Accepting or Procuring Another Tenant*, 75 A.L.R. 5th 1 (2000).

11 87 N.Y.2d 130. The New York Court of Appeals in 2014, re-affirmed the holding in *Holy Properties Ltd.* that, under New York law, a landlord is not to be subject to a duty to mitigate after a tenant abandons the premises; see *172 Van Duzer Realty Corp. v. Globe Alumni Student Assistance Assn., Inc.*, 24 N.Y.3d 528, 2 N.Y.S.3d 39 (2014) decided December 18, 2014.

York that the landlord has no duty to mitigate damages after a tenant abandons the premises.¹²

In New York, as noted in the *Holy Properties Ltd.* decision, the landlord has three options when a tenant has abandoned the leased premises before the lease expires: (1) do nothing and collect the full rent due under the lease;¹³ (2) accept the tenant's surrender, re-enter the premises and re-let the premises for the landlord's own account, thereby releasing the tenant from further liability for rent; or (3) notify the tenant that the landlord is entering and re-letting the premises for the tenant's benefit.

If the landlord chooses the third option, the rent collected would be apportioned to pay the tenant's rent obligation after first repaying the landlord for the expenses in entering and re-letting the premises. Accordingly, this option may offer some degree of mitigation, but only after the landlord's expenses have been covered and only if the rent collected for the premises after the tenant's abandonment is equal to (or greater than) the tenant's rental obligation under the lease for the abandoned premises.

As a result of the absence of any duty for the landlord to mitigate, a commercial tenant in New York State may have substantial economic exposure, including liability for continuing accrual of rent due under the lease, if the tenant unilaterally abandons its leased premises. Negotiating a lease surrender agreement gives the parties an opportunity to express their

12 See Vaeth, *supra* note 10. For an analysis of the landlord's duty to mitigate in New York State and the *Holy Properties Ltd.* case, see Jason Kee Low, *Have Reports of the Death of the Duty to Mitigate in New York Been Greatly Exaggerated? A New Interpretation of Holy Properties Ltd., L.P. v. Kenneth Cole Productions, Inc.*, N.Y. Real Prop. L.J. (NYSBA) Vol. 30, No. 2, at 77 (Spring 2002), where the author suggests that "[t]here potentially exists a duty to mitigate damages by a landlord [in New York State]." In concluding, the author raises key issues regarding: first, whether the duty to mitigate would apply to residential leases; second, whether, "[b]y not imposing a duty to mitigate upon the landlord," the court appeared to be "implicitly stat[ing] that the contract was terminated along with the conveyance, instead of being breached"; and, third, whether a provision in the lease relieving the landlord of any duty to mitigate is a necessary antecedent to a landlord's position of having no mitigation duty. Since this chapter is exclusively about commercial leases and, furthermore, since many commercial leases contain provisions relieving landlords of any duty to mitigate, the article does not appear to alter the subject matter or positions set forth in this chapter on commercial lease surrender agreements. However, a Bronx County Supreme Court decision in 2004 made a distinction from the *Holy Properties Ltd.* case for residential leases; see *29 Holding Corp. v. Diaz*, 2004 N.Y. Misc. Lexis 277 (Sup. Ct., Bronx, March 31, 2004). For an example of other states' opinions that do impose a duty to mitigate on landlords and therefore are contrary to New York State law, see the Supreme Court of Ohio decision in *Frenchtown Square P'ship v. Lemstone, Inc.*, 99 Ohio St. 3d 254, 791 N.E. 2d 417 (2003).

13 *Holy Props. Ltd., L.P.*, 87 N.Y.2d at 133–34 (citing *Becar v. Flues*, 64 N.Y. 518 (1876), and *Sancourt Realty Corp. v. Dowling*, 220 A.D. 660, 222 N.Y.S. 288 (1st Dep't 1927)).

intent for the landlord's acceptance of the surrender of the premises and termination of the lease.

[32.10] I. The Difference Between Termination of Lease and Early Termination of Lease

The most common form of lease termination occurs at the time of the original expiration date set forth in the lease. Because this form of lease termination is not an "early termination," there is no "surrender of possession" nor "surrender of the lease." When a tenant vacates the premises at the expiration of the term, there is no estate to be re-conveyed because the tenant's rights to the premises have expired by the terms of the lease. Therefore, a lease surrender agreement is not necessary when the termination of a lease occurs on the original expiration date set forth in the lease.

Even then, however, the parties may find a written agreement on the tenant's vacating of the premises helpful in clarifying and resolving issues such as:

- (i) setting forth the repairs and work, if any, that the tenant must perform to meet the underlying obligations of the lease pertaining to restoration of the premises;
- (ii) identifying which property in the premises constitutes improvements that shall remain in the premises and which the tenant shall remove;
- (iii) allocating the risks and costs of any environmental remediation, possibly obtaining an environmental insurance policy coverage;
- (iv) obtaining representations by the parties regarding any claims or litigation;
- (v) obtaining a representation that the premises are vacant of all occupants;
- (vi) determining whether any personal property remaining in the premises after vacatur shall be deemed abandoned and which of the parties shall be responsible for any costs of removal;

- (vii) setting the amount of the security deposit that shall be returned, if any, and time when it would be returned, if any; and
- (viii) obtaining, possibly, a limited release of the parties.

[32.11] J. Conclusion

A lease surrender agreement gives landlords and tenants an opportunity to chart the course of any early (or even any scheduled) termination of the lease and surrender of possession of the premises, set forth an orderly time schedule, allocate existing and post-termination liabilities, and limit exposure to the uncertainty and risk associated with an early termination of a commercial lease. A lease surrender agreement can give the parties:

- (i) an orderly return of the possession of the premises to the landlord;
- (ii) a specific date upon which the tenant shall be relieved from further obligations under the terms of the lease, such as subsequent rent;
- (iii) an allocation of the liability from claims and the cost of the removal of property left in the premises;
- (iv) an agreement on the condition of the premises upon surrender, including the extent of the restoration and/or the remediation of the premises; and
- (v) a set time and amount of the return of the security deposit.

The uncertainty of the process and continuing liability of the landlord and tenant are some of the major distinctions between the arrival of the original expiration date and the date of an early termination of the lease. A lease surrender agreement can provide some certainty and clarity about the process and allocate any continuing liability arising from the early termination of the lease and surrender of the premises.

[32.12] III. DRAFTING LEASE SURRENDER AGREEMENTS

[32.13] A. Introduction

In the early stages of negotiating a lease surrender agreement, the parties should consider the following issues that could influence its terms, conditions, and method of drafting:

- determining whether the lease surrender agreement must be in writing;
- identifying the appropriate and necessary parties (whether to include other occupants such as subtenants and whether to secure the consent or approval of lenders);
- confirming the accuracy of the parties' representations through appropriate due diligence;
- securing timely information and documentation that could be useful, yet difficult to obtain, after the surrender;
- clarifying the definition of "surrender" of the premises;
- defining the continuing liability of the parties (see Section IV.C.);
- deciding whether to include a confidentiality clause; and
- deciding whether to record the lease surrender agreement.

A significant resource for obtaining information and identifying issues in drafting a lease surrender agreement is the underlying lease. Commercial leases often contain articles—or specific language within different articles—setting forth certain responsibilities of the tenant upon the expiration date of the lease term, such as the tenant's responsibility to restore the premises to a certain condition or to remove the tenant's personal property. Therefore, as a first step in negotiating the lease surrender agreement, counsel to landlord and tenant should carefully review the lease to determine whether it addresses these issues and decide whether to proceed within the provisions of the lease, modify them, rescind them, or create new terms in a lease surrender agreement.

**[32.14] B. Written or Oral Lease Surrender Agreements:
Determining Whether the Lease Surrender
Agreement Must Be in Writing**

In general, a lease surrender agreement should be in writing. The landlord and tenant, however, may have a choice of entering into a written or oral lease surrender agreement. In some circumstances, an express lease surrender agreement can be oral, when the balance of the remaining term of the lease does not exceed one year. To determine whether a lease surrender agreement must be in writing, landlords and tenants should consider the New York State statutory requirements on creating and terminating interests in real property, as well as the specific provisions of the lease.

In New York State, the statute that requires a lease surrender agreement to be in writing is section 5-703 of the General Obligations Law (GOL), which codifies the part of the Statute of Frauds on conveyances and contracts relating to real property. According to GOL § 5-703(1):

An estate or interest in real property, other than a lease for a term not exceeding one year . . . cannot be . . . surrendered . . . unless by act or operation of law, or by a deed or conveyance in writing, subscribed by the person . . . surrendering . . . the same, or by his lawful agent, thereunto authorized by writing.

As a result of the “exception” language of GOL § 5-703 (“other than a lease for a term not exceeding one year”), a lease agreement need not be in writing when the term of the lease does not exceed one year. It is well established in New York that GOL § 5-703 applies to lease surrender agreements. It is also well established that the “not exceeding one year” period refers to the duration of the remaining lease term being surrendered (i.e., the period measured from the lease surrender date until the expiration date originally set forth in the lease), rather than the duration of the original term set forth in the lease (even if that original term had exceeded one year).¹⁴

¹⁴ *Smith v. Devlin*, 23 N.Y. 363, 364 (1861). See *Mt. Read Terminals, Inc. v. Great Lakes Express Co., Inc.*, 92 Misc. 2d 578, 400 N.Y.S. 2d 699 (Sup. Ct., Monroe Co. 1977); *Volkening v. Raymond*, 91 Misc. 53, 154 N.Y.S. 145 (App. Term, 1st Dep’t 1915); *Baldwin v. Cohen*, 132 A.D. 87, 116 N.Y.S. 510 (2d Dep’t 1909); *Levine v. Sidney Rosenstein & Co.*, 109 Misc. 299, 179 N.Y.S. 669 (Sup. Ct., N.Y. Special Term 1919).

Therefore, landlords and tenants may enter into oral lease surrender agreements provided that the balance of the term of the lease that is being surrendered does not exceed one year, regardless of the original length of the lease term.¹⁵ When the balance of the term (as measured from the date of surrender through the date set forth in the lease as its original expiration date) exceeds one year, though, the lease surrender agreement must be in writing unless the termination occurs by act or operation of law.

Even if a lease surrender agreement can be oral and need not be in writing under GOL § 5-703 or the terms of the lease, there are sound reasons to put the lease surrender agreement in writing. The terms of an oral lease surrender agreement, if disputed later, may be difficult to establish. If they conflict with the terms of the underlying lease, they may be unenforceable if the lease included a bar against oral modifications—as do nearly all commercial leases.

In the case of *85 John Street Partnership v. Kaye Insurance Associates, L.P.*,¹⁶ the tenant's claim that the landlord had orally agreed to be responsible to re-let the premises as part of their lease surrender agreement was rejected by the court based upon two provisions in the lease: one provision barring oral modifications and the other specifically relieving the landlord of any liability for failure to re-let the premises.¹⁷ Furthermore, many commercial leases include specific proscriptions against oral modifications of the terms of the lease and, often, against an oral agreement to terminate the lease. With regard to leases with such provisions, section

15 Dolan, *supra* note 1, § 26:3.

16 261 A.D.2d 104, 105, 689 N.Y.S.2d 473 (1st Dep't 1999).

17 *Id.* The "no-duty to re-let" clause in the lease stated that: "Landlord shall in no event be liable in any way whatsoever for failure to re-let the demised premises." Provisions relieving the landlord of any duty to mitigate are commonplace in commercial leases in New York.

15-301 of the GOL statutorily prohibits the oral changing or surrendering of such leases unless the agreement is in writing and signed by the party.¹⁸

A tenant, in deciding whether to pursue the early termination and surrender of its lease, may inappropriately rely on the oral representations of a landlord to allow the surrender of the lease or to agree to assume the duty to re-let the premises (and therefore limit the tenant's exposure to liability after the surrender). Those oral representations, however, may not be enforceable against the landlord based upon the provisions of the written lease expressly prohibiting oral modification of the lease, prohibiting oral termination of the lease, or providing that the landlord shall not be liable for the failure to re-let the demised premises.

It is therefore recommended that the lease surrender agreement be in writing to reduce the potential for disputes over the terms of an oral lease surrender agreement.

[32.15] C. Setting Forth the Appropriate and Necessary Parties

The effectiveness of a lease surrender agreement may depend upon identifying and addressing the appropriate and necessary parties. In addition to the landlord and tenant, other parties may be necessary or appropriate parties, including assignees, subtenants, other occupants in the premises, ground lessors, and—depending on the financing arrangements—lenders. Landlords and tenants should discuss and include representations and warranties in the lease surrender agreement that the tenant

18 GOL § 15-301 states:

When written agreement or other instrument cannot be changed by oral executory agreement, or discharged or terminated by oral executory agreement or oral consent or by oral notice.

1. A written agreement or other written instrument which contains a provision to the effect that it cannot be changed orally, cannot be changed by an executory agreement unless such executory agreement is in writing and signed by the party against whom enforcement of the change is sought or by his agent.

2. A written agreement or other written instrument which contains a provision to the effect that it cannot be terminated orally, cannot be discharged by an executory agreement unless such executory agreement is in writing and signed by the party against whom enforcement of the discharge is sought, or by his agent, and cannot be terminated by mutual consent unless such termination is effected by an executed accord and satisfaction other than the substitution of one executory contract for another, or is evidenced by a writing signed by the party against whom it is sought to enforce the termination, or by his agent.

See Tompkins Med. Office Bldg. Assocs. L.P. v. Meltzer, 238 A.D.2d 851, 656 N.Y.S.2d 533 (3rd Dep't 1997); *Roth Young Personnel Serv. v. 1500 Realty Co.*, 204 A.D.2d 75, 611 N.Y.S.2d 514 (1st Dep't 1994).

is the only party with regard to its interest in the lease and premises or, in the alternative, set forth all other interested parties.¹⁹

As noted below (and later in Sections V.A. and V.D.), in the absence of their consent or approval of the lease surrender agreement (i) subtenants may have rights to remain in the premises after the tenant has voluntarily surrendered the premises and (ii) lenders may be able to assert that the lease surrender agreement is not effective as to their interest in the lease or premises. Attorneys should thoroughly pursue with their clients the possibility of other interested parties to assure that the objectives of the lease surrender agreement are realized. The premises should be inspected immediately prior to the execution of the lease surrender agreement to confirm the status of their occupancy. Thoroughly review pertinent documents and records—including leases, assignments, subleases, deeds, financing agreements, loan documents, recorded mortgages and other instruments, and nondisturbance agreements—to determine any lender interests.

[32.16] 1. Identifying Occupants Who Should Be Parties to the Lease Surrender Agreement

If the intent of the parties is for the premises to be vacant and free and clear of all occupants upon the surrender date set forth in the lease surrender agreement, then—in addition to the tenant—all other non-tenant occupants (subtenants and any sub-subtenants) in the premises and interested parties (such as assignees) of the lease should be parties to the agreement. Alternatively, the agreement should be conditioned upon all

¹⁹ An example of Model Language pertaining to the representation that the tenant is the sole owner of the tenant's interest in the lease is provided by Dennis L. Greenwald and Mark A. Senn in the *Commercial Lease Law Insider* article entitled "Cover 11 Key Points in Lease Termination Agreement" (p.1 (July 2003)) (hereinafter "11 Key Points") and republished here with permission of Brownstone Publishers, Inc., New York City, N.Y.:

Model Language

Tenant represents and warrants that Tenant is the sole owner of the tenant's interest in the Lease; it has not made any assignment, sublease, transfer, encumbrance, conveyance, or other disposition of:

- a. Any interest it has in the Lease; or
- b. Any claim, demand, obligation, liability, action, or cause of action arising under or relating to the terms of the Lease, to any person or entity.

occupants of the premises, including non-party occupants, having vacated the premises.²⁰

The doctrine in New York State is that a voluntary lease surrender agreement between the landlord and the prime tenant will not automatically terminate the estate of a valid subtenant.²¹

As a general rule, where a landlord and prime tenant enter into an agreement to voluntarily terminate the paramount lease, the subtenant becomes the immediate tenant of the original lessor, and the interest of the subtenant and terms of the sublease continue as if no termination had occurred.²²

Upon the voluntary surrender of the lease between the landlord and lessee and the consequent merger of the greater and lesser interest terminating that lease, the landlord becomes the immediate landlord of the subtenant and has only such rights against the subtenant as the lessee would have had to the possession of the premises before the expiration of the term.²³

20 An example of Model Language pertaining to the lease surrender agreement being conditioned upon the all occupants vacating the premises is provided in 11 Key Points, *supra* note 19, at 2, and republished here with permission of Brownstone Publishers, Inc., New York City, N.Y.:

Model Language

Landlord and Tenant agree that the Lease shall be terminated effective as of [insert time] on [insert date] (“Termination Date”); provided that:

- (i) the conditions specified in Paragraphs [insert #s] have not been met, and
- (ii) Tenant and all subtenants or occupants have vacated the Premises.

If such conditions have not been met or Tenant or any subtenants or occupants have failed to vacate the Premises on the Termination Date, Landlord may declare an incurable Event of Default and pursue its remedies under Clause [insert #] of the Lease.

21 *Eten v. Luyster*, 60 N.Y. 252 (1875); *Goldcrest Transp. Ltd. v. Across Am. Leasing Corp.*, 298 A.D.2d 494, 495, 748 N.Y.S.2d 411 (2d Dep’t 2002); *Ocean Grille, Inc. v. Pell*, 226 A.D.2d 603, 641 N.Y.S.2d 373 (2d Dep’t 1996); *Benderson v. Computer Task Group*, 216 A.D.2d 922, 629 N.Y.S.2d 559 (4th Dep’t 1995); *Unionport Shoes v. Parkchester S. Condo. Inc.*, 205 A.D.2d 385, 613 N.Y.S.2d 605 (1st Dep’t 1994); *Da Costa’s Automotive, Inc. v. Birchwood Plaza Shell, Inc.*, 106 A.D.2d 484, 482 N.Y.S.2d 832 (2d Dep’t 1984); *Ashton Holding Co. v. Levitt*, 191 A.D. 91, 180 N.Y.S. 700 (1st Dep’t 1920); *Precision Dynamics Corp. v. Retailers Representatives, Inc.*, 120 Misc. 2d 180, 465 N.Y.S.2d 684 (Civ. Ct., N.Y. Co. 1983); see Stephen T. Kaiser, *Giving Up on Voluntary Surrender: The Rights of a Sublessee When the Tenant and Landlord Cancel the Main Lease*, 24 *Cardozo L. Rev.* 2149 (May 2003).

22 *Goldcrest Transp., Ltd.*, 298 A.D.2d at 495.

23 See *Eten*, 60 N.Y. 252; *Ashton Holding Co.*, 191 A.D. at 94.

In the decision of *Da Costa's Automotive, Inc. v. Birchwood Plaza Shell, Inc.*,²⁴ the Appellate Division, Second Department, noted that since the subtenant was not a party to the lease surrender agreement, the subtenant's interest and term as a subtenant of the lessee continued as if no surrender had been made and the landlord/owner of the premises, upon the surrender of the lease, became the subtenant's immediate landlord. Assuming the subtenant is in possession of the premises pursuant to a valid sublease agreement, the landlord would not be entitled to evict the subtenant from the demised premises by reason of the lessee's voluntary surrender of the paramount lease.²⁵

The doctrine that a lease surrender agreement is a voluntary termination of the lease between the landlord and tenant, and therefore the estate of a valid subtenant would not be automatically terminated upon the voluntary termination of the prime tenant's estate, is in contrast to the basic rule that a sublease is dependent on and limited by the terms and conditions of the main lease from which it is carved and that subtenancy may be terminated by the expiration of the term of the lessee or a re-entry by the landlord for a condition broken.²⁶

The contrast is reflected in the distinction made in New York State between the termination of a prime lease based upon a voluntary lease surrender agreement and the termination of a prime lease based upon its own terms (termination upon default of the prime lease, a re-entry by the landlord for some condition broken, or expiration of the prime lease).

The result is that a valid subtenant that is not a party to the lease surrender agreement may legally be entitled to remain in possession after the prime tenant has surrendered the premises pursuant to a voluntary lease surrender agreement. This is a matter of some significance and can affect the negotiating positions of the parties. The application of this doctrine might be regarded as an unexpected result (for some New York landlords): a subtenant, without any privity to the landlord, without a new

24 106 A.D.2d 484.

25 See *Ocean Grille, Inc.*, 226 A.D.2d 603.

26 *Precision Dynamics Corp. v. Retailers Representatives, Inc.*, 120 Misc. 2d 180, 181, 465 N.Y.S.2d 684 (Civ. Ct., N.Y. Co. 1983) (citing *Eten*, 60 N.Y. 252; *Jacob Hoffmann Brewing Co. v. Wuttge*, 234 N.Y. 469 (1923); *Ashton Holding Co.*, 191 A.D. 91; *N.Y. Rys. Corp. v. Savoy Assocs.*, 239 A.D. 504, 268 N.Y.S. 181 (1st Dep't 1933); *Metropolitan Life Ins. Co. v. Hellinger*, 246 A.D. 7, 284 N.Y.S. 432 (1st Dep't 1935), *aff'd*, 272 N.Y. 24 (1936); *World of Food, Inc. v. N.Y. World's Fair*, 22 A.D.2d 278, 254 N.Y.S.2d 658 (1st Dep't 1964); see Dolan, *supra*, note 1, §§ 9:73 and 9:74, subpart M "Subtenant's Rights on Voluntary Surrender of Paramount Lease."

lease, and without a subordination, nondisturbance and attornment agreement from the landlord, may have rights to continue possession of the premises, along the lines of a merger of the estate, after the prime tenant has surrendered and vacated the premises pursuant to a voluntary lease surrender agreement.

A landlord may consider a request for consent to a sublease as a routine request which, if granted, merely represents that the particular sublease by the tenant would not constitute a violation of the lease. The landlord may find, however, that such valid subtenant would be permitted to automatically attorn to the position of tenant as a result of the prime tenant's voluntary surrender of the lease, absent the subtenant's consent to surrender the premises pursuant to the lease surrender agreement.

In general, the landlord's denial of the request to sublet, wherein a subtenant's interest is expressly conditioned upon consent by the landlord, will mean that the party "never became a sublessee but remained merely a potential sublessee"²⁷ and is not entitled to rights of continued possession of the premises under the voluntary surrender agreement doctrine. Issues arise when there has been no express consent or denial by the landlord. A party alleging the status of "subtenant" for the purposes of protection of the lease surrender doctrine may be afforded an opportunity to establish, if it can, that the landlord impliedly consented to the subleasing arrangement²⁸ or that there was a waiver of the subletting prohibition based upon the length of the asserted subtenancy.²⁹

Another issue that may be litigated is whether the termination of the lease was based upon a breach of the lease or based upon a voluntary surrender of the lease, which, in some court decisions, may be determined

27 *Duane Reade v. I.G. Second Generation Partners, L.P.*, 280 A.D.2d 410, 411, 721 N.Y.S.2d 42 (1st Dep't), *appeal denied*, 96 N.Y.2d 716, 730 N.Y.S.2d 32 (2001); *see 767 Third Ave., LLC v. Kadem Capital Mgmt.*, 303 A.D.2d 199, 756 N.Y.S.2d 539 (1st Dep't 2003).

28 *Da Costa's Automotive, Inc. v. Birchwood Plaza Shell, Inc.*, 106 A.D.2d 484, 485, 482 N.Y.S.2d 832 (2d Dep't 1984).

29 *Unionport Shoes v. Parkchester S. Condo., Inc.*, 205 A.D.2d 385, 387, 613 N.Y.S.2d 605 (1st Dep't 1994).

upon the circumstances or upon a finding of collusion between the landlord and prime tenant.³⁰

In summary, subtenants may well be appropriate parties to a voluntary surrender agreement. Alternatively, the surrender agreement should be conditioned upon all subtenants having vacated the premises or the parties must set forth in the lease surrender agreement which, if any, subtenants would be permitted to continue in possession after the prime tenant's voluntary surrender of the possession of the premises.

[32.17] 2. Financing Arrangements with Third Parties— Lenders

Commercial landlords and tenants may have financing arrangements with covenants regarding the leasehold and the premises. These financing covenants may provide a third party, such as a lender, with consent rights or approval rights prior to the early termination of a lease. Therefore, the lender would be an appropriate party to the lease surrender agreement for the limited purpose of providing the lender's necessary consent or approval to the termination. The landlord should inquire whether the tenant has encumbered the lease as collateral and require the leasehold mortgagee to release its security or consent to the termination.³¹ Tenants should inquire about the landlord's lenders since typical loan documents can require consent prior to lease termination or require the borrower to assign to the lender all of the borrower's rights under the lease.

Failure to secure the consent of the mortgage holder could be a violation of the underlying financing arrangements (e.g., mortgages) and therefore, the lease surrender agreement would not be effective upon the mortgagee.³² “[A]n agreement by the mortgagor with respect to the mortgaged premises is not conclusive upon the mortgagee, or the receiver,

30 *Ocean Grille, Inc. v. Pell*, 226 A.D.2d 603, 641 N.Y.S.2d 373 (2d Dep't 1996); *Benderson v. Computer Task Grp.*, 216 A.D.2d 922, 629 N.Y.S.2d 559 (4th Dep't 1995); *Ashton Holding Co. v. Levitt*, 191 A.D. 91, 180 N.Y.S. 700 (1st Dep't 1920); *Precision Dynamics Corp. v. Retailers Representatives, Inc.*, 120 Misc. 2d 180, 465 N.Y.S.2d 684 (Civ. Ct., N.Y. Co. 1983); see Stephen T. Kaiser, *Giving Up on Voluntary Surrender: The Rights of a Sublessee When the Tenant and Landlord Cancel the Main Lease*, 24 Cardozo L. Rev. 2149 (May 2003) (Part II).

31 See, e.g., *Franklin Assocs. v. GSL Enters.*, 213 A.D.2d 313, 624 N.Y.S.2d 396 (1st Dep't 1995) (a \$9.25 million leasehold mortgage lien remained attached even after the surrender of possession by the tenant because there had been no consent to the lease surrender agreement by tenant's lending bank).

32 See *Crossland Fed. Sav. Bank v. Pekofsky*, 226 A.D.2d 667, 641 N.Y.S.2d 406 (2d Dep't 1996).

where such agreement contravenes an express covenant or the necessary implications of a prior recorded mortgage.”³³

In accordance with RPL section 291-f, an agreement restricting the right of surrender of the premises may also be binding upon a tenant or subtenant and could result in a lease surrender agreement being voidable as against a mortgage holder wherein:

- (i) the lease surrender agreement was entered into without the mortgage holder’s consent;
- (ii) there is an agreement containing restrictions on the right of the owner of the mortgaged real property to terminate the lease;
- (iii) the agreement containing the restrictions refers to section 291-f of the RPL and is contained in a recorded mortgage of real property, or in a recorded instrument relating to such mortgage;
- (iv) notice has been provided by the mortgage holder and is accompanied by the text of the restriction agreement; and
- (v) the lease has an unexpired term of five years or more at the time of the restrictive agreement.³⁴

Additionally, the parties must determine if the lender’s consent requires that any termination consideration be paid directly to the lender to reduce an outstanding loan balance.³⁵

[32.18] 3. Due Diligence: Conduct a Review of the Documents and Representations

To accurately determine all of the occupants in the premises and identify the parties from whom authorization or consent to the early termination of the lease may be required, the landlord and tenant should conduct

33 *N.Y. City Cmty. Pres. Corp. v. Michelin Assocs.*, 115 A.D.2d 715, 717–18, 496 N.Y.S.2d 530 (2d Dep’t 1985) (citing *Bank of Manhattan Trust Co. v. 571 Park Ave. Corp.*, 263 N.Y. 57, 62 (1933)); see *Colter Realty, Inc. v. Primer Realty Corp.*, 262 A.D. 77, 27 N.Y.S.2d 850 (1st Dep’t 1941).

34 RPL § 291-f “Rights where recorded mortgage restricts landlord’s action in respect to leases.”

35 Brian Mashian, *Lease Terminations: Negotiating Buy Outs and Buy Downs: Landlords and Tenants Must Resolve Significant Legal Issues*, Los Angeles Law., Feb. 1997, at 19.

a due diligence review. This should include researching, investigating, and inspecting the premises; requesting and reviewing pertinent documents; and setting forth in the lease surrender agreement express representation and warranties of full disclosure of the occupants and applicable third parties. The representations and warranties in a lease surrender agreement by the landlord and tenant may include, as appropriate:

- Representations by the tenant that it is the only party in possession of the premises and the only party with an interest in the tenant's interest in the lease. Alternatively, the tenant should set forth the names, relationship and status of any other occupants (e.g., subtenants and licensees) and any other parties with interests in the lease (e.g., affiliates or subsidiaries of the tenant as well as other parties that may occupy the premises through a change in control, merger or acquisition).

[For this purpose, it would be advisable for the parties to conduct physical inspections of the premises to confirm the status of the occupancy of the premises; inspections could be conducted at the beginning of (and during) the negotiation process and on the date of the surrender.]

- Representations by each party that the party has the authority to enter into the agreement, holds the entire interest, and is the appropriate party to enter into the agreement.

[For this purpose, the parties may require corporate resolutions or other written form of verification of the individual's capacity to bind the party. In addition, the parties may review the most recent title report (or even order a new search) or a conduct a search of the records at the appropriate registrar's office for the most recent recorded deed and any recorded leases, leasehold mortgages and/or memorandum of any of them.]

- Representations setting forth the form of the business entity of the landlord, tenant, subtenant and assignee (e.g., corporation, limited liability company, professional corporation, partnership, sole proprietorship) and the accuracy of the names of the parties.

[To check the accuracy of the names and status (e.g., active standing) of landlord and tenant corporations (as well as limited liability company entities), conduct a name search on the New York State Department of State, Division of Corporations, Corporation and Business Entity Database's website: https://www.dos.ny.gov/corps/bus_entity_search.html. The county clerk's offices maintain records on partnerships and sole proprietors doing business as assumed names—"d/b/a."]

- Representations that there are no third parties with financial interests or superior interests in the premises or the lease that may affect the interests in the lease (such as lenders or ground lessors) and—if there are such interests—whether any of the underlying financial agreements have restrictions on the right to terminate the lease, such as requirements for consent for the early termination of a lease before a surrender of a lease can be effectuated.

[Careful review of the loan documents as well as any subordination, nondisturbance and attornment agreement or any estoppel certificates that the parties have signed could reveal the existence of such restrictions on the termination of the lease.]

- Representations by each party that there are no defaults of the lease or facts, circumstances, situations, or events known to the party that would constitute a default of the lease.

For a further discussion of the issues and impacts of the potential liability of the parties in the context of a lease surrender agreement, see Section IV.C.

[32.19] D. Clarifying and Defining What Constitutes the “Surrender” of the Lease

In negotiating the definition of the “surrender” of the premises, the parties should consider:

- the specific date of the surrender of possession;
- surrender of all rights, interests and claims to the premises;
- all occupants vacating the premises (see Sections III.C. and V.A.);
- removal of all personal property, equipment, debris, and trade fixtures (see Section V.C.);
- repair of any damage caused by vacating the premises (including damage to the premises or common areas from the removal of personal property, trade fixtures or tenant improvements);
- restoration of the premises in accordance with the lease terms (see Section III.B.);
- premises “broom clean”;
- return of the keys.

At the time of the surrender of the premises, the parties are advised to conduct a walk-through to confirm that the premises are vacant and their condition complies with the terms agreed upon in the lease surrender agreement.

[32.20] E. Confidentiality Clauses

A confidentiality clause may be appropriate when one or both parties would prefer that the terms of the lease surrender agreement not become public information.³⁶ There are a number of reasons that the landlord or tenant may want the terms to remain confidential.³⁷ The tenant may not want its competitors to know any economic information about it (e.g., its present or past operations, obligations, or liabilities). Additionally, the tenant may be concerned about the perception of investors or the public concerning its financial status. The landlord may be negotiating with other tenants to surrender their tenancies on terms that are more favorable to it, or be concerned that other tenants might seek to negotiate a surrender of their premises upon the terms offered this tenant. In the context of lease surrender agreements, confidentiality clauses may be problematic to enforce and it may be difficult to prove damages in the event of a breach. These clauses may provide a level of comfort for the parties, however, by expressly setting forth the intent that information about the terms of the lease surrender agreement should not be released. The potential of a lawsuit for the breach of the confidentiality clause may act as a deterrent against any prohibited release of information.

36 An example of Model Language for confidentiality language is provided in 11 Key Points, *supra* note 19, at 4, and republished here with permission of Brownstone Publishers, Inc., New York City, N.Y.:

Model Language

Landlord and Tenant acknowledge that this Agreement contains confidential information. Accordingly, Landlord and Tenant agree that they shall keep this Agreement confidential and shall not disclose it to anyone other than the following:

- (i) Attorneys for the Landlord or Tenant;
- (ii) Accountants for Landlord or Tenant;
- (iii) Lender or mortgagee of Landlord; and
- (iv) Any other person, whom Landlord determines, is reasonably necessary or required to review these contents.

37 Dennis Greenwald, *Lease Termination Agreements*, Prob. & Prop. (A.B.A.), Sept./Oct. 2000, at 40.

[32.21] F. Recording the Lease Surrender Agreement

The parties may also have the option to record the lease surrender agreement. If the underlying lease—or a memorandum of the underlying lease—was recorded, the parties may be advised to record the lease surrender agreement—or a memorandum of the lease surrender agreement or memorandum of lease termination.³⁸ In order to record an interest in the real property at the registrar’s office, the document must be notarized and conform to the appropriate notarization format.³⁹

**[32.22] IV. LEASE SURRENDER AGREEMENTS:
GENERAL ISSUES**

This section will focus on four general issues that arise in negotiating a lease surrender agreement: (a) determining whether the landlord or the tenant is entitled to a “termination fee”; (b) clarifying the “condition of the premises” upon surrender by the tenant; (c) determining the extent of the continuing liability of the tenant after the surrender of the lease; and (d) resolving contingent rights and pending proceedings.

As a starting point in the negotiation process, the landlord and tenant should review the terms of the lease to determine if these issues are addressed and decide whether to incorporate the lease terms into the lease surrender agreement, or to modify or rescind them or create new terms.

**[32.23] A. Who Is Entitled to the Termination Fee for the
Early Termination of a Lease?**

In negotiating a lease surrender agreement, one of the more extensively negotiated issues is whether there should be a “termination fee” and, if so, how to determine its amount. In effect, a termination fee is consideration to compensate the landlord (or the tenant, as appropriate) for the costs associated with the early termination of the lease. As set forth below, these may include:

38 See Nancy E. Grauman & Pamela L. Westhoff, *Get Signed Memorandum of Lease Termination Upfront*, *Commercial Lease Law Insider*, Brownstone Publishers, Inc., pages 1–5, November 2003 (Note: in the context of lease surrender agreements, it is recommended that the beginning of paragraph 2 of the Model Form of the Memorandum of Lease Termination be modified to read “The Lease has terminated or expired in accordance with the terms and conditions more specifically set forth therein or more specifically set forth in a written lease surrender agreement” (underlined portion is the recommended modification)).

39 RPL § 309-a.

- cost of moving (incurred by the tenant),
- cost of negotiating and drafting the lease surrender agreement (and any other associated legal costs),
- cost to repair damage caused during the tenant's vacating the premises (incurred by the landlord), or
- future damages, such as the potential loss of rental income for the period pending the placement of a new tenant and/or for a lower rental rate than the surrendering tenant had been obligated to pay.

Consideration paid by the landlord to the tenant is sometimes referred to as a “buy-out” of the lease and consideration paid by the tenant to the landlord is sometimes referred to as a “buy-down” of the lease.⁴⁰

[32.24] 1. Factors in Negotiating the Termination Fee

Early termination of a lease can change the underlying economics of the lease. Commercial landlords and tenants negotiate the rent and evaluate the inducements to rent the premises based upon the length of the lease. Expediting the termination of the lease shortens the length of time the parties have to amortize costs such as the broker's fee, tenant improvement allowance, rent credits, and free rent period, as well as tax benefits from the depreciation expense.

The tenant that vacated the premises to accommodate the landlord's needs may incur an additional cost calculated as the difference between the original rent and an increased rental rate at another location. The landlord may experience the loss of rental revenue if the premises are vacant before the next tenant moves in and/or if the new rent is lower than the rent set forth in the surrendered lease.

The termination fee may also include other costs associated with the correction or removal of alterations improperly performed by the tenant (e.g., those not in compliance with local building codes). Alternatively, the parties may negotiate a dollar amount to be paid to the landlord in exchange for waiving any lease provisions regarding the condition of the premises upon surrender (e.g., requiring the tenant to restore the premises to “good” or “original” condition or to leave them clean and vacant of all personal property and fixtures).

⁴⁰ Greenwald, *supra* note 37, at 40.

[32.25] 2. From the Tenant's Perspective

The cost to the tenant for complying with a landlord's request to surrender the premises may include the costs associated with finding an alternative location—such as an increased rental rate, the cost of the build-out of the new premises, the expenses of transferring the tenant's business to the new location and perhaps having to find new employees or pay higher impositions such as higher taxes based upon the other location. The termination fee paid to the tenant may include moving costs as a further incentive to move. The tenant may also negotiate for reimbursement of a portion of the expense that it incurred to build out the premises that constituted substantial improvements (such as internal stairways, structural subdivisions within the premises, telecommunication systems, etc.) which the tenant must now leave, without having received the full extent of use.

[32.26] 3. From the Landlord's Perspective

The cost to the landlord associated with the early termination of the tenant's lease may include the loss of rental revenue (from the premises remaining unoccupied for a period of time and/or from the premises being rented at a lower rental rate). "Hidden" costs may include having to find another tenant for the premises (and providing another rent-free period or rent credit for the new tenant's improvements), making improvements to the premises in advance of a new tenant's occupancy, or paying another broker's commission.

Even if the landlord secures a new tenant immediately after the surrender of the premises, the landlord may have to offer the new tenant a greater amount of inducements (e.g., rent-free periods, tenant improvement allowances, as well as payment of another real estate broker fee) than the original tenant was given. Therefore the landlord should demand at least an apportioned payment relative to the balance of the lease term that is being surrendered.

Some commercial leases contain provisions that the entire amount of tenant inducements shall be repaid to the landlord in event of default. However, the tenant could legitimately argue that such a provision would unjustly enrich the landlord and should be apportioned relative to the remaining time of the unexpired term of the lease (calculated from the date of surrender to the original lease expiration date).

[32.27] 4. External Matters Affecting the Determination of a Termination Fee

The negotiation of the termination fee may be influenced by the current real estate market as well as the financial position of the parties.

Real estate market. If there is strong demand in the local real estate market with generally increasing rental rates (e.g., the mid- to late-90s), a landlord may not demand a termination fee—or may accept a lower amount—in order to recover the premises as quickly as possible to take advantage of the higher per-square-foot rental rates. In this type of market, a tenant may demand a higher termination fee to cover the anticipated additional rent at another location. Conversely, if the local real estate market is depressed (e.g., oversupply of available commercial space, corporate downsizing, and decreasing rents), a landlord may insist on a higher termination fee to cover additional tenant inducements, an extended vacancy period, and possible lower rent. A tenant, however, may not demand as high a termination fee in order to take advantage of the lower rent at another location.

Financial position of the parties. If the tenant is in financial trouble, the landlord may decide to enter into a lease surrender agreement for little or no termination fee in order to promptly obtain possession of the premises. For instance, if the tenant already owes rent for a period prior to the proposed surrender date, the landlord may be willing to waive the rental arrears or negotiate that the payment of all, or part, of the existing rental arrears may constitute the termination fee and such would be paid before or at the time of the execution of the lease surrender agreement. Alternatively, part or all of the rental arrears could be paid even subsequent to the lease surrender date—such as in the form of an Affidavit of Confession of Judgment. In this manner, the landlord could possibly avoid a long delay and legal fees associated with instituting a summary proceeding and evicting the tenant. Additionally, in some circumstances the tenant may have few assets that the landlord could attach and satisfy a money judgment. The tenant's only significant asset may be the lease for the premises, while the equipment and inventory in the premises may have been leased from a third party or obtained on credit. Accordingly, in the absence of a personal guaranty or security deposit, even if the landlord successfully obtained a money judgment against the tenant, the tenant's revenues and assets that the landlord could attach to collect the judgment might be nominal and not sufficient for the landlord to recover its damages.

Therefore, unless there is some guaranty of payment (such as a large security deposit, letter of credit, or personal guaranty) that could be applied, the landlord might not be able to collect on a money judgment against the tenant even if the landlord had a meritorious claim and successfully litigated the matter, instead of entering into a lease surrender agreement. Alternatively, if the tenant were to file for bankruptcy, the landlord could be subject to delay in the return of the premises and only receive a nominal payment for the landlord's unsecured claims for rental arrears and costs associated with the early termination of the lease.

[32.28] 5. Tax Implications of Lease Surrender Agreements and Termination Fees

Landlords and tenants should consider the categorization of the termination fee because of the potential tax implications. The portion of the termination fee, if any, that reflects the settlement of the "rent" payments for the period after the lease surrender may be classified as income and taxed accordingly (also, there may be real estate transfer tax implications). The compensation for the capital improvement may or may not be a non-taxable event.

Additionally, there may be real property transfer tax implications applicable to the surrender of real property. Pursuant to section 11-2102 of the New York City Administrative Code, there may be tax imposed with respect to the consideration for granting of the surrender of a leasehold which is located in whole or in part in within the city of New York.⁴¹ Both the lease surrender agreement's landlord/owner and the tenant can be held responsible for the payment of this real property transfer tax: "The grantee shall also be liable for the payment of such tax in the event that the amount of tax due is not paid by the grantor or the grantor is exempt from tax."⁴² The New York State real estate transfer tax provisions are set forth in article 31 of the New York Tax Law.⁴³

There may also be sales tax implications depending upon the structure of the surrender agreement. An example is an auction of personal property that was surrendered: the purchaser of the personal property may be obligated to pay a sales tax.

41 N.Y.C. Admin. Code § 11-2102(a)(10).

42 N.Y.C. Admin. Code § 11-2104.

43 See Tax Law §§ 1401 (definitions), 1402 (imposition of tax), 1404 (liability for tax).

Recognizing that the subject of taxation is complex and beyond the scope of this chapter, it is recommended that landlords and tenants confer with their accountants (and with specialists and lawyers that specialize in tax issues) for a full analysis and discussion of the tax implications of a lease surrender agreement and, in particular, the termination fee.

[32.29] B. Negotiating Tenant’s Obligations to Restore the Premises and Comply With Lease Terms Regarding Its Condition

Commercial leases often contain provisions pertaining to the condition of the premises at the time of the expiration or early termination of the lease (e.g., the tenant is obligated to restore the premises to a “good,” “original,” “normal,” or “lawful” condition—all usually “with normal wear and tear excepted”—and/or the tenant is obligated to remove tenant alterations and property). Additionally, other lease provisions may indirectly impose obligations on the condition of the premises, including the tenant’s obligation to repair and maintain the premises during the lease period, comply with restrictions and conditions placed on tenant improvements and alterations, and obey local, state, and federal laws.

When negotiating the condition of the premises upon the surrender of the lease, the landlord’s objective is to secure possession in order to prepare for the next tenant as quickly as possible and to minimize the associated costs. The tenant’s objective is to minimize its costs associated with vacating the premises and limit (or be released from) its obligations pursuant to the terms of the lease to maintain, repair and restore the premises.

[32.30] 1. Costs Associated With the Condition of the Premises

From the landlord’s perspective, the tenant’s improper actions or inadequate performance of the terms of the lease could result in unanticipated costs that become apparent with the tenant’s surrender of the premises.

These unanticipated costs could include expenses to restore the premises to a condition that is acceptable to a future tenant or to remove/correct alterations made by the tenant that do not comply with the law. This may include making changes to comply with local building codes (e.g., the tenant installed wooden partitions where metal ones are required, doors that do not meet the fire safety rating, ceiling tiles that cover sprinkler heads, lofts built without a permit, or areas with insufficient ventilation). The landlord may need to change tenant alterations that do not comply with federal Americans with Disabilities Act (ADA) requirements

(i.e., mandates covering ingress and egress to the premises, door widths, or bathroom configuration). Additionally, any necessary alterations would cause time-consuming delays.

The landlord could also incur costs after the lease surrender agreement has been signed and after the tenant has moved out. For example, the cost to repair damage caused by the tenant in vacating the premises (e.g., damage to walls or doors or damage caused in removing equipment, trade fixtures, or machines); and/or to remove and possibly store the tenant's property (e.g., equipment, machines, fixtures, materials, inventory, debris, or other personal property left in the premises by the tenant or its invitees). Future costs may arise relating to the remediation of the site, such as remediation of hazardous materials that may have been improperly stored or disposed of by the tenant, or remediation of asbestos that became "friable" as a result of actions of the tenant, or, more recently, responding to the presence of—and allocating the costs associated with the removal of—"toxic" mold⁴⁴ or abandoned wires (e.g., telecommunications, fiber, cable, fire alarm, and electric power cables).⁴⁵

[32.31] 2. Inspection of the Condition of the Premises

To evaluate and assess the condition of the premises, the landlord and tenant should conduct inspections during the negotiation of the lease surrender agreement and on the date of the surrender of possession (or, in the case that the tenant has already vacated the premises, upon the effective date of the surrender of the lease).

An inspection of the premises should provide the parties with an opportunity to consider:

- (i) the level of repair at which the tenant maintained the premises (i.e., whether the condition of the premises is in a suffi-

44 See Walter G. Wright, Jr. & Stephanie M. Irby, *The Transactional Challenges Posed by Mold: Risk Management and Allocation Issues*, 56 Ark. L. Rev. 295 (2003); Stephen J. Henning & Daniel A. Berman, *Mold Contamination: Liability and Coverage Issues: Essential Information You Need to Know for Successfully Handling and Resolving Any Claim Involving Toxic Mold*, 8 Hastings W.-NW. J. of Envtl. Law & Policy 73 (Fall 2001); Thelma Jarman-Felstiner, *Mold Is Gold: But, Will It Be the Next Asbestos?*, 30 Pepp. University L. Rev. 529 (2003).

45 The issue of the removal of abandoned wire is addressed in the new National Electric Code issued by the National Fire Protection Association and may become the basis for New York State and local laws. See Gerard Lavery Lederer, *New Electrical Code Requires Removal of Abandoned Wire*, Professional Office Building Management (Brownstone Publishers, Inc.), Nov. 1, at 1, November 2003; see also Gerard Lavery Lederer, *When Telecommunications Access Becomes Too Much*, Prob. & Prop. (A.B.A.), July/Aug. 2003, at 8–13.

cient state of repair taking into account “ordinary wear and tear”);

- (ii) the type and extent of tenant improvements and alterations (e.g., whether the improvements were authorized under the terms of the lease, add value to the premises, may be desirable for the next occupant, may detract from the ability to rent the premises—or perhaps the improvements, or alterations, are “illegal,” such as those constructed without permits or from materials unacceptable under the building code, in which case the landlord may insist that the tenant remove them or that they be included in the landlord’s estimated costs of removal as part of the termination fee);
- (iii) the existence of unlawful conditions (e.g., including asbestos that may have been installed prior to the tenancy that may have become “friable” either over time or exacerbated by the tenants occupancy or vacatur; and, since the late 1990s, similar concerns about the presence of “toxic” mold;⁴⁶ and, as of 2003, the requirement for the removal of abandoned telecommunications, fiber, cable, fire alarm, and electrical power cable wires);⁴⁷ and
- (iv) damage to the premises caused by the removal of personal property, equipment, and trade fixtures (and, to the extent required and/or permitted by the terms of the lease, fixtures) during the tenant’s vacating of the premises.

[32.32] 3. Factors to Consider in Negotiating the Condition of the Premises

The negotiation of the lease surrender agreement provides an opportunity for the landlord and tenant to establish the extent of the obligations of the tenant pertaining to the condition of the premises. The landlord and tenant can agree to apply the existing lease obligations, modify the obligations of the lease, or formulate entirely new obligations.

Several factors affect the landlord’s negotiation of the tenant’s obligation. If the landlord has requested the tenant to surrender the premises in order to accommodate its own needs (e.g., to provide the premises to another tenant that needs to expand, permit the landlord to perform sub-

⁴⁶ See *supra* note 44 for articles on “toxic” mold.

⁴⁷ See *supra* note 45 regarding the issue of the removal of abandoned wire.

stantial alterations to the premises, or comply with the terms of a prospective purchaser of the premises), then the landlord may accept the premises virtually “as is” without requiring the tenant to comply with the restoration requirements of the lease.

Even if the tenant requested the lease surrender, however, the landlord may accept surrender and the costs associated with the condition of the premises instead of litigating the matter. Factors (such as the weak financial position of the tenant) might lead the landlord to conclude that the tenant would not correct the conditions (but a long delay in securing possession of the premises would ensue while the landlord insisted the tenant resolve the matter). The real estate market might be so strong that the increase in rentals would offset the delay in pursuing the tenant to correct the conditions. See Section IV.A.4. for a discussion of the real estate market and “financial position of the tenant” factors. Although, if there are substantial costs, such as those associated with environmental remediation, then it would be less likely that a landlord would accept these costs.

In considering whether to negotiate the issue of the condition of the premises, the landlord and tenant can evaluate the alternatives to entering into the lease surrender agreement (which may include litigating those “condition of premises” issues that would constitute a default of the lease). From the landlord’s perspective, however, litigation could cause a long delay in securing possession of the premises, the condition of the premises could deteriorate during that time, and the end result could be a money judgment that is difficult, if not impossible, to collect from the tenant. From both the landlord’s and tenant’s perspectives, there could be extensive legal fees arising from litigation.

Additionally, in certain circumstances, the tenant’s alterations may be deemed by the landlord to add value to the premises or have potential value for a subsequent tenant. In such cases, the landlord would waive a restoration obligation.

It is therefore advisable that the lease surrender agreement expressly set forth the obligations of the tenant as to the condition of the premises, and the landlord should conduct itself accordingly. Failure to address the issue of the “condition of the premises” upon surrender can result in extended dispute, expensive litigation, delay in restoring the premises to an income-producing asset, and possibly the waiver of the tenant’s obligation under the lease. In the event of a subsequent dispute, some courts may interpret a voluntary lease surrender agreement as a basis to reduce

the tenant's obligations, or interpret the conduct of the landlord as a basis to discharge some of the tenant's obligations.⁴⁸

[32.33] 4. Pitfalls and Difficult Issues Regarding Repairs and Remediation

One of the more vexing issues that arises at the expiration of the term of the lease (whether by early termination or upon the original expiration date set forth in the lease) with regard to the condition of the premises is the level of the obligations regarding the repair and remediation of the premises (particularly if there are expensive environmental remediation issues).

Interpreting the nature and extent of the repair/restore/removal clauses can become particularly difficult in the context of remediation. The potential liability associated with environmental remediation is enormous pursuant to the Comprehensive Environmental Response, Compensation and Liability Act (CERCLA).⁴⁹ Another area of continuing concern is the responsibility for remediation of asbestos which can arise in a number of contexts, including the need for abatement of an asbestos condition that is aggravated by the tenant's presence in the premises or in vacating the premises or by the necessity to remove equipment or improvements that were illegally installed.

In some commercial leases, the issue of asbestos arises in part as a result of the change in the laws over the past 40 years. As the court noted in the *Chemical Bank v. Stahl*⁵⁰ case, fireproofing that consisted of asbestos-containing materials (ACM) was legally required during the 1960s. Meanwhile, by the 1970s, the use of ACM in construction was prohibited by many municipalities as the dangers of asbestos became more apparent. The result has been an enormous cost for the remediation of asbestos through removal, encapsulation, and other methods. Similar concerns arise when considering the possible impact of the growing litigation over "toxic" mold⁵¹ and the requirement for the removal of abandoned telecommunications, fiber, cable, fire alarm, and electrical power cable wires.⁵²

48 See *Chem. Bank v. Stahl*, 272 A.D.2d 1, 712 N.Y.S.2d 452 (1st Dep't 2000).

49 42 U.S.C. §§ 9601–9645.

50 272 A.D.2d 1.

51 See *supra* note 44 for articles on "toxic" mold.

52 See *supra* note 45 regarding the issue of the removal of abandoned wire.

[32.34] C. Determining Continuing Liability After Lease Surrender

By entering into a lease surrender agreement the parties are effectively accelerating the expiration of the lease, which raises a number of issues regarding the continuing liability of the parties. These include indemnification for pending and potential claims and actions brought by third parties for personal injury or property damage, as well as responsibility arising from the condition of the premises. To determine the continuing liability after the surrender of a lease, the landlord and tenant should carefully review the applicable provisions of the lease, common law, and statutory law upon which continuing liability is based. The parties can also set forth in the lease surrender agreement specific references to those obligations in the lease that the parties intend to survive its termination.

[32.35] 1. Continuing Liability in General

Continuing liability occurs when claims against the landlord and/or tenant, which arose from the usage of the premises or an incident that occurred in the premises, continue (and in some cases are discovered) after the lease has been surrendered. In general, such claims arise from third-party claims for personal injury, bodily injury (including death), or property damage; claims, fines or penalties by governmental authorities for violations of law or regulations (e.g., violation of environmental laws, building codes, fire codes) or claims between the landlord and tenant for incidents that occurred during the surrender of the premises (e.g., damage to the premises caused by the removal of trade fixtures or equipment).

Continuing liability associated with claims by third parties for personal injury, bodily injury (including death), and property damage should be evaluated in the context of whether the landlord or tenant owes an obligation of indemnification to the other party. This obligation may arise pursuant to either the contractual indemnification provision of the lease or common-law indemnification (or both). Landlords and tenants should carefully examine the indemnifications, representations, warranties and various obligations in the lease—undertaken by themselves and any other party—and determine which liabilities should survive the surrender of the lease.

Continuing liability may also arise from costs incurred by the landlord from correcting conditions of the premises caused by the tenant. The landlord could incur substantial costs correcting alterations by the tenant which did not comply with city, state, and federal law. For example, the

tenant may not have complied with the ADA (e.g., not meeting the ADA requirements for a bathroom) or with local building codes (e.g., making inadequate provisions for ventilation or lighting) or with fire safety codes (e.g., installing doors with insufficient fire rating or drop ceilings covering existing sprinkler heads) or with local laws requiring permits to perform certain construction. Environmental conditions represent another area of concern. A tenant's non-compliance with environmental laws such as the Resource Conservation and Recovery Act (RCRA),⁵³ the Toxic Substances Control Act (TSCA),⁵⁴ and CERCLA⁵⁵ could result in significant liability and remediation costs arising from improper handling, storage, use, leakage, or disposal of hazardous materials.⁵⁶

Additionally, in the event the landlord and tenant do not enter into a lease surrender agreement or the agreement does not resolve outstanding arrears in rent, there may be continuing obligations of the tenant with regard to the payment of rental arrears (as well as arrears in "additional rent" including tenant's proportionate share of the operating costs, utility costs, insurance premiums, taxes, late fees and other charges as set forth in the commercial lease) that are due through the lease surrender date. As noted in Section II.H. of this chapter, a tenant in New York State may con-

53 42 U.S.C. §§ 6901–6992k.

54 15 U.S.C. §§ 2601–2692.

55 42 U.S.C. §§ 9601–9675.

56 *See supra* Section III.

tinue to be liable for the payment of “rent”⁵⁷ after abandoning the premises until the end of the term set forth in the lease. By entering into a lease surrender agreement, however, the parties can negotiate a “termination

57 At times there appears to be some confusion between the terms “rent” and “damages” with regard to the obligation under a lease to pay “rent” for the period after a tenant has abandoned the premises. The courts in New York have generally held that the landlord’s right to a money judgment does not accrue until the period for which the rent is due has occurred. The basis is a breach of contract and that the “rent” set forth in the lease that will be due for the subsequent periods is not due until that period. Therefore, under contract principles, the “rent” is classified as “damages” and the right to a money judgment occurs only after the tenant has “breached” the lease (contract) terms which occurs after the period the “rent” was due. The use of the phrase “rent” due for the period after the surrender of the lease is somewhat of a misnomer. Although the parties may negotiate as part of the termination fee an amount to compensate the landlord for the “rent” that may have come due after the surrender of the premises, technically, the amount is “damages” and not continuing liability unless the parties negotiate for the payment in the lease. The lease surrender agreement constitutes a voluntary termination of the lease by expediting the expiration date of the lease. One should note that this is quite different from circumstances wherein the tenant abandoned the premises (or the lease is terminated pursuant to a default by the tenant). In those circumstances a commercial landlord can opt to claim for rent (if the tenant abandoned the premises and landlord does not re-take the premise) or for damages (instead of “rent” if the lease is terminated pursuant to a tenant default) for each subsequent month. In the case of the voluntary surrender of the lease, the parties can negotiate whether the landlord is entitled to any payment for “rent” or “damages” for the period after the lease surrender date until the original lease expiration date. However, in the absence of a negotiated agreement set forth in the lease surrender agreement as to the continuing liability for the payment of rent, the lease surrender agreement would extinguish the obligation of the tenant for payment of rent due for the period after the lease surrender date.

fee,” if any, and can clarify the termination of the tenant’s obligation, if any, to pay “rent” for the period following the surrender date.

[32.36] 2. Factors in Negotiating Continuing Liability

The extent to which the landlord and tenant are willing to negotiate the issues regarding continuing liability will be affected by the particular type of continuing liability. Continuing liability regarding third party claims for personal injury (including death) or bodily injury and extensive property damage and substantial fines or penalties may be hard to quantify and the parties may be focused upon conducting due diligence to ascertain the issues (such as the existence or extent of insurance coverage). Other types of continuing liability, however, such as minor property damage claims and legal fines and penalties, as well as some rental arrearages, may be quantifiable enough to set forth in the lease surrender agreement as specific amounts, or the amount may be estimated to be so negligible that the parties decide to waive continuing the liability.

For additional factors that influence negotiations, see Sections IV.A.4. and IV.B.3. These factors include

- (1) the financial position of the tenant—if the tenant is in financial trouble, has few assets or revenue streams, could petition for bankruptcy, and there is no personal guaranty nor a substantial security deposit or letter of credit, then the landlord may be willing to secure the premises through the lease surrender agreement and not pursue some costs;
- (2) the economic situation of the real estate market—if the rent per square foot is increasing, then the landlord may pursue a quick return of possession of the premises in order to take advantage of significantly more rent from the next tenant in exchange for waiving some lease provisions or claims for damage to the premises; and
- (3) alternatives to entering into the lease surrender agreement, such as litigating those issues that constitute a default of the lease.

The alternative of pursuing the tenant for the default of the lease, however, could entail expensive and extensive litigation and result in significant delay in the return of possession of the premises. Depending upon the parties’ perceptions, the above may be factors in deciding whether to enter into a lease surrender agreement.

[32.37] 3. Managing Uncertainty and Risk in Assessing Continuing Liability

Assessing continuing liability can be complicated by a number of issues, such as the difficulty inherent in managing risks associated with real property. In part, the difficulty arises from the absence of accurate and timely information and uncertainty regarding potential claims that are as yet unknown to the parties. Claims for personal injury, property damage, and environmental actions have statutes of limitations that can extend for years after the lease has been surrendered (e.g., under New York State law, the statute of limitations for a regular “slip and fall” personal/bodily injury case or a general property damage case that is based upon negligence is three years,⁵⁸ and it is six years for a breach-of-contract case⁵⁹).

Secure as much information, data, records, and documents as possible during the negotiation of the lease surrender agreement. This provides the landlord and tenant with an opportunity to understand and manage the uncertainty and potential risk associated with continuing liability that can arise pertaining to the lease, tenant’s use of the premises, and any incidents that occurred in the premises, as well as all alterations and repairs made to and in the premises during the tenancy. A number of items listed below may be required by the lease and perhaps are already known by—or are already in the possession of—the parties.

- Request representations by each of the parties regarding any defaults of the lease or facts, circumstances, situations, or events known to the party that would constitute a default of the lease.
- Request the following information and data:
 - a) a list of representations regarding, information on, and records about, all of the legal actions, proceedings, and claims pending against the parties that arise from the lease or the use of the premises—and the current status of these matters (along with pertinent information such as their full caption, index number, court, and appropriate counsel, insurance companies, and contact persons for all pending claims);

⁵⁸ N.Y. Civil Practice Law and Rules 214 (hereinafter “CPLR”).

⁵⁹ CPLR 213.

- b) a list of all anticipated or threatened legal actions, proceedings, and claims;
 - c) a list of all equipment lenders and parties with security liens to any of the tenant's personal property in the premises; and
 - d) a list of any mechanic's or construction liens (private or public) on the premises, as well any contractors who have not been paid or have claims for payment.
- Request the following records and documents:
 - a) copies of the underlying notices and papers, including all records and correspondences to and from the parties regarding any personal injury or property damages claims and lawsuits, both pending and expected to be commenced; and
 - b) copies of all of the certificates of insurance and, as appropriate, copies of the entire insurance policies.
 - Request records regarding repairs, alterations and the condition of the premises:
 - a) representations setting forth all alterations made to the premises and any hazardous materials stored, processed, used, or disposed of by the tenant (whether at, in, or from the premises); along with a summary of the contractors and copies of the applicable contracts, manifests, and insurance policies;
 - b) copies of all "as-built" plans, drawings, and specifications of improvements, alterations, utility systems, or any other substantial work done at the premises or to the building systems (and initial plans, specifications, and drawings if "as-built" not prepared yet)—all of which would preferably be in a CAD format;
 - c) copies (and assignments) of all warranties applicable to alterations or work performed at the premises or to the building systems; and
 - d) copies of all permits, temporary certificates of occupancy, certificates of occupancy, and/or certificates of completion (as appropriate, pursuant to local building codes).
 - Request information and records regarding financial and risk management issues:

- a) copies of all appropriate financial records that apply to tax issues, such as records of costs of tenant's improvements (may be helpful in a tax certiorari proceeding);
 - b) copies of insurance policies or, at least, copies of the certificate of insurance and perhaps the "Declaration" page(s) and the policy's endorsements; and
 - c) copies of all recognition, nondisturbance, subordination, and attornment agreements and all estoppel certificates.
- Request information regarding potential environmental liability.

As a result of the potential extensive exposure to environmental liability that can be imposed upon the landlord and tenant, it is advised that the parties engage in sufficient discussions and exchanges of information, data, records, and documents (perhaps even conduct an environmental audit or evaluation as an benchmark).⁶⁰

Environmental liability information should include representations and a written summary setting forth any hazardous materials (e.g., "hazardous waste," "hazardous materials," "hazardous substances"; or Polychlorinated Biphenyls (PCBs), asbestos, and petroleum and petroleum by-products) stored, processed, used, or disposed of by the tenant (whether at, in, or from the premises). A summary of the contractors, transporters, disposal sites, material safety data sheets, manifests, and copies of any notices of violations, administrative orders, consent orders, consent decrees, civil orders, applicable contracts, and insurance policies should be included.

For commercial industrial sites or other large sites, the document request could extend to a review of the federal, state, and local environmental permits and pending applications for any such permits. All correspondence with (and records of any negotiations with) federal, state, and local environmental regulatory agencies and any inspection reports, and EPA identification number(s)

⁶⁰ For examples of some environmental review standards, see those established by the American Society for Testing and Materials (ASTM), Fannie Mae, or Standard & Poor's for environmental site assessment.

received pursuant to the RCRA should be examined.⁶¹ Descriptions of any underground or above-ground storage tanks (USTs or ASTs) and any Spill Prevention Control and Countermeasure Plan or emergency response plan should be included, along with a list with the name and location of every site or facility used by the tenant or its predecessor since 1980 for the storage or disposal of solid or hazardous waste materials.⁶²

Landlords and tenants can attempt to manage and evaluate the uncertainty and risk associated with their continuing liability by obtaining information, representations, documents, and records. This will improve their ability to assess (and strategically respond to) the uncertainty and risk of potential continuing liability. The lease surrender agreement can provide an opportunity to secure significant information, records, representations, and documents pertaining to pending and threatened liability, exposure, claims, or incidents.

With regard to potentially significant environmental liability, the parties may consider methods of allocating the environmental risk such as obtaining environmental insurance coverage in the form of clean-up cost-cap coverage, environmental impairment liability coverage, and/or a pollution legal liability coverage insurance policy. In conjunction with obtaining the environmental insurance coverage or independent of environmental insurance, the parties may consider entering into a Voluntary Clean-Up Agreement with the New York State Department of Environmental Conservation (for which cost-cap environmental insurance may be appropriate and advisable).

[32.38] 4. Pitfalls to Avoid

The parties may decide to negotiate the release of some of the leasehold obligations pertaining to continuing liability. The release should be limited. The parties should be cautious about using the form “general releases.” Although general releases are commonly available and simple to prepare, in the context of a lease surrender agreement, the “settlement” and general release of the landlord-tenant issues could extinguish all claims, including claims for environmental liability for remediation costs.

61 42 U.S.C. §§ 6901–6992k.

62 For a more extensive discussion of the environmental issues, see Greenwald *supra* note 37, at 40. With regard to environmental due diligence, see New York State Bar Association, *Cost-Effective Environmental Due Diligence for Corporate, Real Estate & Brownfield Transactions* at 24–30 (Fall 1999) (CLE course materials), section entitled “Environmental Due Diligence Document Request List,” as well as throughout the text.

In *Fisher Development Co. v. Boise Cascade Corp.*,⁶³ the owner of the premises gave a general release to former tenants in the settlement of a landlord-tenant dispute for which the owner received \$2,000 and which resulted in extinguishing over \$860,000 in CERCLA liability.

Additionally, there may be pending or potential claims—particularly third-party personal injury, bodily injury, or property damage claims or governmental fines, penalties, or remediation requirements—that would be inappropriate to include in a release of the other party, and which could result in unintentional costly consequences and exposure to liability.

[32.39] D. Resolving Contingent Rights and Pending Proceedings

The lease surrender agreement should resolve, or at least identify, (i) contingent rights of parties arising from the lease and (ii) litigation, arbitration, and other proceedings pending between the parties that are related to or arising out of the lease or leased premises.

Contingent rights of parties arising from or appended to some commercial leases include the tenant's right of renewal, right of first refusal for additional space and/or right of purchase of the premises, as well as the landlord's rights to pursue third parties in accordance with an existing guaranty of the lease. Following a review of the terms of the underlying agreements, the parties should determine whether any of these contingent rights will survive the lease surrender agreement. Generally, the right of renewal of the lease, right of first refusal, or right to purchase the premises is terminated upon the lease surrender.

In general, a guaranty would terminate upon the surrender of the lease; however, the right to proceed against a guarantor of the lease depends upon the language of the underlying guaranty. Some guaranty agreements (such as a "good guy" lease guaranty) terminate the obligations of the guarantor upon the vacatur of the tenant from the premises. It may be appropriate to request written acknowledgement from the guarantor as to which, if any, obligations arising from the lease shall survive the early lease termination and continue to be within the responsibility of the guar-

63 37 F.3d 104 (3d Cir. 1994).

antor to guarantee. This document should also state that the guarantor understands that the lease surrender agreement does not automatically terminate all of the guarantor's obligations under the guaranty.

The lease surrender agreement may afford the parties an opportunity to specifically identify—and, as appropriate, resolve—any litigation, arbitration, and other proceedings that pertain to the lease or the leased premises. Litigation or arbitration relating to the early termination of the lease often is resolved by the negotiation of the lease surrender agreement and should be dismissed, discontinued, or otherwise terminated upon the surrender of the lease. In some circumstances, for some landlords or tenants, the litigation may be maintained as an enforcement mechanism to be discontinued or dismissed upon compliance with the terms of the lease surrender agreement.

There may, however, be additional litigation or claims that may not be appropriate or possible for the landlord and tenant to resolve, including third-party personal injury actions or property damage actions (such as an existing property damage action against the landlord by the tenant's insurance company acting as the subrogee, in the absence of a waiver of subrogation). These matters should be noted in the lease surrender agreement.

A release by the parties can be included in the lease surrender agreement, though advisably in the form of a limited release.

There may be specific litigation or other outstanding claims arising from the lease or the leased premises, that the landlord or the tenant do not want to release, waive, or relinquish as against the other party. In this case, the lease surrender agreement should be drafted to specifically make reference to these matters. This avoids the possibility that the lease surrender agreement would be construed to mean that the parties intended to cancel or forfeit the particular litigation or claim or intended to release or exonerate the other party.

[32.40] V. POTENTIAL PROBLEMS

The negotiation of a surrender of a lease involves addressing both the possession of the premises and the termination of the contractual landlord-tenant relationship of the parties. As described in this chapter, there are a variety of issues that could arise and develop into possible problems, including subtenants remaining in the premises, unintentional acceptance of tenant's abandonment, the handling of tenant's property remaining in the premises, failure to secure necessary approvals, and bankruptcy. In

addition, enforcement of the lease surrender agreement, as discussed in Part V, can be an area of great complexity.

[32.41] A. Subtenants Remaining in the Premises

For a thorough review of the issues and problems with subtenants remaining in the premises, see Section III.C.1. One of the potential problems with a voluntary lease surrender agreement is that it may have the unanticipated result (for the landlord) of automatically converting an existing subtenancy interest into a tenancy interest. The basic rule that a sublease is dependent on and limited by the terms and conditions of the main lease from which it derives is not necessarily applicable in the context of lease surrender agreements. Even though, in general, the expiration of the term of the lessee or a re-entry by the landlord for a breach of a condition of the lease may terminate a subtenancy interest

[W]hen a sublessor voluntarily surrenders his main lease not pursuant to any provision of such lease and same is accepted by the landlord, the subtenant becomes the immediate tenant of the original lessor and the interest and terms of the subtenant continue as if no surrender had been made.⁶⁴

The effect of such a surrender agreement is equivalent to a transfer of the reversion. The interests of the landlord and tenant merge, and what remains is the landlord's fee subject to the subtenancy. Such subtenancy remains because the landlord and tenant may not affect the rights of third parties who are not parties to their separate surrender agreement.⁶⁵

An option for the landlord is to set forth, as a condition of the acceptance of the surrender of the premises, the tenant's delivery of the premises free of any subtenancies or require that all subtenants be parties to the lease surrender agreement.

64 *Precision Dynamics Corp. v. Retailers Representatives, Inc.*, 120 Misc. 2d 180, 181, 465 N.Y.S.2d 684 (Civ. Ct., N.Y. Co. 1983). See the extensive list of cases and articles set forth in notes 21, 26 and 30, *supra*.

65 *Eten v. Luyster*, 60 N.Y. 252 (1875); *Ashton Holding Co. v. Levitt*, 191 A.D. 91, 180 N.Y.S. 700 (1st Dep't 1920). See the extensive list of cases and articles set forth in notes 21, 26 and 30, *supra*.

[32.42] B. Unintentional Acceptance of Tenant's Abandonment

A landlord may unintentionally release the tenant from the lease obligations by impliedly accepting the tenant's unilateral surrender (abandonment) of the premises. In accordance with the *Holy Properties* decision, the second option of the landlord, upon the abandonment of the premises by the tenant, is to accept the tenant's surrender, re-enter the premises, and re-let the premises for the landlord's own account—thereby releasing the tenant from further liability for rent. In the absence of a lease surrender agreement (or in the wake of a failed lease surrender negotiation), the conduct of the landlord—such as re-entry, re-letting, or other expressions manifesting an intent to accept the surrender of the tenant—should be carefully evaluated. The landlord's conduct may be found by the court “obviously inconsistent with the landlord-tenant relationship,” therefore constituting an acceptance of the tenant's surrender as an operation of law.⁶⁶ If the landlord intends to exercise the third option set forth in *Holy Properties*⁶⁷—to re-let the premises on behalf of the tenant—then the landlord's intent must be made evident. Otherwise, if any rent is owed or any other provision of the lease has been breached, then the landlord should commence a summary proceeding for non-payment of rent or holdover to indicate the non-acceptance of the tenant's surrender.⁶⁸

[32.43] C. Tenant's Property Remaining in the Premises

The law on property left in the premises by a tenant is not definitive. In the absence of an agreement between the parties, such as a lease surrender agreement or express provision in the lease, the improvements, trade fix-

66 *Altamuro v. Capocchetta*, 212 A.D.2d 904, 905, 622 N.Y.S.2d 155 (3d Dep't), *appeal denied*, 85 N.Y.2d 808, 628 N.Y.S. 2d 51 (1995).

67 *Holy Props. Ltd., L.P. v. Kenneth Cole Prods., Inc.*, 87 N.Y.2d 130, 637 N.Y.S.2d 964 (1995).

68 In *Altamuro*, 212 A.D.2d 904, the court held that the landlord's attempt to sell (and the actual sale of) the premises after the tenant surrendered possession constituted acts precluding the landlord from seeking damages that accrued thereafter because, by operation of law, they constituted landlord's acceptance of the tenant's surrender.

tures, equipment, and other personal property of the tenant left in the premises can be a conundrum for the landlord.⁶⁹

The lease surrender agreement can expressly provide that any property remaining in the premises shall be deemed abandoned by the tenant and may be disposed of by the landlord in any manner including—without limitation—sale, use, retention, giving away, donating, or disposing as debris. There should be representations by the tenant as to the ownership of the property and, in the case of equipment and major items, the landlord can conduct a UCC search. Additionally, the tenant could be required to indemnify the landlord for any costs associated with the property and its removal from the premises.

Upon the vacatur of the tenant, if there is property remaining in the premises and the landlord is concerned about a possible lawsuit, the landlord may be advised to make an inventory and record by photo or video the remaining property in the premises.

Other options for resolving the issue of property left by the tenant include:

1. giving notice to the tenant of 30 days (or other “reasonable” amount of time) to remove the property, otherwise the property shall be deemed abandoned and disposed of by the landlord in any manner that the landlord deems appropriate, while the tenant shall be liable for the costs incurred by the landlord;
2. setting up a temporary storage room elsewhere in the facility for the property and perhaps providing the tenant 30 days or longer without charge to remove the property, then charging for the storage or implementing subsection (1) above or subsection (3) below; or
3. arranging for removal and having the property stored by a storage company.

⁶⁹ Robert J. Krapf, *Ownership of Personal Property: Removal and Abandonment on Lease Termination*, Prob. & Prop. (A.B.A.), Sept./Oct. 1999.

[32.44] D. Failure to Secure Approval of Termination in the Context of Financial Agreements

If there are any financing agreements, such as a loan or a mortgage on the premises or the leasehold, the landlord and tenant must conduct a review of the provisions of the financing agreements. Loan documents should be reviewed, as well as any subordination, nondisturbance, and attornment agreements or any estoppel certificates and any recorded mortgages and other recorded instruments of the applicable real property, or a recorded instrument relating to such loan documents. Consent may be required to terminate the landlord's lease with the tenant.

For further detailed discussion with cases and statute citations, see Section III.C.2. The failure to secure such lender consent could be a violation of the mortgage, and the mortgagee could be found not to be affected by the lease surrender agreement.⁷⁰ “[A]n agreement by the mortgagor with respect to the mortgaged premises is not conclusive upon the mortgagee, or the receiver, where such agreement contravenes an express covenant or the necessary implications of a prior recorded mortgage.”⁷¹

Additionally, as described in Section III.C.2., pursuant to RPL section 291-f, a lease surrender agreement may be voidable as against a mortgage holder without the mortgage holder's consent.

[32.45] E. Bankruptcy

While the consequences of a bankruptcy filing by either the tenant or the landlord are beyond the scope of this chapter, such a development could represent a significant problem for the non-bankrupt party to the lease surrender agreement. Even though a lease surrender agreement has been executed (and the premises surrendered) prior to the filing of the bankruptcy petition, the lease surrender agreement may be found to have been a “fraudulent conveyance” under the U.S. Bankruptcy Code.⁷² This

70 *Crossland Fed. Sav. Bank v. Pekofsky*, 226 A.D.2d 667, 641 N.Y.S.2d 406 (2d Dep't 1996).

71 *N.Y. City Cmty. Pres. Corp. v. Michelin Assocs.*, 115 A.D.2d 715, 717–18, 496 N.Y.S.2d 530 (2d Dep't 1985) (citing *Bank of Manhattan Trust Co. v. 571 Park Ave. Corp.*, 263 N.Y. 57, 62 (1933)); see *Colter Realty, Inc. v. Primer Realty Corp.*, 262 A.D. 77, 27 N.Y.S.2d 850 (1st Dep't 1941).

72 Title 11 of the U.S.C.

could happen in the event the surrender was within 365 days prior to filing, pursuant to Bankruptcy Code section 548—and/or possibly a substantially longer prior period, pursuant to the applicable state laws (which, in New York State, could be up to six years).

A determination that the surrender constituted a fraudulent conveyance could result in the avoidance of the lease surrender agreement. In general, the possibility of a finding of fraudulent conveyance would arise in circumstances where, in the case of a bankruptcy of the tenant, the tenant entered into a lease surrender agreement of an under-market lease or, in the case of a bankruptcy of the landlord, the landlord had entered into a lease surrender agreement for an over-market lease. In both of those scenarios, the issue of a valuable asset being transferred at less than fair or reasonably equivalent value would arise.

In order to minimize the risk of a possible fraudulent conveyance problem, either party may wish to consider:

- unilateral termination of the lease, followed by litigation for a final judgment of possession and issuance of warrant of eviction prior to the filing for the bankruptcy;
- “affording some value or consideration for termination if the lease has a definite commercial value because of favorable rent or other benefits”;
- “providing for an automatic permanent increase in rents upon default for the purpose of limiting the value of the lease” and discouraging a financially irresponsible interested party from seeking to take over the lease;
- “imposing requirements of performance and strict deadlines in the exercise of any purchase option or right of first refusal”; and/or
- “imposing a prohibition on assignment of a lease in default.”⁷³

73 Robert E. Goodman, Jr., *Avoidance of Lease Terminations as Fraudulent Transfers*, 43 Bus. Law. (A.B.A.) 807 (May 1988).

[32.46] VI. ENFORCEMENT OF LEASE SURRENDER AGREEMENTS

Enforcement of leases, in general, can be a perplexing problem because leases represent an amalgam of contract rights and property interests. Enforcement of a lease surrender agreement is further complicated because of the early termination of the lease. Depending on the terms of the agreement, enforcement may involve enforcing obligations originally set forth in the underlying lease or new obligations first set forth in the agreement, as well as enforcing the surrender of possession of the premises on the date agreed upon in the lease surrender agreement.

In addition to instituting the traditional contractual civil action for breach of the lease surrender agreement and suing for damages and/or specific performance, the enforcement of the surrender date may involve commencing a summary proceeding to recover real property. The following suggestions (some of which involve ancillary agreements or third parties) may be included as additional provisions in the lease surrender agreement. Including these might provide a disincentive for the parties to breach the agreement or make the enforcement of the agreement more efficient.

The following list of enforcement methods (as well as provisions that could be included or required in a lease surrender agreement or the underlying lease) is by no means exhaustive and these may be used individually or in conjunction with one another, as appropriate:

1. *Contract Actions and Proceedings in Law and Equity.* When enforcing the terms of a lease surrender agreement, the landlord or tenant may commence a civil court action to sue for monetary damages for the breach of the agreement and/or to enforce the terms through specific performance.
2. *Summary Proceeding.* If the tenant does not surrender the premises upon the surrender date, then the landlord may pursue a “holdover” summary proceeding for a warrant of eviction of the tenant (for instance, based upon subsections 3 and 4 described below regarding default of the lease surrender agreement or an expiration of the lease). If unauthorized occupants continue in possession after the tenant has

surrendered the premises, the landlord may pursue an eviction of the other party by instituting a “squatter” summary proceeding⁷⁴ that would result in a judgment of possession and warrant of eviction.

3. *Default of the Lease Surrender Agreement Equals a Default of the Lease.* The lease surrender agreement can include a provision that in the event of a default of the agreement (e.g., the tenant and occupants have not vacated the premises upon the surrender date), the landlord may declare an event of default of the underlying lease and therefore have the right to institute a “holdover” summary proceeding to obtain a judgment of possession and warrant of eviction.
4. *Expiration of the Lease.* Another approach would be to amend the lease to include a provision that the term of the lease shall expire upon the surrender date set forth in the lease surrender agreement regardless of the actual surrender of the tenant; therefore, the tenant would be “holding over” and subject to eviction following a “hold-over” summary proceeding resulting in a judgment of possession and warrant of eviction.
5. *Security Deposit.* The lease surrender agreement can provide that the tenant forfeits the entire security deposit in the event of a default (or “material” default) in the terms of the lease surrender. Caveat: The provision should be drafted to avoid the security deposit being deemed liquidated damages, which would limit the damages awarded to the amount of the security deposit.
6. *Letter of Credit or Escrow Account.* Either the landlord or the tenant may request a letter of credit or an escrow account in an amount equivalent to payments required to be paid pursuant to the lease surrender agreement, or in an amount that is an estimate of the costs to comply with obligations set forth in the agreement.
7. *Affidavit of Confession of Judgment.* In addition to the lease surrender agreement, the parties can enter into an Affidavit of Confession of Judgment. This method provides the party with an expedited process for obtaining a money judgment (without incurring the expense and delay that may occur in a civil action) in the event one of the parties defaults in the payment set forth in the agreement.

74 N.Y. Real Property Actions and Proceedings Law art. 7 (RPAPL). See RPAPL §§ 711 and 732 for holdover and nonpayment proceedings and § 713 for squatter proceedings.

8. *“Directed Payments.”* If the lease surrender agreement provides for a payment to the tenant for the early termination of the lease, the tenant may request part or all of the payment prior to the surrender date (e.g., to be applied to the costs of moving from the premises). The landlord could make a payment directly to a third party that would benefit the tenant without directly giving the payment to the tenant. The objective is to reduce the mistrust between the parties by including a third party. Examples of directed payments would include payment directly to a moving company in an amount estimated by the moving company, or payment of the first (or more) month’s rent directly to the tenant’s next landlord.
9. *“Consent Eviction” Proceeding.* If a summary proceeding pursuant to article 7 of the RPAPL has already been instituted (for instance, for default of any of the terms of the lease or for non-payment under the lease) and the parties are amenable to resolving the dispute through a lease surrender agreement, an additional enforcement method would be to continue with the proceeding in order to obtain a judgment of possession and the issuance of a warrant of eviction upon the consent of both the landlord and tenant. By stipulation, the parties can incorporate the lease surrender agreement and stay the execution of the warrant of eviction until the agreed-upon surrender date. If the tenant fails to surrender the premises on or before that surrender date, the tenant could be evicted from the premises pursuant to the warrant of eviction.
10. *Liquidated Damages Clause.* Liquidated damages are technically not methods of enforcement; but, rather, are methods of determining the appropriate compensation in the event of a breach of an agreement. A landlord and tenant should be careful to use the liquidated damages clause in such a way that it is not construed to be a penalty.

A liquidated damages clause in a lease surrender agreement is supposed to provide the landlord and tenant with an opportunity to agree to the amount of damages to be recovered in the event of a breach. The liquidated damages clause, however, must not impose a penalty for non-performance or otherwise violate public policy.⁷⁵ It is well settled that “[a]

⁷⁵ *Truck Rent-A-Center, Inc. v. Puritan Farms 2nd, Inc.*, 41 N.Y.2d 420, 424, 393 N.Y.S.2d 365 (1977).

contractual provision fixing damages in the event of breach will be sustained if the amount liquidated bears a reasonable proportion to the probable loss and the amount of actual loss is incapable or difficult of precise estimation” at the time the agreement was made.⁷⁶ If the amount of the liquidated damages is clearly disproportionate to the expected loss, however, the provision will not be enforced.⁷⁷

In New York State, therefore, it is likely that a liquidated damages clause provision will be upheld only if (1) the amount fixed is a reasonable measure of the probable actual loss in the event of a breach and (2) the actual loss suffered is difficult to determine precisely. In New York State, the courts may closely scrutinize liquidated damages clauses in lease surrender agreements. In *Irving Tire Co. v. Stage II Apparel Corp.*,⁷⁸ the court found that the amount of the actual damages arising from breach of a lease surrender agreement was readily ascertainable and the sum fixed was disproportionate to the landlord’s loss; thus, the court rejected the liquidated damages clause as an unenforceable penalty.

Although these enforcement methods are weighted towards addressing the issue of enforcing the surrender of possession of the premises if the tenant does not vacate the premises upon the agreed date, most of them can be used by either the landlord or the tenant to enforce the contractual obligations set forth in the lease surrender agreement—and they may be available even after the premises have been surrendered.

[32.47] VII. CONCLUSION

This chapter has addressed some of the issues for commercial landlords and tenants in negotiating the early termination of leases and the surrender of possession of the premises through lease surrender agreements. These agreements provide landlords and tenants with an opportunity to chart the course of the early termination of the lease, set forth an orderly time schedule, allocate the existing and post-termination liabilities, and limit the exposure to uncertainty and risk associated with the early termination of the lease and their commercial landlord-tenant relationship. Additionally, through the process of negotiating a lease surrender agreement, landlords and tenants can identify and address the

76 *Id.* at 425.

77 *Id.*; see *139 Fifth Ave. Corp. v. Giallelis*, 1996 U.S. Dist. LEXIS 4056 (S.D.N.Y. Mar. 29, 1996).

78 230 A.D.2d 772, 646 N.Y.S.2d 528 (2d Dep’t 1996).

appropriate parties (e.g., subtenants and lenders) necessary to effectuate the surrender of the premises and secure significant information, records, representations, and documentation about the condition of the premises and possible continuing liabilities.

CHAPTER THIRTY-THREE

MODEL SURRENDER AGREEMENT

Joshua Stein, Esq.*

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MODEL SURRENDER AGREEMENT

Description. This Model Document is a surrender agreement, for use when a Tenant gives up its lease and possession of its space. If this surrender agreement is used in the context of a good-guy guaranty, Landlord may want to make sure that the “surrender” does not eliminate Landlord’s claims against Tenant, even if it resulted in terminating the good-guy guaranty.

[NAME]

[Date]

(the "Effective Date")

[Addressee]

Confirmation of Surrender of Leased Premises at _____

To Whom It May Concern:

Please refer to the _____ Lease between _____ ("*Landlord*") and _____ ("*Tenant*"), dated _____ (the "*Lease*"), for premises located at _____ (the "*Premises*"). The Lease has not been amended, except as follows: _____. Definitions in the Lease apply in this letter agreement (the "*Surrender Agreement*").

The term of the Lease expired on _____ (the "*Termination Date*").¹ The parties desire to confirm that termination and Tenant's surrender of the Premises. Landlord and Tenant therefore agree, acknowledge and confirm:

1. *Expiration and Surrender.* The Lease expired on the Termination Date. Tenant has no further rights to use, occupy or possess the Premises after the Termination Date. Tenant confirms it has vacated the Premises and surrenders the Premises to Landlord. Tenant acknowledges it has removed from the Premises all personal property that Tenant desires to remove. On the Effective Date, Tenant is delivering to Landlord all keys and other access devices for the Premises.

2. *Security Deposit.* Tenant demands the return of Tenant's security deposit, with interest to the extent the Lease or law requires. The principal amount of the security deposit is \$_____. To the extent that the security

¹ For a surrender in the context of a good-guy guaranty, omit any suggestion that the Lease has terminated. Just indicate that Tenant has surrendered possession.

MODEL SURRENDER AGREEMENT

deposit consists of a letter of credit, Tenant demands that Landlord return that letter of credit and execute documents reasonably necessary to consent to its cancellation.²

3. *Acknowledgment by Landlord.* Landlord acknowledges receipt of notice from Tenant that Tenant is surrendering the Premises to Landlord in accordance with the Lease. This Surrender Agreement satisfies any requirement in the Lease that Tenant notify Landlord of Tenant’s surrender of the Premises. Neither this Surrender Agreement nor that acknowledgment by Landlord waives or limits any of Landlord’s rights under the Lease, including the right to collect any rent or other payments due under the Lease, whether or not previously billed. Similarly, to the extent that the Lease requires Landlord to refund any amounts after the Lease terminates, this Surrender Agreement does not limit Tenant’s rights to those refunds.

4. *Tenant’s Address.* From and after the Effective Date, Tenant’s address for any notices is: _____. Notices shall continue to be given (and become effective) as the Lease states.

5. *Status of Lease.* Tenant acknowledges: (a) the Lease has not been modified; (b) Tenant has no claim, counterclaim, defense, offset or setoff against the Lease; (c) Landlord has not waived any right or remedy under the Lease; (d) Landlord is not in default under the Lease; and (e) the Lease terminated and expired on _____.

The Lease, this Surrender Agreement, and _____ collectively constitute the entire understanding between the parties relating to the Premises.

If the foregoing accurately reflects your understanding, please sign and return a copy of this Surrender Agreement to us. It shall then bind the parties as of the Effective Date.

Thank you.

Very truly yours,

NAME

2 If Tenant is surrendering to quality for release of a good-guy guaranty, Tenant might not be entitled to the items requested under this paragraph.

By: _____

Name: _____

Title: _____

By: _____

Name: _____

Title: _____

Confirmed and agreed.

NAME

_____, a _____

By: _____, a _____, its _____

By: _____, a _____, its _____

By: _____

Name: _____

Title: _____

Each of the undersigned, a Guarantor under that certain _____ Guaranty dated as of _____ in favor of _____ (the “*Guaranty*”) consents to the above Surrender Agreement and confirms that, as to that Guarantor: (a) the Guaranty remains in full force and effect; (b) that Guarantor has no defense, claim, counterclaim or offset against its obligations under its Guaranty; and (c) Landlord has not waived or released any of its rights or remedies under that Guaranty.³

³ Ordinarily Tenant and Guarantor would demand a full release in exchange for this surrender. It may, however, make sense to keep Guarantor “on the hook” for any liabilities that arose during the Lease before Tenant surrendered it. A different dynamic applies if this Surrender is being delivered to satisfy conditions to release of a good-guy guaranty.

MODEL SURRENDER AGREEMENT

, _____, a _____, its _____

By: _____, a _____, its _____

By: _____

Name: _____

Title: _____

CHAPTER THIRTY-FOUR

HOW TO STAY AWAY FROM THE MINEFIELDS IN LEASE EXPANSIONS, EXTENSIONS, AND RENEWALS

Joshua Stein, Esq.*

* The author acknowledges with thanks the editorial contributions and comments of Leah R. Fang, who worked with the author at Joshua Stein PLLC and at his previous firm; Alfredo R. Lagamon, Jr., of Ernst & Young; and Donald H. Oppenheim of Berkeley, California. Blame only the author for any errors. Copyright © 2017 Joshua Stein.

When a Landlord and a Tenant want to expand, extend, or renew an existing Lease, they often think it's as simple as "pushing a button" to document their transaction. It isn't. These transactions are tricky, creating all kinds of opportunities for error and surprises.

This chapter will refer to Lease expansions, extensions, and renewals collectively as "Lease amendments." Though they're much less work than negotiating a new Lease from scratch, Lease amendments do require turning over lots of stones and asking lots of questions. Missing one of those can create a mess.

Before you can start to document any Lease amendment, you first need to know what the existing Lease already says. What documents already exist?

Collect all existing Lease documentation, and look at it closely. Don't just look at the original Lease and any prior amendments. Are there any related documents you need to consider? A guaranty? A nondisturbance agreement? Letters that significantly affected the relationship between the parties? Any disputes that have already arisen about the terms of the Lease?

As you look through those documents, see if they suggest any gaps, for example, if the premises seem to have diminished at some point without a document to explain what happened. You may also notice that one document refers to some other document that isn't in the collection you received. Ask to see the missing documents and look at them.

The Lease file might include a Memorandum of Lease, which the parties may have recorded. The parties may, in occasional cases, have even recorded the entire Lease. In either event, today's amendment should mention what was recorded. And if the original Lease (or even just a Memorandum) was recorded, you will usually need to take the extra step of recording the entire Lease amendment, or at least a Memorandum giving notice of the Lease amendment.

Any Lease amendment may require consents from third parties. The Landlord will almost always have a lender. Occasionally, the "Landlord" will really be a Tenant, holding only a Leasehold estate under a long-term ground Lease from the fee owner. Either of these documents may require the Landlord to obtain consent to any future Lease amendments, depending of course on the specific terms of the third-party documents.

Even if no agreement between the Landlord and Landlord's lender (or ground lessor) specifically requires lender (or lessor) approval, ask whether the Tenant entered into a nondisturbance or recognition agreement with the lender or the ground lessor. If that happened, then the agreement will usually say that the lender or ground lessor won't be bound by any Lease amendments made without their consent. Thus, even if the Landlord hasn't directly agreed to seek this third party's consent, the nondisturbance or recognition agreement will effectively require such consent, producing the same practical result.

If you see you will need a third-party consent, start the process of obtaining it as soon as possible. It may require lead time, or nonobvious documentation or procedures. Does any document describe the process or limit the third party's discretion in consenting to Lease amendments? For previous transactions, how did the process work, and how long did it take? Will the third party consider a proposed transaction based on a term sheet or an informal email inquiry, or a final document ready to sign or will they insist on doing nothing until they receive signed documents? Counsel should answer those questions early in the process, and then proceed accordingly. The first step usually consists of trying to identify exactly who to speak with about the requested consent. If the third party is a securitized lender, merely finding a person to talk with can take time and great effort.

The Lease file may contain at least one brokerage agreement, and very likely two, for the original Lease. If it doesn't, you should ask why not, and try to find a copy of any brokerage agreement(s) that exist. Any brokerage agreement may say the broker can collect a further commission if Landlord and Tenant extend or renew their Lease. Sometimes, the broker(s) who negotiated the original Lease will remain in the picture at the time of the Lease extension or renewal, and participate. In other cases, one or another broker is no longer involved, but the agreement may still award them a supplemental commission on an extension. In the worst case, no one can find the brokerage agreement, and no one knows the broker's rights. Once again, this possibility, which is hardly hypothetical, demonstrates the importance of collecting all documents for any transaction in one logical place, where they can be found years later. That principle applies with special force to Leases, given their long life expectancies.

Once you have all the original documentation for the existing Lease, you need to ask whether today's transaction is an entirely new deal never contemplated under the original Lease, or whether the Tenant already had

a renewal or extension right under the existing Lease, and is merely exercising it.

If the Lease already contains an expansion or extension right, the Lease will sometimes contain very specific provisions on how the Tenant can exercise that right, and what happens if the Tenant does so. If the Lease does that and the Tenant merely exercises its rights under the Lease, the necessary documentation to confirm the Lease amendment can consist of a one-page unilateral letter from the Tenant to the Landlord. In that case, however, the Tenant must take care to comply with the specific requirements of the Lease, or the Tenant's exercise of its rights may not be valid or effective.

If the Lease contemplates a process to determine fair market rental value for a renewal or expansion term, the procedures can as a practical matter turn out to be rather sticky and complex, even if they sounded quite simple in the Lease. Whether you represent Landlord or Tenant, you should advise your client to focus on the rent determination process as early as possible. For example, if your client anticipates an appraisal process ahead, your client may want to engage a preferred appraiser before the other party does.¹

Even if the Tenant merely exercises a renewal or expansion right expressly provided for in the Lease, both Landlord and Tenant may want to memorialize the resulting changes in the Lease in a separate Lease amendment. In that case, all the suggestions in this article would apply.

In many—perhaps most—cases, although the Lease gives the Tenant a specific renewal or expansion right, the parties will end up agreeing to do something else. At a minimum, instead of enduring a rent appraisal process, the parties will often agree on the rent. Instead of renewing for five years, the Tenant may want to renew for seven; the Landlord may accommodate. The parties may agree to tweak the escalation clauses. And they may, in any number of other ways, proceed in a way that's not exactly what they had in mind years before when they negotiated their Lease.

In many cases, the original Lease did not contemplate expansion or renewal, or may have addressed the topic in a sloppy, incomplete, or min-

1 For some suggestions on how a Tenant and its counsel can successfully navigate some of the minefields of exercising renewal rights and determining "fair market" rent in any renewal term, see Joshua Stein, *A Checklist for Giving Legally Effective Notices*, *The Practical Lawyer*, August 2005, at 11.

imalistic way. This can occur when the Tenant never saw value in having rights of this type, or if the Landlord didn't really want to grant them. Some Landlords try, as a matter of policy, not to include extension or expansion options in their Leases. They reason that they may be in a better bargaining position when the Lease term expires and don't want to agree to any rights that extend beyond the initial term. Landlords may also value the future flexibility that they retain by not having to reserve space to accommodate future contractual extension and expansion rights. If you represent the Landlord, though, don't assume that a negotiated extension or renewal avoids the need to pay a commission to the broker(s) who originally negotiated the Lease. Often these brokerage agreements require another commission on any extension or renewal.

In documenting any Lease amendment, the issue of first and most importance to the parties will be the rent payable under the Lease amendment. In most significant Leases, the parties' brokers will agree on the rent as part of a negotiated term sheet. The term sheet will state whether the Landlord must give the Tenant a new "free rent" period and whether the Landlord will give the Tenant a new Tenant improvement allowance. The term sheet, which is something lawyers are not often involved in negotiating, will also likely include important items such as base years for escalations, and perhaps changes in Tenant's share of expenses above the base.

The final term sheet goes to counsel as a rough guideline for drafting the Lease amendment, usually accompanied by statements that: (a) it's a very simple transaction; (b) the parties want to get it signed up as quickly as possible; and (c) they have already been negotiating the transaction for, e.g., an entire year, so this makes it all the more important to sign as quickly as possible.

If Landlord and Tenant negotiated the Lease amendment outside of the four corners of the existing Lease, counsel might be tempted to start from scratch and create an entirely new Lease. In most cases this is a waste of time (and expense for the client), unless the existing Lease is truly antiquated and inadequate. Any specific identified mistake or omission can be dealt with in the amendment, which will ultimately be shorter and simpler—less expensive—than drafting an entirely new Lease. A new Lease will also open up a Pandora's Box of Lease issues and negotiations that otherwise probably never would attract anyone's attention. Most likely, both Landlord and Tenant will prefer to just amend their original Lease—for better or worse—particularly since that's how everyone else generally does it. Unless there is an overwhelming compelling reason to prepare an

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entirely new Lease, counsel should stick to the amendment format to memorialize the new deal.

Any Lease amendment must start by accurately handling every point mentioned in the term sheet. If counsel misses or misinterprets even one provision in the term sheet, this is a great way to antagonize, and lose the confidence of, everyone involved the deal, including your own client.

From counsel's perspective, the broker's most important job will consist of reviewing the business terms in the Lease amendment to confirm they accurately reflect the term sheet, which may have been written in a more abbreviated way than a formal Lease amendment.

Doing justice to a term sheet in a Lease amendment is not as simple as cutting and pasting. Even before the Tenant sees the first draft of any Lease amendment, the Landlord's broker should review the Lease amendment to try to confirm that it matches up to the intent of the term sheet. Rental rates, and precise adjustment dates and changes in formulas, are hot buttons in any amendment.

Does the rent always go up on the first day of the month? Or does it go up on an anniversary of a particular date, regardless of the day of the month that date occurred? And is the "base" date for these adjustments the commencement date of the Lease or the rent commencement date? If the term sheet doesn't fully answer these questions, counsel needs to ask them and insist on obtaining answers.

The original Lease may contain detailed provisions on expansion rights under the Lease. These provisions may include a definitive rental rate (or a process for determining rent), the size of the expansion premises, whether the base years for taxes and operating expenses will change, and the termination date of the expansion premises, typically coterminous with the original premises. Here, your main responsibility will consist of memorializing the details of today's transaction in a Lease amendment, and understanding whether the parties somehow varied from what the Lease originally contemplated. Identification of base years for escalations, in particular, is crucially important. If the amendment says nothing on the topic, then the base years in the previous Lease will continue to apply. Usually that's not what the Tenant expected.

Whether or not a broker is not involved, make sure your client carefully reviews the provisions on rent and escalations. They are perhaps 2% of the verbiage in any Lease, but they represent 98% of what matters.

One way to clearly draft the rental section is to create a grid that includes the time periods and the rental for each time period using specific dates. If the commencement of the payment of rent is a contingent date, you can assume a certain date. If you do that, you should explain what you're doing as part of the Lease language, and also include a provision saying the parties will adjust the dates in the rental grid once the Lease has been executed or the conditions necessary for the obligation of rent to be triggered occur. In that case, the commencement date letter for the lease would include an updated grid for rent rates and dates.

The "rental grid" approach with specific dates makes the economics of the Lease amendment far more comprehensible to counsel, brokers, and their mutual clients, thus reducing the likelihood of mistakes. But you still need to remember to finalize them in the commencement date letter. By making the economic terms easier to understand, you make them easier to check, because you don't waste a lot of the reader's brainpower on decoding them.

You should, however, still read through the entire Lease and related documents to make sure you don't miss anything relevant to the Lease amendment. Any provision in the Lease may refer to dates or something that you should now adjust because of the amendment. Simply reviewing the expansion right section in the original Lease without further investigation can invite trouble.

Going beyond the economic terms of the term sheet and the words of the original Lease, any Lease amendment can also be used to adjust the relationship—solve problems—between the Landlord and the Tenant. It can give both parties a chance to repair mistakes in the original Lease or its administration. Sometimes the Lease amendment process will itself focus attention on these mistakes.

For example, in one Lease amendment the author handled, the parties had miscalculated the expiration date of the original Lease. Both parties simply had the wrong date. As part of the amendment, the parties corrected their mistake. (The problem arose because the original Lease treated the commencement date and expiration date in a way that was almost incomprehensible. It came as no great surprise that no one had properly comprehended it.)

Issues may have arisen about either Landlord's or Tenant's obligations under the original Lease. Perhaps Landlord did not complete its construction obligations or fully disburse a Tenant improvement allowance. The

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Lease may have required the Tenant to perform certain maintenance that it has never actually performed—or that made more sense for the Landlord to perform—and the Landlord actually did the work.

For example, one retail Landlord represented by the author had experienced a number of problems with the Tenant during the initial term. The Tenant was quite desirable, but also badly wanted to keep this particular location, and had no contractual renewal right. Both parties had some degree of leverage. The Landlord's problems with the Tenant did not relate to payment of rent, but instead related to practical considerations such as use of basement space, storage of trash, lighting, scheduling of deliveries, and other operational matters.

As part of the Lease amendment negotiations, the Landlord asked for changes in all the provisions of the Lease that had proven inadequate to deal with these practical issues. The Tenant didn't agree to everything the Landlord wanted, but did agree to most of it. The likely result: a more satisfactory Landlord-Tenant relationship in the renewal term – assuming anyone pays any attention to the words of the Lease going forward.

One particular Lease required the Tenant to perform certain maintenance obligations. The Tenant hadn't bothered to comply during the initial term. To avoid municipal penalties, the Landlord performed the Tenant's obligations, but never notified the Tenant of its default. The original Lease did not adequately address Tenant's maintenance obligations and the consequences of Tenant's nonperformance, i.e., Landlord's rights and remedies. As a result, the subsequent amendment revisited the section on maintenance obligations and set up consequences for the Tenant's nonperformance in certain circumstances. Because the maintenance obligations under the Lease were supposed to be picked up by Tenant, its counsel did not push back.

These various examples teach the same lesson. A Landlord can and should use a Lease amendment to revisit the existing relationship, and think about whether anything needs adjustment or repair. In many cases, the same areas of concern in these examples will raise concerns for other Landlords.

Lease amendments can clear up these situations by rethinking them as necessary. If the terms of the original Lease need to be reaffirmed, the Lease amendment can do that. By specifically addressing these obligations, the Lease amendment prevents future disputes, underscores what

the parties really expect, clarifies the parties' obligations, cleans up messes, and prevents claims of waiver that might otherwise arise.

Regardless of which party you represent in a Lease amendment, ask whether anything about the leasing relationship to date has proven unsatisfactory and might merit change or correction. If so, now is the time to change or correct it. Of course, that approach may complicate and draw out a Lease amendment that could otherwise be quite simple. The client will have to decide whether those costs are worth the benefits. It amounts to a business decision.

If the Landlord and Tenant have had disputes about anything – or if any disputes are underway at the time of the Lease amendment – the Lease amendment may give both parties an opportunity to resolve their dispute and prevent it from recurring. In the alternative, if the parties want to leave it open, they should expressly say so, to avoid any surprises about unintentional waivers or releases of claims.

Whether a Lease amendment merely addresses a few economic terms or makes wholesale adjustments in the relationship between the parties, write any amendment in an organized manner. Usually this means following the same order as the original Lease. Delete provisions that no longer apply and may cause confusion in the new amendment. Modify specific provisions of the original Lease where necessary. In some cases, you may want to incorporate by reference certain provisions from the original Lease and in other cases, for clarity, you may want to restate an entire provision, for example if the amendment process would otherwise become very complex and intricate.

Usually, it doesn't make sense to write a Lease amendment in a conceptual way—i.e., addressing a few topics on whatever order counsel wants to cover them, memorializing the agreement of the parties without referring to the terms of the original Lease. This approach creates a high risk of interpretational problems, inviting the parties to disagree on whether some “concept” addressed in the Lease amendment did or didn't change something that appeared in the original Lease.

For example, if the original Lease defined the “Scheduled Expiration Date” and the parties agree to extend the Lease term by ten years, they shouldn't just say “we hereby extend the Lease term by ten years.” The drafter of the Lease amendment should go in and surgically adjust the “Scheduled Expiration Date” by making it ten years later. Otherwise, the parties leave open potential debate over whether the Lease amendment

actually changed the “Scheduled Expiration Date” and any rights and obligations that the “Scheduled Expiration Date” may trigger.

Any Lease amendment on expansion or renewal should clarify whether any expansion or renewal rights in the original Lease continue to apply. Usually, they shouldn't. In such cases, the Landlord's counsel should drive a stake through their heart by deleting them. But what happens if the Lease gives the Tenant further expansion or renewal rights? Clarify that those continue, and only delete the option rights being exercised. Do the parties need to adjust the future option rights to take into account the Lease amendment they sign today? If so, make the adjustment.

Make the Lease amendment as specific as possible while still adhering to the original Lease as much as possible. In the case of an expansion, the definition of “premises” under the original Lease may or may not change. You may find it's easiest to leave the “premises” alone and define a new and separate “expansion premises,” with different economic terms. This approach will typically make sense if the expansion premises: (1) requires the Tenant to pay a different rental rate than the original premises, perhaps with different scheduled increases; (2) has different escalation formulas; or (3) uses the same formula but different base years.

If you find that even one of the foregoing circumstances applies, having a separate definition, with separate economic terms, for the “expansion premises” will create less confusion in the future. The amendment will, of course, then need to include new economic definitions for the expansion premises, such as rent, tax base years, and operating expense base years. For everything else, the Lease should say the expansion premises are governed by the same Lease provisions that govern the original premises.

Any Lease amendment may also need to address construction and Tenant improvements. Will the Landlord provide either of those for the new space or the extension term? If not, the Lease amendment should make that clear, to prevent any argument by implication or inference. If the Landlord will in fact provide either of these benefits, the terms of the original Lease on those subjects may make sense for the Lease amendment, but they also may not. Adjust them as appropriate. Deal with the issue one way or another. Silence is not good.

If the Landlord obtained a guaranty of the original Lease, then the Landlord should insist that the same guarantor, or a satisfactory replacement, guaranty the Lease as affected by the Lease amendment. Absent an

express confirmation from the guarantor, the Landlord may find that the Lease amendment eliminates the guaranty.

Conversely, if the original Lease contained an exculpation or nonre-course clause benefiting the Landlord, the Lease amendment should reaffirm that concept.

Counsel also needs to think about the possible issues created by past and present leasing brokers, as suggested earlier in the context of brokerage agreements. Counsel should ask the client about brokers early in the course of the transaction, especially if you are representing the Landlord, as the Landlord is generally the party who pays the brokerage commission. Your client will not be happy to discover an unexpected brokerage commission on top of the attorneys' fees incurred for the amendment.

If a broker is involved, and there is an existing brokerage agreement (assuming the same broker(s) is involved), counsel should consider drafting a new brokerage agreement or letter agreement that specifically deals with the commission due under the amendment. This amendment will state the amount of the commission and when the payout will occur. And if no existing agreement applies, the Landlord will want to sign a new agreement with the broker about their commission. To prevent unexpected claims, the Landlord may want to sign up that agreement early in the process, with an acknowledgment that the broker can't make a claim unless the parties actually sign and exchange Lease documents and they become fully effective.

To prevent future debates, try to express any commission as a specific number of dollars instead of a formula with inclusions and exclusions inviting debate and disputes over interpretation. The brokerage agreement should expressly include or reaffirm provisions in the original brokerage agreement, such as a broker's indemnity and restrictions on publicity and disclosure.

A broker's involvement can help counsel, as a broker can readily provide answers that the client may not be able to provide quickly. Brokers may help negotiate the Lease amendment. Brokers can be especially helpful when they have intimate knowledge of the space and practical questions arise, such as when a client wants to expand and will need additional riser space, air-conditioning units, back-up generators, or the like. A broker who knows the building well can help counsel understand the building's systems and whether a Tenant's requests can even be accommodated.

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Counsel should, however, keep in the back of their mind the fact that brokers usually don't get paid unless deals get signed and closed. In the author's experience, this fact does not seem to warp the judgment and advice provided by reputable brokers.

Once Landlord and Tenant finalize and sign their Lease amendment, make sure that both lawyer and client have copies in locations where the documents can easily be retrieved for future reference. Counsel hopes that they will be involved in subsequent amendments, but even if the client uses the same firm, different lawyers may handle the next Lease amendment.

This all just represents another reason to make sure any Lease amendment is totally clear ("even clearer than it needs to be") and addresses all possible concerns. This way, the next person who reads the Lease amendment, perhaps five years later, won't need to guess at what the parties really intended, or perform detective work to figure out what the Lease amendment really means.

CHAPTER THIRTY-FIVE

LEASE GUARANTIES

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[35.0] I. INTRODUCTION TO THE LEASE GUARANTY

A Guaranty is a promise to answer for the payment of some debt or the performance of some duty, in case of the failure of another who is liable in the first instance.¹

In the context of a lease, a guaranty is a promise to the landlord by a third party, typically the principal of a tenant-business, that it will remain liable for the tenant's obligations in the event that the tenant is unable to perform.

[35.1] A. Vocabulary

Some necessary vocabulary follows:

The “guarantor” is the party that signs the guaranty. The party may be an individual or a corporate entity.

Three common types of guaranties:

Complete Guaranty: A guarantor promises to remain liable for *all* of the tenant's obligations under the lease for the entire term.

Limited Guaranty: A guarantor promises to remain liable for a fixed portion of the term (e.g., six months' rent), or, up until the surrender of the premises.

Good Guy Guaranty: A type of limited guaranty that typically cuts off the guarantor's liability upon the tenant's surrender of the premises (i.e., vacatur and turning in the keys), and, as has increasingly become standard practice, upon the tenant's satisfaction of additional conditions, such as notice and being current on all rent, which will be discussed later in the course.

This chapter focuses on the Good Guy Guaranty (“GG Guaranty”). It will first introduce you to the simplest form of a GG Guaranty, i.e., the kind that extinguishes the guarantor's liability upon the tenant's surrender of the premises to landlord.

¹ Black's Law Dictionary (10th ed. 2014).

Next, using samples of actual GG Guaranties from the authors' practice as well as related case law, the chapter will illustrate the variety of additional conditions a GG Guaranty can impose on the tenant.

These conditions have the aggregate effect of increasing uncertainty or risk for the guarantor seeking to avoid or minimize liability on the one hand, and, on the other hand, giving the landlord significant bargaining leverage during both lease negotiations and when faced with a tenant who is behind on rent and looking for a way out.

[35.2] B. Why a Guaranty?

Entering into a contract of any kind is like entering into a marriage. If things go well, both parties are better off for having come together. On the other hand, if the relationship becomes too costly for one party or ceases being mutually beneficial for both, the endgame becomes trying to unravel the relationship in the most cost effective manner.

In a marriage, spouses often enter into prenuptial agreements to account for this contingency and to avoid costly divorce litigation in the event they decide to part ways. You can think of a guaranty in the same manner. It is an agreement made at the outset of a relationship to account for the grim possibility that things may not turn out so well—an insurance policy to account for the likelihood that somebody will not perform in the manner they have promised.

[35.3] II. THE ANATOMY OF A GUARANTY

[35.4] A. Who Is the Guarantor?

Remember, the guaranty is only as good as the guarantor!

[35.5] 1. Individual Lessees Are Already Personally Liable

If the lease is signed by an individual or a person “doing business as” (d/b/a), then you already have a complete guaranty!

Remember, the point of a guaranty is to avoid a party charged with certain obligations from abusing the trust of the obligee by imposing certain consequences on the guarantor, namely personal liability, for breaching the underlying agreement.

In the case of a lease, if you already have the individual(s) on the lease, you SHOULD NOT ask them to sign a GG Guaranty. Why? Because you

would, in effect, be entering a new contract with the same individual that turns the complete guaranty into a limited guaranty. How? By signing the lease as an individual, the person is already promising to be *personally* liable for all of its enumerated obligations. If this same person then signs a GG Guaranty that terminates the individual's liability upon surrender of the premises, you just gave the tenant a free pass to walk away from the lease before its natural expiration *without any consequences!* The GG Guaranty becomes the subsequent agreement by the same parties that takes precedence over the prior conflicting lease agreement.

[35.6] 2. A Guaranty Is Only as Good as the Guarantor

Is the Guarantor a corporation or an individual? Is it credit-worthy? This may seem obvious, but it is an all too often neglected, but vital, step in the process—checking the Guarantor's bona fides.

[35.7] a. Individual Guarantor

Individual guarantors are generally better. Having the principal of a company face personal liability in the event of a default is generally better provided the individual has reachable assets. Once again, the fundamental value-added by a Guaranty is the ability to bypass the formal obstacles that get in the way of recovering against a corporate entity. On the other hand, if you have a blue-chip corporation, for example, McDonalds Inc., willing to sign a guaranty, then there is good reason to go with the corporate guarantor because collectability becomes a non-issue.

[35.8] b. Due Diligence

Do the Due Diligence. Before entering into a lease and GG Guaranty with anyone, do your homework. This may include:

- Internet searches on the principal(s) such as Google, LinkedIn, etc.
- Running credit checks using Transunion or other credit reporting services, and an Accurint search to obtain records on the principal(s)' assets.

PRACTICE TIP: Note that obtaining credit reports is governed by federal law 15 U.S.C. § 1681(b) which outlines the “permissible purposes” for a consumer reporting agency to disclose credit reports. The permissible purposes in the case of landlords obtaining credit reports on guarantors are when the report will be used in connection with a collec-

tion involving a “credit transaction,” i.e., the guaranty (§1681b(a)(C)); or, under § 1681b(a)(F) a “legitimate business purpose” concerning a transaction that the consumer, i.e., the guarantor, has initiated.

Essentially, in the context of a lease, this means that counsel can only run credit reports when either the guarantor owes the landlord money, or at the outset of the relationship when landlord is evaluating a guarantor’s creditworthiness.

- Obtain bank statements, tax returns and other financial documentation indicating the principals’ solvency.
- View guarantor’s assets with an eye toward the future. Just because a guarantor has assets at the outset of a lease deal, that does not mean those assets may not dissipate over time.
- If your guarantor is an entity, the due diligence should be even more rigorous and should examine the entity’s balance sheets, annual financial reports, tax returns and prior litigation history.

[35.9] B. Guarantor’s Identifying Information

It is essential that the Guaranty include the following personal information of the guarantor. It is surprising how often one sees a Guaranty that lacks some of these items.

[35.10] 1. Social Security Number

The Social Security Number will also be crucial during the judgment enforcement phase when you will need it to locate and attach assets of the guarantor, such as bank accounts, wages, and personal and/or real property.

[35.11] 2. Home Address

Be sure to include the guarantor(s)’ home address in the signature block of the GG Guaranty. This will aid in running credit reports and will also be the address you will use to effectuate service of papers in the event of litigation.

[35.12] C. Personal Jurisdiction

Most well-drafted GG Guaranties now include personal service waiver clauses like the example below providing for service by certified mail.

This will save landlord the trouble of complying with personal service and the cost of paying for a process server. Courts routinely uphold these provisions.²

EXAMPLE 1:

Guaranty cannot be modified, waived or terminated unless such modification, waiver or termination is in writing, signed by Landlord.

As a further inducement to Landlord to make and enter into the Lease, Guarantor covenants and agrees that (i) in any action or proceeding brought in respect of this Guaranty, the undersigned hereby waives trial by jury, (ii) the Supreme Court of the State of New York of the County of New York (or, in a case involving diversity of citizenship, the United States District Court for the Southern District of New York) shall have jurisdiction of any action or proceeding and (iii) **service of any summons and complaint or another process in any such action or proceeding may be made by certified mail directed to the undersigned at the address below set forth, personal service being hereby waived.** This Guaranty shall be enforced and construed in accordance with the laws of the States of New York and shall be binding upon and inure to the benefit of Landlord and the undersigned and their respective heirs, executors, administrators, legal representatives, successors and assigns.

IN WITNESS WHEREOF, the undersigned has executed this Guaranty as of the date first above written.

[35.13] D. Counsel Fees

Every GG Guaranty should contain a provision allowing the Landlord to recover counsel fees from the guarantor that may be incurred in the enforcement of its terms.

[35.14] E. Survival Clause

Every GG Guaranty should contain a provision that clearly states that the guaranty “*shall remain and continue in full force and effect as to any*

² See *Credit Car Leasing Corp. v. Elan Group Corp.*, 185 A.D.2d 109, 109, 586 N.Y.S.2d 3 (1st Dept. 1992) (holding that service was proper when effectuated in accordance with substituted method provided for in the lease); *Marine Midland Bank, N.A. v. United Missouri Bank, N.A.*, 223 A.D.2d 119, 124, 643 N.Y.S.2d 528 (1st Dept. 1996) (personal service waiver enforceable where defendant “clearly consented to personal jurisdiction in New York and to service [in the manner specified in the agreement]”).

renewal, change or extension of the [underlying agreement].” Variations on this important point are discussed in more detail below. However, the basic idea is to make sure that the guarantor remains liable for obligor’s obligations under the Guaranty in spite of subsequent agreements between the obligee and obligor.

[35.15] F. Signatures

It is essential that the obligee obtain the guarantor’s signature on the guaranty, **as an individual**, and be sure to obtain signatures on the underlying agreement from the obligor’s corporate officers.³

PRACTICE TIP: Get signatures notarized or get a copy of guarantor(s)’ driver’s license to avoid authentication issues in the event of litigation.

[35.16] III. THE BASIC GOOD GUY GUARANTY

As we have already mentioned, the simplest and earliest iteration of the GG Guaranty provides that the tenant’s principal remains liable for the tenant’s obligations under the Lease through the date that the tenant vacates the premises and delivers possession to the Landlord.

EXAMPLE 2

GUARANTY

FOR VALUE RECEIVED, and in consideration for, and as an inducement to Lessor to the reassignment of the lease with _____ for the Premises known as _____ in the building.

City, County and State of New York, the Undersigned guarantees to Landlord, Landlord’s successors and assigns, the full performance and observance of all the covenants, conditions and agreements, therein provided to be performed and observed by Tenant, including the “Rules and Regulations” as therein provided, without requiring any notice of non payment, non performance or non observance, or proof, or notice or demand whereby to charge the undersigned therefor, all of which the undersigned hereby expressly waives; and undersigned expressly agrees that the validity of this Guaranty and the obligations of the Guarantor

3 See *30 Broad, LLC v. Lawrence*, 12 Misc. 3d 1179(A), 824 N.Y.S.2d 767 (Sup. Ct., N.Y. Co. 2006) (“Officers of a corporation are not liable on its contracts, unless they purport to bind themselves in their personal capacities”).

hereunder shall in no wise be terminated, affected or impaired by reason of the assertion or non assertion by Landlord against Tenant of any of the rights or remedies reserved to Landlord pursuant to the provisions of the within Lease. The undersigned further covenants and agrees that this Guaranty shall remain and continue in full force and effect as to any renewal, modification or extension of this Lease and during any period when Tenant is occupying the premises as a "statutory tenant." As further inducement to Landlord to make this Lease and in consideration thereof, Landlord and the undersigned covenant and agreed that any action or proceeding brought by either Landlord or the undersigned against the other on any matters whatsoever arising out of, under or by virtue of the terms of this Lease or of the Guaranty that Landlord and the undersigned shall and do hereby waive trial by jury.

ANYTHING HEREIN TO THE CONTRARY NOTWITHSTANDING this Guaranty shall not extend to any obligations incurred by Tenant under the Lease after the date after the date the Tenant and anyone claiming through the Tenant vacate the premises demised under the Lease, removes all of its personal property therefrom and then offers to deliver possession of the demised premises to the Landlord. This Guaranty does not modify the terms of the Lease and nothing herein contained shall relieve Tenant from any liability thereunder in accordance with the terms of this Lease.

The language appears clear and unequivocal. After the tenant, or anyone claiming through the tenant (i.e., subtenants), vacates the premises, removes all personal property, and offers to deliver possession to the landlord, the guarantor is in the clear.

However, even this simply phrased guaranty could be simpler. For instance, what does it mean to "offer" to deliver possession? When will "delivery" be complete? What if tenant slides the keys under landlord's office or leaves them with a doorman and landlord does not find out that the keys were returned until weeks after the "delivery"?

What if the tenant surrenders the premises in writing and the landlord accepts the keys without saying a word, only to find out later that tenant has abandoned all of its personal property in the premises? And now the landlord wants to pursue a claim for future rent owed under the lease given tenant's failure to comply with the terms of the guaranty.

If landlord accepts tenant's surrender without reserving its rights under the lease and the guaranty, landlord waives any claims to future rent

absent an agreement to the contrary because such acceptance terminates the leasehold.⁴

GG Guaranties are “commonly understood to apply to obligations which accrue *prior to the surrender of the lease premises*.”⁵ If there is a basis to hold guarantor personally liable for future rent given tenant’s failure to surrender the premises in the manner prescribed by the lease and GG Guaranty, Landlord must reserve all of its rights under the GG Guaranty to pursue those claims against guarantor.⁶

[35.17] IV. GG GUARANTIES THAT REFER BACK TO THE LEASE

In current practice, most GG Guaranties require the tenant to surrender the premises in the same condition prescribed under the lease, or, in “broom clean condition,” and many require that the tenant be current in all rent and additional rent due and owing at the time of surrender.

The interplay between a GG Guaranty and provisions of a lease can lead to a whole host of issues for the tenant seeking to terminate the leasehold.

EXAMPLE 3:

GUARANTY

FOR VALUE RECEIVED, and in consideration for, and as an inducement to Landlord making the within Lease with Tenant, the undersigned, guarantees to Landlord and Landlord’s successors and assigns, the payment of base and additional rent as provided in the Lease and that Tenant will bond and/or remove and lien(s) which may be incurred by Tenant, during the period that Tenant (or anyone claiming under or through Tenant) is in possession of all or any part of the premises demised under

4 *See Freeman Foursome v. Cabana Carioca*, Index No. 100289/94 (Sup. Ct., N.Y. Co. Jan. 30, 2001) *aff’d*, 293 A.D.2d 964, 741 N.Y.S.2d 146 (1st Dept. 2002) (holding that landlord’s failure to reserve rights under the lease and guaranty defeated claim for future rent because acceptance of surrender constitutes termination of the leasehold).

5 *Russo v. Heller*, 80 A.D.3d 531, 531, 915 N.Y.S.2d 268 (1st Dept. 2011) (emphasis added).

6 *See also James Leonard 6, Inc. v. Six & Cornelia Assocs.*, 2016 WL 4094712 (Sup. Ct., N.Y. Co. Aug. 1, 2016) (“The reletting expenses, including rent concessions, and broker’s fees occurred after the Plaintiff vacated the Premises and returned the key on May 15, 2015. Defendant does not dispute that Plaintiff returned the keys and vacated the entire premises. Therefore, when [Tenant] vacated the property on May 15, 2015, [Guarantors’] liability for future rent ceased.”).

the Lease (the “Premises”), together with the payment of all costs, attorney’s fees, and other expenses incurred by Landlord in enforcing such payment. Except as hereinafter expressly provided, this Guaranty shall not extend to any obligations incurred by Tenant under the Lease after the date (the “Surrender Date”) on which Tenant and everyone claiming under or through the Tenant (a) vacate the Premises and surrender the same in the condition required under the Lease and (b) deliver all keys for the Premises to the Landlord. The undersigned hereby expressly agrees that the validity of this Agreement and the obligations of the Guarantor hereunder shall in no wise be terminated, affected or impaired by reason of the assertion by Landlord against Tenant of any of the rights or remedies reserved to Landlord pursuant to the provisions of the within Lease.

As a further inducement to Landlord to make this Lease and in consideration thereof, Landlord and the undersigned covenant and agree that in any action or proceeding brought by either Landlord or the undersigned against the other on any matters whatsoever arising out of, under or by virtue of the terms of this Lease or of the Guaranty that Landlord and the undersigned shall and do hereby waive trial by jury.

By accepting this Guaranty, Landlord agrees that it will accept a substitute Guarantor, in the event that Guarantor herein sells her interest in Tenant or Tenant assigns the Lease with Landlord’s prior consent, so long as the substitute Guarantor or Guarantors collectively have a net worth equal to or better than the undersigned Guarantor.

Nothing contained in this Guaranty shall be deemed to limit or exempt the assets of Tenant (including a successor partnership or corporation), or in any manner excuse Tenant from the obligation to fully satisfy the liabilities and obligations of Tenant under the Lease.

The operative language from the above GG Guaranty is the following clause:

this Guaranty shall not extend to any obligations incurred by Tenant under the Lease after the date (the “Surrender Date”) on which Tenant and everyone claiming under or through the Tenant (a) vacate the Premises *and surrender the same in the condition required under the Lease* and (b) deliver all keys for the Premises to Landlord.

When interpreting the guaranty in conjunction with the lease, the first step is to find the surrender provision in the lease which will typically prescribe the condition in which tenant should leave the premises.

[35.18] V. END OF TERM

In the Standard Form of Store Lease prepared by the Real Estate Board of New York (“Standard Board Lease”), Article 21, End of Term, is the relevant provision and it reads:

Upon expiration or other termination of the term of this lease, Tenant shall quit and surrender to Owner the demised premises, broom clean, in good order and condition, ordinary wear excepted, and Tenant shall remove all its property.

Straightforward, right? Think again. Tenant may ask its counsel:

- What does “broom clean” mean?
- What does in “good order and condition” mean? There’s a hole in one of the walls. Will that be a problem?
- I removed all my merchandise and furniture. Is that enough to satisfy “Tenant shall remove all its property”?

Each of these questions, to varying degrees, adds a level of uncertainty that the tenant must reckon with.

The phrase “broom clean” is probably the easiest and least risky condition with which to comply. Counsel may advise tenant to simply sweep the floors and clean off any surfaces before vacating. A landlord is also unlikely to pursue litigation based on a breach of this condition alone unless the premises is left in such a bad state that it requires significant expenditures to clean up.

The phrase “good order and condition” leaves a lot of room for interpretation. If we take the example above of the hole in the wall, counsel may ask tenant, “well how big is the hole?” Depending on the size, what the premises was used for and how the hole got there to begin with, tenant may well be on the hook for the cost of repairing the hole. A more salient question for our discussion, however, is, *has the tenant satisfied the terms of the GG Guaranty by surrendering a premises that is arguably not in “good order and condition?”*

In this scenario, the answer may well be “no,” in which case, the guarantor is not only also on the hook for repairing the hole, but is also on the hook for all future rent for failure to comply with the termination clause of the guaranty!

In other words, the landlord could argue that it has a complete guaranty for all future rent because of tenant’s failure to surrender the premises in “good order and condition” as required by the lease and the guaranty.

WAIVER ALERT! Remember the *Freeman Foursome* case discussed above: landlord can only keep guarantor on the hook for the default and future rent if, at the time of surrender, it expressly states to tenant that “*I accept your surrender but reserve my rights under the Guaranty.*”

Consider the phrase “*tenant shall remove all its property.*” If Tenant has removed its merchandise, furniture and otherwise disposed of all other waste in the premises is tenant’s work finished? Not necessarily. “Property” is a term of art and needs to be interpreted in conjunction with the lease’s definition of what constitutes “tenant’s property.”

[35.19] VI. ALTERATIONS AND FIXTURES

Under a Standard Real Estate Board Lease, if tenant is surrendering the premises, Article 3-Alterations, is implicated. It reads in pertinent part:

All fixtures and all paneling, partitions, railings and like installations, installed in the premises at any time, either by Tenant or by Owner on Tenant’s behalf, shall, upon installation, become the property of Owner and shall remain upon and be surrendered with the demised premises unless Owner, by notice to Tenant no later than twenty days prior to the date fixed as termination of the lease, elects to relinquish Owner’s rights thereto and to have them removed by Tenant, in which event, the same shall be removed from the premises by Tenant prior to the expiration of the lease, at Tenant’s expense.

Assume, for our purposes, that Tenant notifies Landlord that it will be terminating the lease early and vacating the premises in twenty days. Landlord accepts, reserving its rights under the guaranty against the guarantor, and also relinquishes title in certain fixtures and installations made by the Tenant and requires their removal at Tenant’s expense. If the tenant then vacates without removing the fixtures and installations, the guarantor

has not complied with the guaranty's terms and once again could be liable for all future rent!

Depending on the tenant's business, Article 3 can become a quagmire to navigate because the following clause draws a distinction between the fixtures just described, and "trade fixtures". Under Article 3, the Landlord cannot take title to "trade fixtures" and Tenant must remove them from the premises at surrender, restoring the premises to the condition existing prior to the installation. A typical scenario where this comes up is a tenant who runs a restaurant business. We will explore this distinction further when we discuss liens and encumbrances. For the time being, it is simply worth highlighting "trade fixtures" as another issue that tenant's counsel should consider when its clients are planning an early termination of the lease.

[35.20] VII. NOTICE REQUIREMENTS

EXAMPLE 4:

Guaranty

In order to induce _____, a New York limited liability company, as landlord ("Landlord"), to enter into a lease bearing even date herewith with _____ a New York limited liability company, as tenant ("Tenant"), in the form and upon the terms of the lease hereto annexed ("Lease") for premises described as _____ (the "Premises") in the building known as _____ having an address at _____ ("Guarantor"), hereby represents, guarantees and agrees with Landlord as follows:

- (1) Guarantor is a member of Tenant.
- (2) Until the date upon which Tenant delivers possession of the Premises to Landlord, together with the keys to said Premises, vacant (except the Tenant's Improvements), free of all tenancies and occupants (other than Landlord or Landlord's designee pursuant to Article 11 of the Lease), in the condition required pursuant to the terms of the Lease, and confirms its surrender of the Premises pursuant to a (Blumberg form of) surrender agreement via fax whether such delivery of possession and confirmation shall be before or after the occurrence of a default under the Lease, Guarantor hereby guarantees to Landlord:

(a) the payment of any and all costs and expenses, (including, but not limited to, reasonable counsel fees) that are incurred by Landlord in connection with the enforcement of the terms and provisions of the Lease or the exercising of any remedy thereunder or at law or in equity as against Tenant, or with respect to any action or proceeding by Landlord to obtain or attempt to obtain possession of the Premises; and

(b) the payment of minimum rent as defined in Section 3.01(a) of the Lease, additional rent as set forth in Article 22 of the Lease and any all sums for which Tenant may be liable under the Lease, and/or for use and occupancy following a termination of the Lease, as the case may be.

- (3) This Guaranty is primary, absolute and unconditional, except as herein expressly provided, and shall not be discharged, mitigated, or affected by (i) any modification of the Lease; (ii) any failure of Landlord to enforce any of the provisions of the Lease or by any extension of time or indulgence extended by Landlord to Tenant thereunder; (iii) any defense available to Tenant or Guarantor; or (iv) any invalidity or unenforceability of all or any portion of the Lease; and Guarantor hereby consents to all of the foregoing without notice to Guarantor, and Guarantor's liability shall extend to the Lease as so modified or extended.

The structure of the Example 4 GG Guaranty may seem convoluted but it is, in essence, as simple as the basic GG Guaranty discussed earlier, *i.e.* the guarantor's liability is terminated upon surrender of the premises in the condition required pursuant to the terms of the Lease, plus one additional wrinkle:

. . . and confirms its surrender of the Premises pursuant to a (Blumberg form of) surrender agreement via fax. . .

Read in its entirety, ¶ 2 of this guaranty essentially states that the guarantor shall remain liable for the tenant's obligations under the Lease until the date that tenant surrenders the premises in the condition required by the Lease AND confirms the surrender pursuant to a Blumberg form of surrender via fax.

What if Tenant terminates the lease early, surrenders the premises, and confirms the surrender by certified mail? Does the guarantor avoid liability? Technically, no. Terms of a guaranty are strictly construed by the

court.⁷ Where the guaranty provides for a method of notice, guarantors who fail to comply with such provisions have been held liable for future rent under the lease.⁸

Of course, it is worth reiterating that landlord should always expressly reserve its rights under the GG Guaranty at the time of surrender if it hopes to prosecute claims arising from a failure to comply with its terms!⁹

[35.21] VIII. ADVANCE NOTICE REQUIREMENTS

Many GG Guaranties require, among a host of other conditions, advance notice of a tenant's intent to terminate the lease early and surrender the premises, in order to terminate the guarantor's liability.¹⁰ The interpretation of the terms of the Good Guy clause are a question of law for the Court, which accords those terms their plain and ordinary meaning.

EXAMPLE 5:

(H) The obligations of Guarantor under this Guaranty shall be limited to the period of time commencing on the date hereof and ending on the date Tenant has surrendered possession of the Premises in vacant and broom clean condition, free of all tenancies and occupants, on the condition that all of the following have occurred (i) at the time of such surrender, all Fixed Annual and Monetary Additional Rental (but not accelerated rent) due under the Lease have been paid to Landlord up to the later of (a) the time of surrender, or (b) the end of the sixty (60) day period set forth in subsection (ii) below, and (ii) Landlord has received at least sixty (60) days written notice from Tenant of Tenant's intent to vacate the Premises and Tenant has vacated the Premises on or before the date for delivery of possession to Landlord set forth by Tenant in such

7 *Wooster 76 LLC v. Ghatanfard*, 68 A.D.3d 480, 892 N.Y.S.2d 310 (1st Dep't 2009).

8 *Id.*

9 *See Freeman Foursome*, Index No. 100289/94.

10 *See Fairchild Warehouse Associates, LLC v. Water Chef, Inc.*, 2014 WL 12639275 (Sup. Ct., N.Y. Co. 2014) (“[Guarantor’s] arguments are unavailing in light of the unambiguous language in the Guaranty. The Good Guy clause required tenant give landlord two month’s notice prior to the vacancy date. Tenant gave landlord less than 30 days notice. The rent was in arrears (\$72,000) when tenant vacated the premises. Tenant was given timely Notice of Default to allow a cure of the arrears. Since the defendants have failed to satisfy the relevant conditions of the Good Guy clause, the limitation of liability set forth in the Good Guy clause is unavailable to Lazar. The guarantor is liable for damages for the full term of the lease, as it is undisputed that the conditions in the Good Guy clause were never satisfied [citations omitted].”)

notice, and (iii) Tenant has forfeited to Landlord its Security Deposit under the Lease in the amount set forth in Article 31 of the Lease.

IN WITNESS WHEREOF, Guarantor has duly executed and delivered this Guaranty as of the date first above written.

In the above example, subsection (ii) lists as one of the required conditions that:

Landlord has received at least sixty (60) days written notice from Tenant of Tenant’s intent to vacate the Premises and Tenant has vacated the Premises on or before the date of delivery of possession to Landlord set forth by Tenant in such notice . . .

This clause has a dual effect. First, if Tenant fails to give at least 60 days written notice by either giving less than 60 days’ notice, OR gives sufficient notice but orally rather than in writing, then the condition is left unsatisfied and guarantor remains liable under the lease for past and future rent owed. Second, the effect of requiring 60 days advance notice of a tenant’s intent to surrender the premises functions as an additional two months of security. If the notice period was 180 days, it would an additional 6 months of security. Remember, in a basic GG Guaranty, guarantor’s liability is cut off at the time of surrender. Here, the advance notice requirement must be read in conjunction with the surrender provision, subsection (i):

. . . at the time of such surrender, all Fixed and Annual and Monetary Additional Rental [. . .] due under the Lease have been paid to Landlord up to the later of (a) the time of surrender, or (b) the end of the (60 day period set forth in subsection (ii) below. . .

By requiring the advance notice and also requiring that all fixed annual and additional rental be paid through the date of surrender or the end of the 60 day period, landlord has effectively tacked on two months that the guarantor will be liable for one way or another. Below are two scenarios to demonstrate how this plays out.

Scenario 1

Tenant gives 60 days written notice of its intent to surrender. Landlord accepts, reserving its rights under the GG

Guaranty. Tenant occupies the premises for the duration of the 60 days and vacates on the 60th day as per the notice. If guarantor wants to walk away from this with no personal liability for all obligations past and future, it must pay the rent due and owing for those two months in addition to any other arrearage.

Scenario 2

Tenant gives 60 days written notice of its intent to surrender. Landlord accepts, reserving its rights under the GG Guaranty, but tells Tenant that it can vacate and surrender even earlier than the 60th day. Any difference in what needs to happen for guarantor to satisfy the termination clause of the GG Guaranty? No! Read the language of subsection (i) carefully. It reads that all Fixed Annual and Monetary Additional Rental due under the lease must be paid to Landlord *up to the later of* (a) the time of surrender, or (b) the end of the sixty (60) day period.

One possible downside of drafting a GG Guaranty with an advance notice requirement is that it makes it harder to obtain a summary determination when enforcing a GG Guaranty.¹¹

[35.22] IX. LANDLORD'S ACCEPTANCE OF SURRENDER

It is absolutely critical that landlord reserves its rights under the guaranty even if it may seem that the tenant has complied with the advance notice requirement.

EXAMPLE 6:

CERTIFIED MAIL

June 10, 2010

11 See *Pajeot & Otter LLC v. Westbeth Entertainment LLC*, 2016 WL 6125407 (Sup. Ct., N.Y. Co. 2016) (“Generally, a ‘good guy’ guaranty only holds the guarantor liable for rent and/or additional rent due prior to the tenant’s surrender of a commercial premises. In this case, the guarantor also agreed to provide specific notice of its intent to surrender the premises in accordance with the terms of the expired lease . . . The conflicting allegations regarding, inter alia, notice, payment of rent, condition of the premises etc., make this case unworthy of summary judgment.”).

Dear Guarantor,

We are in receipt of your letter dated May 27, 2010 regarding vacating the premises on August 31, 2010. The lease dated May 13, 2009 has an expiration date of May 31, 2016, and does not have an early termination clause. Your letter meets the requirements of the Personal Guaranty, however, XYZ Corp. will remain on the lease and be liable for all damages after vacating the premises.

Please be advised in order to ensure the tenancy has elevator service, the Landlord has instructed _____ to make any required repairs and maintain the present elevator. If a situation arises whereby the elevator needs to be manually operated, the Building will provide such personnel at no charge to the tenancy. You may contact _____ at the building office _____ the day prior to a delivery in order to schedule the manual operation, and give a follow up call approximately ten minutes prior to the actual arrival of the delivery to ensure the operator will be on site.

Also be advised the _____ elevator has undergone contractor solicitation for a completion modernization and/or renovation. The Landlord is taking your concern and complaints very seriously.

Sincerely,

Managing Agent on behalf of Landlord

In Example 6, the managing agent's letter was inadequate. It lacks language reserving its rights under the GG Guaranty.

Example 7:

Dear Guarantors:

Our firm has been retained by OWNER LLC ("Landlord") to handle all matters pertaining to the above-referenced Lease. We write to advise that on or about _____, 2010 (the "Surrender Date"), XYZ Company ("Tenant") surrendered possession of the Premises.

TAKE NOTICE that although the Landlords hereby acknowledge Tenant's surrender of possession only of the subject Premises, effective as of the Surrender Date, the Landlords do so expressly without prejudice to their rights under the Lease and pursuant to any and all applicable law. **In particular, Landlords reserve the right to sue and collect damages,**

including but not limited to past and/or future rent that has or will become due under the Lease, as well as costs and attorneys' fees, for Tenant's untimely vacatur and breach of the Lease. Landlords also reserve the right to sue and collect damages under the Personal Guaranty dated _____ executed by John Doe and Jane Doe.

Without this language, landlord cannot seek all arrears and future rent against the guarantor.

[35.23] X. LIENS AND ENCUMBRANCES

By way of review, we first note that this GG Guaranty features a 180-day notice provision. Notice must be given at least 180 days before the intended date of surrender, and landlord effectively has six months of additional security as a result.

In addition to the notice period, the termination clause of this GG Guaranty requires tenant to *deliver possession of the Premises [...] free from all liens and encumbrances*.

EXAMPLE 8:

GUARANTY OF LEASE

1. In consideration of, and as an inducement for the granting, execution and delivery of a certain lease dated as of June 24, 2008 ("Lease"), by _____ landlord therein named ("Landlord," which term shall be deemed to include the named Landlord and its successors and assigns) to _____ tenant therein named ("Tenant," which term shall be deemed to include the named Tenant and its successors and assigns) for the premises located at _____ as more particularly described in the Lease ("Premises") and in further consideration of the sum of One (\$1.00) Dollar and other good and valuable consideration paid by Landlord to the undersigned, the receipt and sufficiency of which are hereby acknowledged, the undersigned, _____ and _____ (collectively, "Guarantor" which term shall be deemed to include each named Guarantor and his successors and assigns), hereby guarantees, absolutely and unconditionally, to Landlord all of the obligations and liabilities of Tenant under the Lease arising or accruing at any time prior to the date that Tenant, on not less than one hundred eighty (180) days prior written notice to Landlord sent in accordance with the terms of the Lease, deliv-

ers possession of the Premises to Landlord, vacant and free of all tenancies and occupancies, free of all liens and encumbrances and otherwise in the condition required under the Lease, together with delivery to Landlord of the keys to the Premises and a letter from Tenant to Landlord stating that: “We have delivered possession to you of the premises located at _____ and leased to us pursuant to Lease dated as of June 24, 2008 in accordance with the terms of such Lease.” The date upon which such delivery of possession occurs in accordance with the provisions of the Lease and this Guaranty is referred to as the “Surrender Date.”

2. This Guaranty is absolute and unconditional. The liability of Guarantor is coextensive with that of Tenant and this Guaranty shall be enforceable against Guarantor without the necessity of any suit or proceeding on Landlord’s part of any kind or nature whatsoever against Tenant and without the necessity of any notice of nonpayment, nonperformance or nonobservance all of which Guarantor hereby expressly waives. Guarantor hereby expressly agrees that the validity of this Guaranty and the obligations of Guarantor hereunder shall in no way be terminated, affected, diminished or impaired by reason of (a) the assertion or the failure to assert by Landlord against Tenant of any of the rights or remedies reserved to Landlord pursuant to the terms, covenants and conditions of the Lease, or (b) any non-liability of Tenant under the Lease, whether by insolvency, discharge in bankruptcy, or any other defect or defense which may now or hereafter exist in favor of Tenant.
3. This Guaranty shall be a continuing Guaranty, and the liability of Guarantor hereunder shall in no way be affected, modified or diminished by reason of (a) any assignment, renewal, modification, amendment or extension of the Lease, (b) any modification or waiver of or change in any of the terms, covenants and conditions of the Lease, (c) any extension of time that may be granted by Landlord to Tenant, (d) any consent, release, indulgence or other action, inaction or omission under or in respect of the Lease, (e) any dealings or transactions or matter or thing occurring between Landlord and Tenant, or (f) any bankruptcy, insolvency, reorganization, liquidation, arrangement, assignment for the benefit of creditors, receivership, trusteeship or similar proceeding affecting Tenant, whether or not notice thereof or of any thereof is given to Guarantor.

[35.24] XI. MECHANIC'S LIENS

One of the most common liens that may attach to a property is a mechanic's lien. A mechanic's lien is a security interest in the property belonging to someone who provided labor and/or materials to the tenant/landlord to improve the property.

A common scenario that gives rise to a mechanic's lien is when tenant contracts to have alterations made to the premises for its business purposes. Assume a dispute arises between tenant and the contractor resulting in tenant refusing to pay the entire amount invoiced by the contractor. Contractor feels it is entitled to the funds having completed the alteration and files a mechanic's lien with the County Clerk's office against the demised premises. Only months into its lease, tenant's business suffers and it seeks to terminate the tenancy and absolve the guarantor of liability. If tenant notifies landlord of its intention to surrender the premises complying with the notice period, but does nothing to discharge the lien, the GG Guaranty stays in effect and keeps guarantor on the hook for the entire term of the lease!

[35.25] XII. UCC LIENS

UCC liens are filed by vendors of equipment/merchandise and, are typically a security interest in the items that are leased or sold. This may lull tenants into a false sense of comfort that a UCC lien on, for example, a set of computers and sales equipment for a store, does not implicate the leased premises, and therefore need not be discharged prior to surrender.

The authors of these materials handled a case in which a restaurant leased space from the landlord and performed certain alterations to the space that included installation of kitchen equipment, sales systems and an HVAC system. Months after the restaurant opened its doors, it fell into financial turmoil, eventually falling behind on rent and seeking bankruptcy protection (we will discuss the effect of declaring bankruptcy later in this course using the same case study, however, for the purposes of our present discussion we focus solely on the lien dimension of the case).

The principal of the restaurant had financed the improvements to the premises using a loan from his sibling. The sibling secured the loan by filing a UCC lien against *"all assets and personal property and fixtures of Debtor, of every description, whether now or hereafter existing or now or hereafter owned or acquired, wherever located."*

This is what is known as a *blanket lien* because it can be construed to include among other things, fixtures that, by the lease's terms, belong to the landlord.

Recall our discussion about Article 3 of the Standard Board Lease. Earlier, we alluded to the distinction between those alterations that the landlord can elect to assume ownership of, and those characterized as "trade fixtures" which the tenant must remove at the expiration of a lease. Article 3 reads, in pertinent part:

Nothing in this article shall be construed to give Owner title to, or to prevent Tenant's removal of, trade fixtures, moveable office furniture and equipment, but upon removal of same from the demised premises or upon removal of other installations as may be required by Owner, Tenant shall immediately and at its expense, repair and restore the demised premises to the condition existing prior to any such installations, and repair any damage to the demised premises or the building due to such removal.

The natural follow-up question is, "What are trade fixtures?" There is no simple answer and you may have guessed by now that there is a whole body of case law interpreting this term in different contexts. For our purposes, it is enough to note that the distinction between those installations that the landlord may elect to assume ownership of, and those that are "trade fixtures" is vague enough to add to the uncertainty facing a tenant who wants to terminate the lease early and surrender the premises.

In this particular case, in addition to Article 3, the lease also had the following provision included in a Rider to the Lease:

At the expiration or sooner termination of the term of this Lease, except with respect to furniture, movable fixtures and equipment, and except as Landlord may elect otherwise under Article 3 hereof, all such installations and equipment made or installed by or for Tenant, including, without limitation, kitchen and HVAC equipment and duct work, shall be and become the property of Landlord and shall remain upon and be surrendered with the Demised Premises.

Reading these provisions together, a blanket UCC lien that purports to have a security interest in “*all assets and personal property and fixtures of Debtor, of every description,*” can cast enough of a cloud over the title to the premises to cause the tenant to be in default of a GG Guaranty’s provision requiring that the premises be free and clear of all liens or other encumbrances upon surrender, thus leaving the guarantor potentially liable for all future rent.

[35.26] XIII. RENT ABATEMENT AND CLAWBACK PROVISIONS

EXAMPLE 9:

64. “GOOD GUY” GUARANTY

(a) Tenant represents that all of its corporate stock is owned by the shareholders whose names, residence addresses, social security number (or tax identification numbers) and signatures are set forth in Schedule B annexed hereto and made a part hereof. Tenant further represents that the shareholders referred to in said Schedule B are all of the shareholders of Tenant and that there are no other shareholders at the present time. In order to induce Landlord to enter into the lease and in consideration of Landlord’s entering into this lease, the individuals and entities set forth on said Schedule B (hereafter individually and collectively referred to as “Guarantor”) hereby guaranties, unconditionally and absolutely, to Landlord, its successors and assigns (without requiring any notice of nonpayment, nonperformance or nonobservance or proof of notice or demand whereby to charge Guarantor, all of which Guarantor hereby expressly waives), the payment as and when due of the fixed rent (which is sometimes referred to in this lease as the “annual rental rate”), payable by Tenant under Article 39 of the lease (hereinafter collectively referred to as “Tenant’s Monetary Obligations”). Notwithstanding the foregoing, Guarantor’s liability pursuant to this Article 64 (hereinafter sometimes referred to as the “Guaranty”) shall be limited to the sum of: (x) the payment of Tenant’s Monetary Obligations which accrue up to the date that is the last to occur of: (A) Tenant vacates the demised premises, (B) Tenant removes its property from the demised premises, and (C) Tenant delivers the key to Landlord.

First, it is important to note that this GG Guaranty appears in the lease itself and names the guarantors in a schedule annexed to the lease. This does not alter the legal effect of the GG Guaranty. Think Shakespeare: “*A rose by any other name would smell as sweet.*” If drafting a GG Guaranty

clause within a lease and listing guarantors in an attached schedule, just go over our handy checklist discussed at the top of the chapter and make sure you include all the guarantor(s)' vital information that will be necessary to conduct due diligence on their credit worthiness or to enforce a judgment. And, of course, do not forget signatures (for each guarantor in their individual capacity)!

Second, by way of review, note that this is also a basic GG Guaranty where the guarantors' liability cuts off once the tenant perfects surrender of the premises to landlord, i.e. the last day that tenant vacates the premises, removes its property from the premises, and delivers the key to the landlord.

[35.27] A. Rent Abatements

Example 9 is included to highlight the interplay between a GG Guaranty and provisions in a lease that entitle tenant to rent abatements conditioned on the tenant's good standing.

It is not uncommon for leases to include incentives such as rent reductions or months of free rent, to encourage tenants to stay in good standing and remain current on payments.

In this particular case, the tenant had negotiated rent abatement via an amendment to the lease, for the month of January 2011 and two months' free rent for the months of February and March 2011, *i.e.* the last two months of the lease. The amendment read in pertinent part:

Notwithstanding anything contained in the Lease to the contrary, provided Tenant has made all payments required under this Lease no later than fifteen (15) days after such sums were due: (a) Tenant's monthly rent for the month of January, 2011 shall be reduced by \$6,666.66, provided Tenant is not in default of a monetary obligation under the Lease and not in default of a nonmonetary obligation under the Lease beyond the expiration of any applicable notice and grace period as of January 1, 2011; (b) Tenant's monthly rent for the month of February, 2011 shall be reduced by \$31,666.67, provided Tenant is not in default of a monetary obligation under the Lease and not in default of a nonmonetary obligation under the Lease beyond the expiration of any applicable notice and grace period as of February 1, 2011; and (c)

Tenant's monthly rent for the month of March, 2011 shall be reduced by \$31,666.67, provided Tenant is not in default of a monetary obligation under the Lease and not in default of a nonmonetary obligation under the Lease beyond the expiration of any applicable notice and grace period as of March 1, 2011.

As the language clearly indicates, tenant was only entitled to the rent abatement in January if it had made *all payments* required by the lease within 15 days after such payments were due. Then, each month of free rent for February and March were also contingent on the tenant being current on monetary obligations and, not in default of nonmonetary obligations under the lease.

In this case, the tenant made a payment for January 2011 of \$25,000 on January 10, 2011, citing the rent abatement as the reason for deducting \$6,666.66 from the base rent of \$31,666.67.

Landlord notified tenant that it was not entitled to the rent abatement as it had consistently made late rental payments beyond the prescribed 15th day of each month. It further noted that, for the same reason, tenant was also not entitled to the free rent in February and March of 2011.

Tenant failed to make its February payment and Landlord sued the guarantors under the guaranty clause of the lease.

Eventually, landlord was able to use the leverage of having the guarantors on the hook for a little over \$70,000 in back-rent and electric charges, to extract a favorable settlement without ever going to trial.

Here, the effect of the GG Guaranty was to leave the landlord in a better position at the end of the tenancy than it may have originally predicted. Although tenant may have been current on all payments up through December 31, 2010, the fact that the payments were made chronically late, in violation of the rent abatement provision, was enough to trigger landlord's right to "clawback" the rent reduction in January and the free rent for February and March 2011. Moreover, landlord was able to accomplish this efficiently by capitalizing on the GG Guaranty's leverage against the principals.

In the preceding example, tenant received the free rent concession in the final two months of the term, *if* it had not made late payments up until that time. In other words, this was a condition precedent to receiving the

rent concession at all. Landlord, up until that time, had not foregone any rent and could demand full payment of the two months if the tenant failed to comply with the condition and, as we learned, hold the guarantor liable.

[35.28] B. Clawbacks

EXAMPLE 10:

Section 3.02. Notwithstanding the provisions of Section 3.01 hereof, and provided Tenant is not then in default hereunder after any applicable notice and expiration of any applicable cure period, Tenant shall be entitled to an abatement of part of the minimum rent only in the amount of \$15,437.50 per month for each of the first, second, third, fourth, and fifth months following the Commencement Dates, provided that the balance of minimum rent of \$1,385.42 for each month shall be due and payable. Tenant acknowledges that the consideration for the aforesaid abatement of minimum rent is Tenant's agreement to perform all of the terms, covenants and conditions of this Lease on its part to be performed. Therefore, if Tenant shall be in default under any of the terms, covenants and conditions at any time, during the term hereof, the aggregate amount of all minimum rent that was abated shall immediately thereafter become due and payable by Tenant to Landlord. In the event of Tenant's failure to pay such aggregate amount to Landlord, Landlord shall be entitled to the same rights and remedies as in the event of tenant's default in the payment of minimum rent. Tenant shall be required to pay additional rent and all other sums from and after the Commencement Date.

In this example, the rent concession comes at the beginning of the lease term and it lasts for five months, totaling almost \$78,000.

Assume that tenant's principal has signed a simple GG Guaranty guarantying the tenant's obligations up until the time of surrender. If tenant becomes unable to carry the lease to its full term and is forced to surrender, can the guarantor be held liable for the abatement amount in light of the following language in the lease? Yes. Recall that guarantors are liable to the full extent of tenant's obligations.

Tenant acknowledges that the consideration for the aforesaid abatement of minimum rent is Tenant's agreement to perform all of the terms, covenants and conditions of this Lease on its part to be performed. *Therefore, if Tenant shall be in default under any of the terms, covenants and conditions at any time, during the term hereof, the aggre-*

gate amount of all minimum rent that was abated shall immediately become due and payable by Tenant to Landlord.

If the tenant breaches the lease by terminating early, that default triggers the “clawback” of the rent concession given at the beginning of the term making tenant liable for the concession amount under the lease. Thus, landlord may pursue the guarantor for the concession amount.

[35.29] XIV. LEASE RENEWALS, EXTENSIONS AND MODIFICATIONS

The scenario we examine in this section is the following: landlord, tenant, and guarantor have already entered into a lease and a GG Guaranty, respectively. Subsequently the parties agree to another set of terms embodied in either a lease renewal or extension at the expiration of the term, or a lease modification, amending certain rights and obligations of the parties.

Query: Does the GG Guaranty still bind the guarantor? It depends.

The Presumption: Courts construe guaranties strictly in favor of private guarantors.¹² If a guaranty is silent as to its effect in light of a renewal or other subsequent agreement between the landlord and tenant, courts will not extend the guaranty’s enforceability beyond the original agreement.¹³

[35.30] XV. SURVIVAL CLAUSES

One way to ensure that the GG Guaranty still binds the guarantor after a subsequent agreement between the landlord and the tenant is to include a survival clause in the original GG Guaranty. We previewed this clause at the top of the course when we covered the anatomy of a GG Guaranty. The following is sample language for a survival clause in its entirety:

This Guaranty shall be a continuing Guaranty, and the liability of Guarantor hereunder shall in no way be affected, modified or diminished by reason of (a) any assignment, renewal, modification, amendment or exten-

¹² *Levine v. Segal*, 256 A.D.2d 199, 200, 682 N.Y.S.2d 375 (1st Dep’t 1998).

¹³ *Trump Management Inc. v. Tuberman*, 163 Misc. 2d 921, 622 N.Y.S.2d 851 (Civ. Ct., Kings Co. 1995), citing *Gulf Oil Corp. v. Buram Realty Co.*, 11 N.Y. 2d 223, 228 N.Y.S.2d 225 (1962).

sion of the Lease, or (b) any modification or waiver of or change in any terms, covenants and conditions of the Lease, or (c) any extension of time that may be granted by Landlord to Tenant, (d) any consent, release, indulgence or other action, inaction or omission under or in respect of the Lease, or (e) any dealings or transactions or matter or thing occurring between Landlord and Tenant, or (f) any bankruptcy, insolvency, reorganization, liquidation, arrangement, assignment for the benefit of creditors, receivership, trusteeship or similar proceeding affecting Tenant, whether or not notice thereof or of any thereof is given to Guarantor.

First, note that this is a harsh example of a survival clause because the guaranty *even survives an assignment*. From the guarantor's perspective, it does not want to be on the hook even after a new business (and presumably new principals), have taken over. Guarantor should negotiate that upon assignment, a suitable guarantor of equal or greater financial net worth assume the guaranty and release the original guarantor.

This survival clause errs on the safe side to say the least. The draftsman of this clause was clearly aware of the situations that can arise which may well defeat a GG Guaranty's survival clause because its language fails to contemplate the contingency at hand.

The following cases illustrate how (1) a survival clause can fail to keep the guarantor on the hook, and (2) how changes to material terms of a lease may require a showing that guarantor consented to the changes.

[35.31] A. New Agreement

In these cases, the operative fact was that the guaranty's survival clause did not contemplate the kind of arrangement that the landlord and tenant's subsequent agreement embodied, i.e. the guaranty was inextricably tied to the original lease and its terms.

Where a guaranty executed in 2000 stated that it would "remain and continue in full force and effect as to any renewal, change or extension of the Lease," the language was held not to cover an "extension agreement" between landlord and tenant that, *inter alia*, (1) specifically referred to the 2000 lease as "expired" and, (2) materially altered the terms of the 2000 lease by increasing rent for the tenant, and thus, increasing the risk for the guarantor without his consent.¹⁴

Where a guaranty stated that it would “remain and continue in full force and effect as to any renewal, change or extension of the Lease,” and tenant stayed on as a month-to-month tenant after the expiration of the term, the court held that the guaranty no longer applied, because there hadn’t been a renewal or extension of the lease.¹⁵

[35.32] B. Material Terms of the Original Lease Have Changed

A creditor (landlord) and debtor (tenant) cannot materially alter the terms of an agreement that a surety (guarantor) is bound to without the surety’s (guarantor’s) consent.

Where a modification agreement increased rent, which was a material term, but guarantor could not make a *prima facie* showing that it did not consent to modification, summary judgment dismissing counts against guarantor was not warranted.¹⁶

Where a lease renewal agreement changed a material term of the lease by granting landlord a right to terminate the lease unilaterally, without qualification, in the event of a use violation placed on the premises, the guarantors were discharged of their obligation because they had not consented to the change in their individual capacity.¹⁷

[35.33] XVI.WAIVER OF NOTICE OR RATIFICATION

There are two ways to avoid the issue of showing that a guarantor consented to a “material” change in a lease modification, renewal, or extension.

[35.34] A. Guarantor Waives Notice

Where the original guaranty includes a provision in which guarantor expressly waives his right to receive notice of changes to the lease, the

14 *Lo-Ho LLC v. Batista*, 62 A.D.3d 558, 881 N.Y.S.2d 33 (1st Dep’t 2009).

15 *665-75 Eleventh Ave. Realty Corp. v. Schlanger*, 265 A.D.2d 270, 697 N.Y.S.2d 270 (1st Dep’t 1999).

16 *Arlona Ltd. Partnership v. 8th of Jan. Corp.*, 50 A.D.3d 933, 857 N.Y.S.2d 208 (2nd Dep’t 2008); *cf. 404 Park Partners, L.P. v. Lerner*, 75 A.D.3d 481, 906 N.Y.S.2d 36 (1st Dep’t 2010) (reversing trial court’s grant of summary judgment to plaintiff and remanding for trial, where a guarantor did not sign the second guaranty executed with a lease extension and issue of fact remained as to whether he consented).

17 *Mangold v. Keip*, 177 Misc.2d 953, 679 N.Y.S.2d 240 (App. Term, 1st Dep’t 1998).

guaranty is not extinguished simply because material changes to the lease were made without giving notice to the guarantor.¹⁸

[35.35] B. Ratification of Guaranty

Where guarantors execute a ratification or reaffirmation of the guaranty and acknowledge their assent to any material changes in the terms of the original contract, courts will hold guarantors liable.¹⁹

EXAMPLE 11:

RATIFICATION AND CONFIRMATION OF GUARANTY

By signing below, _____ and _____ (jointly and severally, “Guarantors”) (i) ratify and confirm all of the terms and conditions of that certain “Good Guy” Guaranty dated as of June 17, 2005 (the “Guaranty”) from Guarantors to _____ (“Landlord”) guaranteeing unto Landlord the payment by _____ and _____ (“Tenant”) of all the terms, covenants and conditions of that certain Agreement of Lease dated as of June 17, 2005 (the “Lease”), and (ii) acknowledge and agree that the Guaranty of the Lease, as amended by this Agreement, remains in full force and effect.

GUARANTORS:

PRACTICE TIP: The best practice is to have the guarantor(s) sign a ratification of the guaranty anytime the underlying agreement is in anyway modified, renewed, or extended irrespective of whether you may consider the change to be a “material” term.

[35.36] C. Continuing the Guarantor Relationship

Someone who seemed to be a solid guarantor at the inception of a lease may later fall into insolvency for any number of reasons. E.g. halfway through a five year contract term, if the guarantor faces litigation and is subject to a \$1.5 million money judgment that wipes out its assets, obligee will be left holding the bag if the guarantor’s business is the next thing to

¹⁸ *Pamela Equities Corp. v. The Law Suite, L.P.*, 14 Misc. 3d 1217(A), 836 N.Y.S.2d 487 (Sup. Ct., N.Y. Co. 2005).

¹⁹ *See, e.g., North Hill Funding of New York, LLC v. Maiden & Madison Holdings, LLC*, 27 Misc. 3d 1232(A), 911 N.Y.S.2d 694 (Sup. Ct., N.Y. Co. 2010).

fold. In that case, you may decide that you will only continue the relationship if the guarantor posts additional security or obtains a letter of credit from a bank.

[35.37] XVII. WITHDRAWING FROM A GG GUARANTY

Sometimes GG Guaranties signed by multiple partners or shareholders allow for withdrawal of such guarantors as they withdraw from the business. Example 12 demonstrates how a small restaurant with four partners was handled for purposes of the GG Guaranty.

EXAMPLE 12:

15. Notwithstanding anything in this Guaranty to the contrary, (a) if (i) any individual constituting Guarantor shall transfer his membership interest in Tenant to any other individual constituting Guarantor, (ii) the aggregate net worth of the remaining guarantors equals or exceeds \$1,000,000 and (iii) Tenant is not then in default under the Lease, then the transferor will be released from all obligations under this Guaranty; and (b) if (i) any individual constituting Guarantor shall transfer his membership interest in Tenant to a third party, (ii) either (x) such transfer does not require Landlord's consent under the Lease or (y) such transfer does require Landlord's consent and Landlord has consented thereto, (iii) the transferee executes, acknowledges and delivers to Landlord a guaranty in the form of this Guaranty, and (iv) the aggregate net worth of the remaining original guarantors and the new guarantor equals or exceeds \$1,000,000, then the transferor will be released from all obligations under this Guaranty.

Next, we examine, in detail, a case where the court considered whether two of the four partners in a law firm were properly withdrawn from a GG guaranty. *150 Broadway N.Y. Assocs., L.P. v. Shandell*²⁰ concerned a law firm tenant. The law firm was a partnership of four lawyers. The GG Guaranty was signed by all the partners. There was a provision whereby partners could bail out of the guaranty if they bailed out of the partnership. The GG guaranty stated:

In order to induce Owner to enter into this Lease and in consideration of Owner's entering into this Lease, the four (4) individuals executing this lease rider at the foot

²⁰ 27 Misc.3d 1234(A), 910 N.Y.S.2d 763 (Sup. Ct., N.Y. Co. 2010).

hereof (hereinafter, collectively, referred to as “Guaranty”) hereby guaranties, unconditionally and absolutely, to Owner, its successors and assigns (without requiring any notice of nonpayment, nonkeeping, nonperformance or nonobservance or proof of notice or demand whereby to charge Guarantor, all of which Guarantor hereby expressly waives) . . . (the payment as and when due of the Fixed Annual Rent, Additional Rent, charges and damages payable by Tenant under the Lease) . . . up to the date that Tenant vacates the demised premises and removes its property therefore, delivers the key to Owner and gives written notice to Owner that it is surrendering possession of the premises.

(i) Notwithstanding anything to the contrary contained in this Good Guy Guaranty, in the event that any Guarantor (1) fully withdraws as a partner from the limited liability partnership which is the tenant under this Lease (hereinafter referred to as the “LLP”) and (2) physically vacates the Demised Premises, except that such Guarantor may remain associated with the LLP as “of counsel” and in connection therewith may utilize a small portion of the Demised Premises and further provided that all Fixed Annual Rent, Additional Rent and other charges due and payable under the lease by the Tenant is then current, and if proof satisfactory to the Owner which shall include a signed statement by the LLP and each other Guarantor of the within lease certifying that the that both of the foregoing events described in items (1) and (2) of this subparagraph have occurred, then such withdrawing Guarantor shall be released and discharged from his guaranty of this Lease. Such release shall not have any effect upon the Guaranty of each other Guarantor hereunder which shall remain in full force and effect.”

Two of the partners withdrew from the partnership and attempted to get out of the guaranty by sending the above-described notices. The landlord rejected the notices, on the basis that there were rent arrears at the time of the withdrawal notices.

Tenant argued that only the current month’s rent was due at the time their respective withdrawal notices were sent. One notice was dated January 23, 2006, at which point January 2006 rent had not yet been paid

(tenant was otherwise current). The rent was, however, paid in full by January 30, 2006.

The court found for the withdrawing tenant guarantors, stating:

The interpretation of the guaranty that plaintiff urges the court to accept, that a guarantor cannot be released from his or her guaranty the day the notice is tendered, because the current month's rent is paid several days or weeks later, allows the owner unfettered discretion on when to cash any payments that the tenant makes. Theoretically, this would eviscerate a guarantor's express right to terminate the guaranty when s/he notifies the owner in good faith that s/he has withdrawn from the law firm as partner. This was clearly not the underlying intention of the lease provision at bar. Under the guaranty, each guarantor waived notice of any rent arrears the tenant might have. The guarantors did not, however, waive the right to notice that their individual withdrawal notices were rejected as inadequate or deficient by the owner. Therefore, when Shandell sent his notice of withdrawal it was up to the landlord to either notify him it was satisfactory or unsatisfactory. The landlord did not tell Shandell there were rent arrears or that his notice was rejected for that reason. Instead, the landlord played coy and had its attorney send an obtuse letter which avoids this issue altogether.

[35.38] XVIII. BANKRUPTCY & GG GUARANTIES

This section focuses on the effect bankruptcy has on a landlord's ability to proceed against the guarantor to recover rent and other damages arising from the tenant's default under the lease.

Specifically, we are examining the scenario where a business/tenant files a petition in federal bankruptcy court, thereby invoking the protection of the "automatic stay" under the Bankruptcy Code that stays all pending actions against the debtor-business, and the debtor proceeds, either with liquidation under Chapter 7, or reorganization under Chapter 11.

Below the question is addresses of whether the landlord proceed directly against the guarantor/principal of the business who guaranteed the tenant's obligations under the lease

[35.39] A. The Automatic Stay

Title 11 of the United States Code (“Bankruptcy Code”) governs proceedings in federal bankruptcy court.

Bankruptcy Code § 362 provides that a bankruptcy petition “operates as a stay, applicable to all entities,” of the commencement or continuation of judicial proceedings against the debtor.²¹

Thus, under § 362 of the code, a landlord SHOULD NOT attempt to evict, or otherwise pursue judicial relief against, a tenant who has filed for bankruptcy.

The landlord will likely know that a tenant has filed for bankruptcy. When the debtor files for bankruptcy, creditors who are listed by the debtor on its schedules, receive notice of the filing. However, under § 362 of the Code, the petition’s filing itself triggers the automatic stay and Landlord is immediately restrained from pursuing ANY claims against the tenant, including seeking eviction, and would be well advised to consult with its attorney before serving any kind of notice or correspondence on the tenant in connection with defaults under the lease.

Section 362 of the Bankruptcy Code imposes an automatic stay upon the filing of a bankruptcy petition, prohibiting, *inter alia*, “any act to obtain possession of property of the estate or of property from the estate or to exercise control over property of the estate.”²²

Section 362 further provides that “an individual injured by any willful violation of a stay provided by this section shall recover actual damages, including costs and attorneys’ fees, and, in appropriate circumstances, may recover punitive damages.”²³

For the purposes of § 362(k), “willful” means “any deliberate act taken in violation of a stay, which the violator knows to be in existence.”²⁴

21 See 11 U.S.C. § 362(a)(1).

22 11 U.S.C. § 362(a)(3).

23 11 U.S.C. § 362(k)(1).

24 *In re Crysen/Montenay Energy Co.*, 902 F.2d 1098, 1105, 902 F.2d 1098 (2d Cir. 1990).

In other words, specific intent to violate the stay is not required; instead, “general intent in taking actions which have the effect of violating the automatic stay” is sufficient to warrant damages.”²⁵

In a typical landlord-tenant scenario, the debtor is usually a business, i.e., a corporate entity. The debtor’s “estate” is comprised of the debtor’s assets, including, among other things, real and personal property.

Thus, formally speaking, the guarantor is distinct from the debtor and the debtor’s estate. However, given the state of the law, merely relying on a formal distinction to go after the guarantor for tenant’s defaults under the lease would be ill advised.

Landlord’s counsel should instead recommend to the client that a safer way of pursuing the guarantor may be to file a motion in bankruptcy court seeking a declaration that the guarantor is not protected by the stay, or, in the alternative, a lift of the automatic stay to go after the guarantor if landlord’s interest is not “adequately protected.”

[35.40] B. Landlord’s Motion In Bankruptcy Court

As with any motion, you should know the court’s standards and consider the likelihood of success in light of the associated litigation costs and potential recovery for the client.

[35.41] 1. The Standard for Proceeding Against Guarantor

It is axiomatic that stays pursuant to § 362(a) “are limited to debtors and do not encompass non-bankrupt co-defendants.”²⁶

Thus, a plenary action against a good-guy guarantor of a bankrupt entity falls outside the protection of the stay.²⁷

25 *In re Sturman*, 2011 WL 4472412 (S.D.N.Y. Sept. 27, 2011).

26 *Teachers Ins. and Annuity Ass’n of America v. Butler*, 803 F.2d 61, 65 (2d Cir. 1986) (declining to extend stay to non-bankrupt general partners); *see also Fortier v. Dona Anna Plaza Partners*, 747 F.2d 1324, 1329-30 (10th Cir. 1984) (“The language of [sec. 362] extends stay proceedings only to actions ‘against the debtor.’”).

27 *Live Nation Worldwide, Inc. v. GTA, Inc.*, 2007 WL 1489761, at *4 (S.D.N.Y. May 18, 2007) (“Notwithstanding the initiation of a primary obligor’s bankruptcy proceeding and the resulting automatic stay, a creditor may bring a debt collection against a guarantor in accordance with the guaranty’s venue provision.”); *Conti v. Blau*, 234 B.R. 627, 628 (S.D.N.Y. 1999) (holding that stay did not prevent hearing to proceed against general partners to determine whether employees committed malpractice).

The rationale behind this prohibition is that creditors obtain “the protection they sought and received when they required a third party to guaranty the debt.”²⁸

However, a Court can extend the stay to a non-bankrupt party such as a guarantor in certain limited circumstances where it can be shown that such party is essential to any reorganizational effort.²⁹

In cases involving small businesses like restaurants or retail outfits involving one or two principals, this exception may apply and extend the stay to the principal-guarantors.

PRACTICE POINTER: On one hand, the presumption is that guarantor/non-debtors are fair game as far as the Bankruptcy Code is concerned. The creditor bargained for a security blanket in the form of a GG Guaranty, and bankruptcy law honors that agreement.

On the other hand, assume for argument’s sake, that you do go after the guarantor(s), confident that no bankruptcy court would extend the stay to protect them.

Assuming the guarantor/tenant is represented by competent counsel, he or she might file a motion in bankruptcy court seeking to extend the stay to the guarantor.

If counsel is particularly aggressive, they may even seek a declaratory judgment finding that landlord violated the automatic stay and is now liable for attorneys’ fees associated with the motion. However, given the presumption in favor of limiting the stay to cover the debtor, a bankruptcy court is unlikely to grant the relief.

In any case, you see where we ended up?—right back in bankruptcy court while our clever motion for summary judgment in lieu of complaint is stalled by the pending bankruptcy motion. So instead of a shortcut, this tactic ended up being a detour which resulted in the client having to pay

28 *Credit Alliance Corp. v. Williams*, 851 F.2d 119, 121 (4th Cir. 1988).

29 *See In re Lazarus Burman Associates*, 161 B.R. 891, 899–900 (Bankr. E.D.N.Y. 1993) (enjoining guaranty actions against non-debtor principals of debtor partnerships because principals were the only persons who could effectively formulate, fund, and carry out debtors’ plans of reorganization); *Clain v. Int’l Steel Group*, 2005 WL 273015 (S.D.N.Y. 2005); *but see In re Shirms Pontiac GMC, Inc.*, 2010 WL 3928532, at *2 (Bankr. M.D. Pa. 2010) (declining to extend stay to landlord and a corporation owned by debtor’s principal where it could not be shown that debtor’s rented property was essential for its continued operations).

for both the state court papers AND the briefing associated with defending against the guarantor's bankruptcy motion.

You will also have a very disgruntled client on your hands after you explain why you were bounced back to bankruptcy court. Therefore, the most prudent course that would be beyond reproach would be to file a motion in bankruptcy court seeking a declaration that the stay does not apply to the guarantor in order to allow an action on the guaranty to proceed in state court uninhibited.

[35.42] 2. The Standard for Getting Relief From The Stay

Whether landlord's counsel opts for the aggressive tack we just played out or decides to file a motion in bankruptcy court seeking its blessing to go after the guarantor, there is a possibility that the court will find that the automatic stay should apply to the guarantor for one of the two limited exceptions developed in the case law we discussed; namely

- guarantor is essential to any reorganizational effort; or,
- there is such an identity between debtor and the guarantor that a judgment against guarantor would be like a judgment against the debtor.

Should this happen, landlord's counsel has one last resort—Bankruptcy Code § 362(d). It reads, in pertinent part:

On request of a party in interest and after notice and a hearing, the court shall grant relief from the stay provided under subsection (a) of this section, such as by terminating, annulling, modifying, or conditioning such stay—

(1) for cause, including the lack of adequate protection of an interest in property of such party in interest....³⁰

Under this provision the court has broad discretion to tailor a remedy that protects landlord's interest while allowing the debtor to reorganize.

Indicative of the court's inherent discretion is the fact that Congress did not provide any guidance as to what constitutes "cause" under the statute. Thus, the courts developed their own methodology examining a variety of factors to arrive at what may constitute adequate "cause" to lift the stay.

³⁰ 11 U.S.C. § 362(d)(1).

The test adopted by the Second Circuit originates from *In re Sonnax Industries, Inc.*³¹ Other circuits follow similar tests but counsel should always conform the analysis to the appropriate jurisdiction's methodology.

In *Sonnax*, the Court identified twelve factors that bankruptcy courts in the Second Circuit have come to use as guideposts in determining whether sufficient cause exists to grant relief from the automatic stay:

- (1) whether relief would result in a partial or complete resolution of the issues;
- (2) lack of any connection with or interference with the bankruptcy case;
- (3) whether the other proceeding involves the debtor as a fiduciary;
- (4) whether a specialized tribunal with the necessary expertise has been established to hear the cause of action;
- (5) whether the debtor's insurer has assumed full responsibility for defending it;
- (6) whether the action primarily involves third parties;
- (7) whether litigation in another forum would prejudice the interests of other creditors;
- (8) whether the judgment claim arising from the other action is subject to equitable subordination;
- (9) whether movant's success in the other proceeding would result in a judicial lien avoidable by the debtor;
- (10) the interests of judicial economy and the expeditious and economical resolution of litigation;
- (11) whether the parties are ready for trial in the other proceeding; and
- (12) the impact of the stay on the parties and the balance of harms.³²

³¹ 907 F.2d 1280, 1285 (2d. Cir. 1990).

³² *Id.* at 1286.

In the landlord-tenant context, bankruptcy courts have weighed the above factors and found sufficient cause to lift the automatic stay when:

- the debtor has filed a bankruptcy petition on the eve of trial or an eviction;
- remained delinquent in its obligations to pay rent;
- failed to provide adequate assurances to landlord, and
- paid no post-petition rent or otherwise indicated that it can make the landlord whole.³³

[35.43] XIX. EXAMPLES

To highlight the major themes that guided our discussion during this chapter, we offer two final GG Guaranty examples.

[35.44] A. Tenant Friendly GG Guaranty

The first is extremely tenant-friendly, to a fault, if you are the landlord.

EXAMPLE 13:

ANYTHING HEREIN TO THE CONTRARY NOTWITHSTANDING, this guarantee shall not extend to any obligations incurred by Tenant or Guarantor under the lease either:

1. After the date Tenant vacates the demised premises, removed all of its personal property therefrom and then offers to deliver possession of said premises to the Landlord, or

³³ See, e.g., *In re Burger Boys, Inc.*, 183 B.R. 682, 688 (S.D.N.Y. 1994) (affirming bankruptcy court's lift of the automatic stay where Chapter 11 petition was filed by tenant on the eve of a civil court summary eviction proceeding and where the bankruptcy court found that the issues would be more expeditiously resolved in the state forum); *Zagata Fabricators, Inc. v. Superior Air Products*, 893 F.2d 624, 628 (3d Cir. 1990) (holding that bankruptcy court erred in denying landlord relief under Section 362 (d) and allowing it to pursue state law remedies where debtor remained in possession of landlord's premises but failed to pay rent, stating that "no authority of which this court is aware provides support for the extraordinary remedy granted here, namely, possession free of charge"); *In re Rocchio*, 125 B.R. 345, 347 (Bankr. D. R.I. 1991) ("[t]he Debtor's failure to pay postpetition rent, together with a total absence of evidence that they [sic] will: (1) cure the default, (2) provide adequate protection, or (3) give adequate assurance of future performance, all violate clear requirements of § 365(d)(3), and we hold that said violations (individually and cumulatively) constitute 'cause' under § 362(d)(1) to lift the stay.").

2. Upon tenant assigning this lease or subletting the premises, provided however that the principal officer and such assignee or subtenant assumes the responsibility of the Guarantor hereunder.

Subparagraph 1 looks standard. Read together with the preamble, this means the guarantor will be relieved of liability upon vacatur (including removal of personal property) and surrender of the premises.

The next clause, however, is troubling if you are the landlord. It reads that the guaranty shall not extend to obligations incurred if:

Upon tenant assigning this lease or subletting the premises, provided however that the principal officer and such assignee or subtenant assumes the responsibility of the Guarantor hereunder.

Sounds reasonable right? NO! Under this clause, a tenant-guarantor could literally assign the lease or sublet it to anybody who would sign a piece of paper irrespective of whether he is a creditworthy person who would actually have the assets to collect against in the event of a default. There might as well not be a guaranty!

Example 13 highlights, by way of contrast, the primary concern of landlord—to make it as difficult as possible for tenant and the guarantor to walk away from the lease by ensuring a level of security in terms of cash and uncertainty for tenant in terms of how to terminate early while relieving guarantor of personal liability.

[35.45] B. Landlord Friendly GG Guaranty

EXAMPLE 14:

SCHEDULE B

Guaranty

In order to induce _____ a New York limited liability company, as landlord (“Landlord”) to enter into a certain lease dated July 7, 2011 (the “Lease”) with _____ a New York corporation, as tenant (“Tenant”) for that certain premises in the lobby (the “Premises”) of the building located at _____ residing at _____ (“Guarantor”), hereby represents, guarantees and agrees with Landlord as follows:

1. Guarantor is a majority shareholder of Tenant.
2. Guarantor hereby unconditionally guarantees to Landlord the full, prompt and complete payment, performance, and observance of and compliance with all of the Tenant's obligations under the Lease, including, without limitation, the payment of the minimum rent and additional rent (including under Article 4 and Article 25 of the Lease) and all other charges and sums due and payable by Tenant under the Lease. Notwithstanding the foregoing, provided that (i) Tenant is not in default under the Lease, (ii) Tenant has paid to Landlord not less than twelve (12) consecutive months of the minimum rent, and (iii) after Tenant pays twelve (12) consecutive months of the minimum rents, Tenant then delivers to Landlord (in accordance with the notice requirements of the Lease) not less than nine (9) months prior written notice (the "Notice") that Tenant will surrender the Premises, and Tenant paying such minimum rent and then giving the Notice to Landlord thereafter surrenders the Premises to Landlord, together with the keys to the Premises, on the date set forth in the Notice, with the lien free completion of Tenant's Work to prepare the Premises for Tenant's occupancy and in accordance with Article 6 of the Lease, in vacant broom-clean condition, free of all subleases and occupants, in accordance with the terms and conditions of the Lease (the date upon which the Premises is so surrendered in accordance with the preceding is hereinafter referred to as the "Surrender Date"), then Guarantor's liability shall cease with respect to any further obligations under the Lease accruing after the Surrender Date. Anything to the contrary notwithstanding in the Lease and this Guaranty, in the event that Tenant delivers the Notice, then Tenant shall not be entitled to the return of the security deposit under the Lease and Landlord shall have the absolute right to retain the entire security deposit as fee without being required to apply the security deposit to any minimum rent, additional rent or any other changes.
3. This Guaranty is a primary, absolute and unconditional guaranty of payment and performance. This Guaranty shall not be discharged, mitigated, or affected by (i) any modification, renewal or extension of the Lease; (ii) any failure of Landlord to enforce any of the provisions of the Lease or by extension of time or indulgence extended by Landlord to Tenant thereunder; (iii) any defense available to Tenant or Guarantor; or (iv) any invalidity or unenforceability of any portion of the Lease; and Guarantor hereby consents

to all of the foregoing without notice to Guarantor, and Guarantor's liability shall extend to the Lease as so modified, renewed or extended.

The Example 14 GG Guaranty piles on the protection for the landlord and leaves a lot for tenant and guarantor to worry about before they can terminate the relationship. The protections break out into the themes we have highlighted throughout this course:

[35.46] C. Additional Security for Landlord

This guaranty provides for a generous 9 months prior written notice which, as we discussed earlier, functions as 9 months' additional security on top of the security deposit.

Under subparagraph (ii) It also has a *minimum rent clause*. That is, tenant and guarantor cannot even consider terminating the lease early before tenant has paid 12 consecutive months of minimum rent if guarantor hopes to walk away with zero liability.

Finally, it explicitly states that if the tenant does choose to serve a notice indicating its intent to surrender the premises before expiration, landlord has an absolute right to retain the entire security deposit without being required to apply it towards minimum rent or any other charges.

In sum, landlord has secured at least as much as 21 months of rent from the tenant in addition to the amount it holds as a security deposit!

[35.47] D. Additional Uncertainty for Tenant

On top of the significant cushion this landlord was able to negotiate, this GG Guaranty also has all the elements we discussed that could trip up a tenant who is trying to terminate early:

- that written notice be provided at least 9 months prior to the surrender date.
- that surrender of the premises must be lien free with respect to tenant's work that was conducted to prepare the premises for its occupancy.
- that surrender of the premises should be in "vacant broom-clean condition" and "in accordance with the terms and conditions of the Lease."

CHAPTER THIRTY-SIX

MODEL LEASE GUARANTY

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[36.0] I. INTRODUCTION

“Should I stay or should I go?” – The monthly decision process of an uncreditworthy tenant, as immortalized by The Clash.¹

When an owner of commercial real property (“Landlord”) signs a lease with a space tenant (“Tenant”), Landlord will care a lot about Tenant’s creditworthiness. If Tenant doesn’t have strong credit, Landlord will have to hold its breath at least 12 times a year to see if Tenant has decided to stay, go or even try to stay but not pay rent. To bring more certainty to its cash flow, Landlord will often demand that someone more creditworthy than Tenant guaranty Tenant’s obligations. The guaranty could cover all Tenant obligations under the Lease (a “full” guaranty), or just some of them (a “partial” guaranty), or just Tenant’s obligations until Tenant surrenders the premises without a fight and pays rent until then (a “good guy” guaranty). A guaranty can also go away, either all at once or gradually, or have a cap on liability.

The following Model Lease Guaranty offers template language for the three main flavors of Guaranty, plus optional language for other particular circumstances or deal structures.

This Guaranty template started, once upon a time, as a “short-form” Guaranty, in contrast to a “long-form” Guaranty. Both appeared in the first and second editions of the New York State Bar Association Commercial Leasing treatise edited by the author. Over time the Guaranties converged into this one Guaranty. The “base” Guaranty omits optional and “overkill” provisions, making most available instead as options. And after footnote removal, the “base” version takes up only about four pages.

The “base” Guaranty consists of a full Guaranty of a Tenant’s obligations under a commercial lease (the “Lease”), to be signed at the same time as the Lease. The “base” Guaranty contains a reasonable set of Guarantor waivers—though one can always add more, such as from the optional provisions after the “base” Guaranty. Blank spaces, brackets and footnotes indicate blanks to fill, options, and issues to consider.

The optional provisions after the base Guaranty cover partial guaranties, good-guy guaranties, limited guaranties, representations and warranties, multiple or off-shore guarantors, bells, whistles and other long form (a.k.a. “overkill”) provisions that sometimes appear in Lease Guaranties.

¹ For details, visit https://en.wikipedia.org/wiki/Should_I_Stay_or_Should_I_Go.

These optional provisions can make any Lease Guaranty quite long. Some may matter in some transactions. More often they just add words. They are offered here for use as needed or desired. Few serious commercial Lease Guaranties will be shorter than the “base” form offered here, though this article offers two possibilities that are even shorter than the model Guaranty.

Landlord and its counsel typically fear a court will try very hard to find a way to not enforce any Guaranty. Why? Courts often seem to believe that any Guarantor is a “fool with a pen” who calls out for the court’s special sympathies and protection. In commercial transactions, that theory usually holds no water. Still, judges seem to have gone out of their way to invalidate or limit guaranties, particularly in California, less so in New York, with other states all over the lot.

Which party does this model Guaranty favor—Landlord or Guarantor? That’s a simple question with a complicated answer. A Guaranty is supposed to achieve a very simple result for Landlord: Guarantor stands behind Tenant’s obligations, so Landlord gets the benefit of Guarantor’s credit in addition to Tenant’s, all as if Guarantor had signed the Lease instead of, or in addition to, Tenant. That is a rather simple goal. To the extent the Guaranty achieves it, the Guaranty helps Landlord meet its expectations. Guarantor cannot complain.

The courts have, however, turned Guaranties into a complex minefield by giving Guarantors a panoply of defenses, some rather counterintuitive and exotic. Any or all of these defenses can interfere with Landlord’s achieving its reasonable expectations. The defenses “favor” Guarantor.²

Faced with apparently boundless judicial solicitude for Guarantors, any Landlord tries to level the playing field by requiring Guarantor to waive defenses. But those waivers sometimes go so far that Landlord achieves more than its reasonable goals. Instead, Landlord burdens Guarantor with obligations and procedural burdens that unnecessarily or inappropriately exceed Tenant’s. If a Guaranty does that, it unreasonably favors Landlord. This Guaranty seeks not to do that. Instead it limits the waivers to the minimum necessary to undo the damage done by the courts in their zeal to protect Guarantors.

2 For an introduction to them, see Joshua Stein and Elaine Wang, *Revisiting the 24 Defenses of The Guarantor—24 Years Later*, *The Practical Real Estate Lawyer* 9, January 2012.

A Guarantor should live with waivers that make Guarantor's position no worse than Tenant's, but reject waivers that put Guarantor in a worse position than if Guarantor had simply signed the lease itself. A careful Guarantor should also ask serious questions about the underlying Lease. Since Guarantor should end up with the same liability as if it had signed the Lease, Guarantor should care whether the Lease is a balanced document, reasonably negotiated for Tenant. A Lease defines a relationship far more complex than a Guaranty. Landlords want and usually achieve leases that favor Landlords, period. Guarantor will have to live with everything in the Lease. Rather than focus primarily on whether the Guaranty "favors" Landlord or Tenant, Guarantor should focus on the Lease itself. And, by delivering the extra credit support of a Guaranty, Tenant and Guarantor can in exchange sometimes obtain a more balanced Lease.

[36.1] II. GENERAL COMMENTS AND ISSUES TO CONSIDER

[36.2] A. Bankruptcy Risks

If a Guaranty covers all obligations under a Lease, this will increase the likelihood of a substantive consolidation if Tenant or Guarantor files bankruptcy. That risk terrifies securitized lenders to a point where its mitigation becomes a major obsession in the closing process. But it is a small price for Landlord to pay for the benefit of receiving credit support via the Guaranty. Some Landlords will worry about it anyway and, of course, any Lease or Guaranty (or other business transaction of any kind) could face special issues if any party to the transaction filed bankruptcy. Those issues lie beyond the scope of this model document, but Landlord's counsel should think about them in structuring and negotiating any Lease and Guaranty. Others have written about those issues at length.

[36.3] B. Bankruptcy Risks—Large Security Deposits

If Tenant delivers a security deposit or letter of credit that exceeds one year's rent, which doesn't happen all that often, and then files bankruptcy, the bankruptcy courts may force Landlord to "disgorge" part of the large security deposit or L/C proceeds. That result makes no sense given the independence principle underlying any L/C, but bankruptcy judges may care more about unsecured creditors than about the independence principle.

Landlord might protect itself, with or without a creditworthy Guarantor, by having Guarantor rather than Tenant deliver the large security

deposit or L/C. The Guaranty becomes a mechanism to support an L/C or security deposit, even if the Guarantor has no credit at all. Having Guarantor rather than Tenant deliver the L/C or cash security should protect Landlord—although one can never guarantee anything in bankruptcy court. This model Guaranty does not offer special language for these circumstances, but the author can provide it on request. As is so often true in leasing, L/C's and bankruptcy, it is not as simple as it sounds.

[36.4] C. Completion Guaranties

This model Guaranty does not include sample language for a completion Guaranty. That type of Guaranty typically arises in ground leasing, not so much in ordinary commercial space leasing, and raises interesting and substantial questions about remedies and measures of damages. The author has a template for completion Guaranties, which is available on request and devotes some attention to the special issues that completion Guaranties create. It will appear in the second edition of the author's book on ground leases.³

[36.5] D. Conflicts of Interest

The interests of Guarantor and Tenant may conflict, yet the same counsel typically represents both. Counsel may want to disclose that conflict and obtain an informed waiver.

[36.6] E. Different Deals

One can readily adapt this Guaranty to become a “partial” Guaranty or a “good guy” Guaranty, depending on the business deal. For example, a “good guy” Guarantor's liability might continue until six months after Tenant has moved out and surrendered possession of the space, rather than immediately after those events have occurred. Or the Guaranty might cover the entire Lease for two years, and then only after a default-free two years does the Guaranty convert to a mere “good guy” Guaranty--though perhaps still covering claims and issues that accrued during those first two years. A Guaranty might also in some other way “burn off” over time or limit Guarantor's exposure in other ways. This represents a business negotiation to be resolved as part of the fundamental Lease deal, best docu-

³ See Joshua Stein, *A Guide to Ground Leases (With Forms and Checklists)*, ALI-ABA, 2005. This book went out of print several years ago. The author is slowly preparing a second edition, which he plans to self-publish. Readers may purchase electronic copies of the first edition or receive an announcement of the second by sending email to office@joshuastein.com. Readers can also preview the first edition through books.google.com.

mented as part of the letter of intent or term sheet and not left for future conversation. Optional provisions offered here can help document many possible business deals.

[36.7] F. Distributions

One could prohibit Guarantor from receiving distributions from Tenant when the Lease is in default. Such provisions rarely appear in Lease Guaranties, though, so are not offered here even as “overkill” options for the Guaranty. Nor would a Guaranty otherwise typically limit salary increases, bonuses, or other payments to Guarantor’s principals, but some lawyers might think of that.

[36.8] G. Due Diligence

For an entity Guarantor, Landlord should perform the same due diligence one would on a borrower or tenant—confirm its legal existence and exact name; obtain organizational documents, resolutions and consents; perhaps even obtain an opinion of counsel for, e.g., a foreign guarantor. Verify reputation and financial condition. Perform litigation search; general online searches; etc. For an individual person acting as Guarantor, check the Guarantor’s address. Confirm it’s a residence and not, for example, a vacant lot, motel or office building. Does Guarantor actually own it?

[36.9] H. Enforcement

For an offshore Guarantor, Landlord might consider having the Guaranty provide for arbitration rather than litigation if Landlord ever needs to enforce the Guaranty. Foreign courts are often more hospitable to arbitration awards than to American court judgments. Use of arbitration clauses in guaranties is, however, unusual and might create issues of inconsistency with Lease enforcement. On the other hand, the Guaranty allows Landlord to enforce the Guaranty without enforcing the Lease at all. Whether and exactly how to go down this road depends on the circumstances of a particular Guaranty, including the Guarantor’s home country. As a result, this model Guaranty does not offer arbitration language, but Landlord’s counsel should think about it and consult with arbitration experts. In the author’s experience, no arbitration expert ever likes the arbitration language crafted by any transactional lawyer.

[36.10] I. Full Recourse?

If the Guaranty covers less than all Lease obligations, consider adding language to create full liability for all Lease obligations if Guarantor or Tenant commits bad acts, such as frivolous litigation, or seeks a “*Yellowstone*” injunction⁴ (a New York procedure by which the tenant seeks to maintain the status quo)—much like the growth of nonrecourse carveouts in loan documents. This concept is, however, off market.

[36.11] J. Joinder by Spouse

For an individual Guarantor, consider requiring Guarantor’s spouse to join in the Guaranty to avoid problems with who owns which assets, particularly in community property states. In this case, include optional language offered here for multiple Guarantors. But also consider legal restrictions on requirements for spousal joinders.⁵

[36.12] K. Not So Good?

A “good-guy” Guaranty protects Guarantor but doesn’t help Tenant. Thus, if Tenant wants the right to move out before the Lease expires by paying rent until departure and satisfying some other conditions, Tenant might prefer to obtain a termination right in the Lease. This would allow Landlord to keep the security deposit and prepaid rent, and perhaps more, rather than structure the arrangement as a good-guy Guaranty. If Tenant has meaningful assets or anticipates it will want to stay in business at another location after “walking” from this Lease before expiration, then Tenant will not want Landlord to have a claim against Tenant. This is the reason for a termination option in the Lease (with the Lease backed by Guarantor until Tenant meets the conditions to termination, and terminates and moves out), instead of a simple “good-guy” Guaranty. Conversely, if the parties agree to a “good-guy” Guaranty, then Landlord will want to preserve its claims against the defaulting Tenant, even if Tenant has moved out and thus terminated Guarantor’s liability.

[36.13] L. Plain English

This Guaranty is written in plain English, to the extent reasonably possible. This means active voice sentences and short paragraphs. Ordinary

4 See *First Nat’l Stores, Inc. v. Yellowstone Shopping Ctr., Inc.*, 21 N.Y.2d 630, 290 N.Y.S.2d 271, (1968).

5 See, e.g., 15 U.S.C. §§ 1691–1691(f); 12 C.F.R. § 292.7(d). States may have their own rules.

English words replace legalese where possible. After making a point, this Guaranty does not repeat the same point in different words. It never refers to section numbers. When this Guaranty must refer to a number, it does so only once. As a result of these and other plain English techniques, this Guaranty sometimes does not read like a typical legal document. A non-lawyer might read and actually understand it. And that's a good thing.

[36.14] M. Principal

This Guaranty assumes Guarantor is a principal of Tenant or otherwise owns or controls Tenant—or at least has some significant interest in Tenant's business—and is somewhat creditworthy. The client should of course confirm this. If Guarantor is no more creditworthy than Tenant, then this Guaranty may, in practice, add little value, except perhaps as a club to hold over Guarantor's head (or as a vehicle for a large security deposit or L/C, as discussed above). If Tenant's credit declines, however, and Guarantor's does not, this Guaranty may indeed have value.

[36.15] N. Security

If Landlord obtains security for Guarantor's obligations, this Guaranty may require changes. Any security arrangements will create their own issues, which: (a) will vary by state; and (b) this model Guaranty does not consider.

[36.16] III. CAVEATS

[36.17] A. Bad Dates

If the parties engage in a mad last-minute scramble to sign and exchange documents, inconsistencies may arise regarding dates. Those inconsistencies can allow a Guarantor to try to disclaim liability under the Guaranty if, for example, the Guaranty refers to the wrong date on the Lease. And if the Guaranty is dated after the Lease, it could raise issues on consideration. As the best practice, counsel should make sure all dates align. Because that might not happen, this Guaranty refers to a Lease dated "on or about" a certain date.

[36.18] B. Defined Terms

The "base case" Guaranty includes its own definitions for all capitalized terms. Check and adjust those definitions as appropriate. They should typically match the nomenclature and definitions in the Lease. Terms fundamentally important to the Guaranty, such as the "Guaranteed Obliga-

tions,” should be defined in the Guaranty, but the wording should match the Lease to the extent appropriate. For lesser definitions, one can refer to the Lease, which avoids the risk of inconsistencies if the parties negotiate the Lease definitions but don’t conform the Guaranty. After the “base case” Guaranty, optional language offered here does not always include all necessary definitions. In any case, check that every capitalized term is defined somewhere, or adjust it to match the structure of definitions in the Lease. As a matter of preference, one might want to move definitions in the Guaranty to an Exhibit, so the reader doesn’t have to wade through them before reaching the Guaranty’s operative language. On the other hand, this Guaranty doesn’t have that many definitions to wade through.

[36.19] C. State-Specific Provisions

This Guaranty assumes New York law governs. New York has no special state-specific provisions that must or should appear in a Guaranty except as this paragraph notes. In any other state, check for state-specific waivers or provisions. For example, use in California would require waivers of specified statutory or even constitutional provisions, sometimes in all capital letters, which may look very fierce but typically just impede comprehension and overwhelm the reader—assuming anyone actually tries to read them. Other states have other requirements. Also consider adding language driven by Guarantor’s home state or other jurisdiction, even if the law of that state or other jurisdiction does not otherwise govern the Guaranty, because Landlord might choose to enforce the Guaranty there. As a New-York-specific provision, optional language for this Guaranty does require Guarantor to acknowledge that the Guaranty is an instrument for the payment of money only. This might give Landlord some benefits under Civil Practice Law and Rules 3213, but those benefits come with issues. The Guaranty does not strictly need to refer to 3213. If the Guaranty covers performance rather than payment, one may wish to delete the reference to 3213, though keeping it probably does no harm. Landlord may choose not to rely on this language. The optional provisions also include some language seeking confidentiality and speed in any action to enforce this Guaranty. Those are generic but not yet market standard.

[36.20] IV. SHORTER-THAN-SHORT

If this model Lease Guaranty does not seem short enough, one could take an entirely different approach and try to distill the essence of a lease guaranty into just a few paragraphs. As an exercise in comparative law, here is how a “shorter-than-short” lease guaranty might look. This was

designed for use in residential leasing outside New York City. No representation or warranty is made on the efficacy of this “shorter-than-short” lease guaranty, particularly in New York City.

1. *Guarantied Obligations.* Guarantor unconditionally and irrevocably guarantees to Owner that Resident shall perform and observe all its obligations under the Lease, or arising by law from Resident’s occupancy of the Premises, including Resident’s obligations to pay rent and do everything else the Lease or law requires (collectively, the “Guarantied Obligations”). Resident’s bankruptcy or other proceeding shall not reduce, limit or discharge the Guarantied Obligations.
2. *Nature of Liability.* Guarantor shall be equally and primarily liable with Resident for all Guarantied Obligations as if Guarantor had signed the Lease. Owner can sue Guarantor directly without suing Resident or applying security to cure a default. This Guaranty remains in full force and effect even if the Lease is assigned, changed, extended or renewed in any way, with or without Owner’s or Guarantor’s consent; Owner makes a claim against Guarantor or Resident; or Resident leaves.
3. *Waivers.* Guarantor waives all notices of any kind, including notices about Resident, the Lease, the Guarantied Obligations or any default. Owner doesn’t need to notify Guarantor of anything at all or deal with Resident in any particular way. Guarantor waives all defenses otherwise available to Guarantor under suretyship or guaranty law except only the defense of actual full payment and performance.
4. *Miscellaneous.* Any amendment or waiver of this Guaranty must be in writing and signed by Owner to be effective. Owner may perform credit checks and other investigations at any time on Guarantor. On request, Guarantor shall deliver a certificate satisfactory to Owner confirming the status of this Guaranty. In any action, proceeding or counterclaim relating to or arising from this Guaranty, the Lease or the parties’ relationship: (a) the parties waive jury trial; (b) Guarantor

consents to New York jurisdiction; and (c) if Owner prevails, Guarantor shall pay Owner's reasonable attorneys' fees.⁶

This language probably delivers 95% of the practical benefit of any Guaranty. It does, however, expose Landlord to the risk that a court might decide Guarantor did not adequately waive one defense or another. In today's world, well-represented Landlords know about those defenses and in most cases can take steps to prevent them. Relatively few recent Guaranty litigations have actually hinged on the exact words of the Guarantor's waivers. Nevertheless, no one wants to be the first commercial real estate lawyer who chopped out most of the standard provisions of a Guaranty.

If even the four paragraphs above are not short enough, one could try replacing them with this, right after Tenant's signature: "I join in, assume, and guaranty payment and performance of all obligations of Tenant, as if I had personally signed the above Lease myself." It makes the point and supports a claim, but leaves out everything else.

[36.21] V. LEASE LANGUAGE BASED ON GUARANTY

The Lease should recognize the Guaranty exists. For example:

[36.22] A. Concessions to Guarantor

To the extent Landlord agrees to any concessions to Guarantor of the types suggested in the optional provisions below, those may work better if incorporated into the Lease than if incorporated into the Guaranty, just so Landlord can't argue the concessions don't bind Landlord. For example, the Guaranty might say Landlord agrees to pay Guarantor's attorneys' fees if Guarantor prevails in litigation. But Landlord never actually signed or became a party to the Guaranty. One can easily argue that Landlord agreed to its terms by preparing and accepting the form of Guaranty, but it's still a potential issue. One could avoid it by moving any "Landlord covenants" out of the Guaranty and into the Lease. As an alternative, if the form of Guaranty is attached to the Lease, Landlord could confirm in

6 Under New York Real Property Law § 234, any attorneys' fees clauses in "leases of residential property" are automatically deemed mutual. As between landlord and tenant, which party (if unsuccessful in litigation) is more likely to actually pay a judgment entered against it for the other party's attorneys' fees? Although § 234 has led to much litigation, no available case indicates whether "leases of residential property" include guaranties of such leases. Ordinary principles of the English language suggest that a "lease" is not a "guaranty" and vice versa. But ordinary principles of the English language are not always a good guide to residential landlord-tenant jurisprudence in New York.

the Lease that Landlord agrees to all the terms of the Guaranty, and will perform all Landlord obligations under the Guaranty. Broad language like that might scare a Landlord, so it may make more sense to move the substantive provisions to the Lease.

[36.23] B. Events of Default

If a Lease contemplates a Guarantor, the Events of Default should include a few that relate to the Guaranty and the Guarantor. Tenant could negotiate a right to cure each by delivering a replacement Guaranty from a Satisfactory Guarantor⁷ within a certain time. As Landlord's starting position, the Lease should define an Event of Default to include occurrence of each of these circumstances:

1. *Guarantor Impairment.* Only for so long as this Lease requires a Guaranty to remain in effect (a "Guaranty Period"), if Guarantor fails to meet the Guarantor Financial Standard.⁸
2. *Guarantor Insolvency.* Only in a Guaranty Period, if any Guarantor is the subject of an Insolvency Proceeding, unless involuntary and dismissed within __ days.⁹

7 This definition will matter. See sample definition of "Satisfactory Guarantor" offered within the optional Concessions to Guarantor later in this model document. Landlord will prefer to have the right to approve any replacement Guarantor in its sole discretion. In that case, Tenant's right to deliver a replacement Satisfactory Guarantor gives Tenant no comfort at all. It doesn't really justify any verbiage, legal time or printing costs.

8 The Lease or Guaranty should define "Guarantor Financial Standard." For inspiration, see the definition of "Satisfactory Guarantor" in § 39.89. If a Lease contains financial covenants for Guarantor, then it should have consequences for not meeting them. But must those consequences always include a premature end of the transaction? Tenant and Guarantor would argue they cannot control the risk of future Guarantor financial impairment, and it should not adversely affect the Lease and Tenant's right to occupy its space and obtain the benefit of its investment in the location. Hence, if Guarantor fails to meet the Guarantor Financial Standard, Tenant may want the right to post a letter of credit; demonstrate that Tenant's credit has improved in a way that compensates for any problems with Guarantor's credit; eliminate or trim back the Guarantor Financial Standard if Tenant has adequately performed for a certain time; or push back in other ways limited only by the ingenuity of counsel. Landlord might suggest that an increase in Fixed Rent, rather than an Event of Default, might adequately compensate Landlord for the increased risk resulting from an impairment of Guarantor's credit.

9 Guarantor or Tenant might propose that, especially for an involuntary Insolvency Proceeding, Guarantor should have a reasonable time in which to assume the Guaranty, cure all defaults, give Landlord relief from the automatic stay, and thereby prevent an Event of Default. Tenant should remember that, if Tenant is not itself subject to an Insolvency Proceeding, then Guarantor's Insolvency Proceeding constitutes a perfectly valid and enforceable Event of Default.

3. *Guarantor Nonperformance.* Only in a Guaranty Period, if Guarantor fails to perform any obligation under the Guaranty, including failure to deliver any document or financial information, or fails to comply with any negative covenant in the Guaranty, and any such failure continues for __ days after notice from Landlord, or if any representation or warranty by Guarantor in the Guaranty is false or misleading in any material respect.
4. *Guarantor Termination.* Only in a Guaranty Period, if any Guarantor dies, becomes disabled,¹⁰ is dissolved or terminates its legal existence.¹¹

[36.24] C. Guaranty

The Lease should require Tenant to deliver the Guaranty, and state that Landlord would not have entered into the Lease without the Guaranty, to prevent any later issues about why the Guaranty existed.

[36.25] D. Interaction With “Good Guy” Guaranty

A “good guy” Guaranty will allow Guarantor to terminate liability if Tenant gives, e.g., 60 days’ notice that Tenant intends to vacate and surrender the Lease. Creative and aggressive Landlords have been known to assert that mere delivery of such a notice constitutes an anticipatory breach of the Lease, immediately entitling Landlord to all remedies for an Event of Default. Although the argument has a certain dubiousness and hypertechnicality to it, Tenants and Guarantors should prevent it entirely by stating in the Lease that delivery of such a notice does not constitute an anticipatory breach. Even better, Tenant and Guarantor should try to simplify the relationship and deal structure by giving Tenant an outright termination option, under conditions like those contemplated in a good-guy guaranty, as suggested above.

[36.26] E. Notices

In the “notices” clause of the Lease, include Guarantor as a party that must receive copies of any notices to Tenant. Guarantor and Tenant

10 Disability should perhaps not constitute an Event of Default, but incompetence or a guardianship might.

11 Tenant may want a mechanism to replace a dead or disabled Guarantor with one or more people, named or to be named, who individually or collectively meet the Guarantor Financial Standard. If Guarantor’s estate assumes the Guaranty, that might also prevent an Event of Default.

should resist any language suggesting that notice to Guarantor is just a “courtesy” and not really required.

[36.27] F. Special Tenant Rights

If the Lease gives Tenant any preemptive rights, such as an expansion or purchase option or a right of first refusal or first offer, Landlord might require that any notice of exercise include Guarantor’s consent. As an alternative, the Guaranty might affirmatively say no such consent is necessary and any exercise will nevertheless bind Guarantor. This model Guaranty does include language to that effect. And if the preemptive right involves a sale of Landlord’s building, does the business deal contemplate that Guarantor will backstop Tenant’s obligations regarding the sale? It may not matter, if Tenant’s liability will not exceed loss of its deposit. That will depend on the circumstances of the particular deal.

[36.28] VI. TENANT OR GUARANTOR?

If Guaranties present so many possible impediments to enforcement, should Landlord instead just ask Guarantor to sign the Lease, along with Tenant? Or perhaps have Guarantor alone sign the Lease instead of Tenant and then sublease to the originally intended Tenant? Would that give Landlord a stronger position against Guarantor?

The answers to those questions are not simple.

Litigation to enforce a Guaranty may turn out to be easier to pursue than litigation to enforce a Lease, especially if the Lease raises lots of complex landlord-tenant issues. The various waivers in the Guaranty may, if Landlord is lucky, eliminate issues that Tenant have raised. Depending on the procedural posture and strategy of the dispute, Landlord might be able to bring separate actions, suing Tenant in one action while also suing Guarantor in a simpler action, or at least having some possible options along those lines.

If the creditworthy Guarantor is a foreign company, Landlord may want the option of easily suing Guarantor in its home country, rather than obtaining a judgment in the United States and then trying to enforce it overseas—not always easy. If Landlord ever did try to sue Guarantor in its home country, Landlord might have better luck trying to enforce a Guaranty (an ordinary contract) rather than a Lease (which the foreign court might deem a real estate transaction that can only be enforced where the

property is located). That’s another reason why Landlord might well prefer a Guaranty to a direct Lease obligation.

A creditworthy Guarantor may also prefer signing a Guaranty to signing a Lease. Signing a Lease may increase Guarantor’s exposure to all kinds of claims and litigation arising from the leased space—personal injury lawsuits, bills from someone providing services, and the other exposures that come from visible operation and occupancy of any real estate. If Guarantor is based overseas, it may want to minimize any argument it is “doing business” in the United States, to protect itself from high corporate tax rates and American plaintiffs and judges in unrelated lawsuits. Signing a Lease looks a lot more like “doing business” than does just signing a Guaranty.

All things considered, it might make sense for both parties to use a Guaranty rather than have a creditworthy parent company directly sign onto the Lease. Of course, that puts the burden on Landlord and its counsel to assure the Guaranty contains the waivers it needs, so Guarantor cannot assert spurious theories to escape liability. This model offers suitable language. For a foreign Guarantor, Landlord may want to add language, also offered here, by which Guarantor appoints an agent for service of process in the United States.

On the other hand, Landlord may also want to consider the business culture of Guarantor’s home country. That culture, unlike the American business culture, might make it very difficult for a Guarantor to default—for example because it would cause great “shame” to Guarantor. In that case, Guarantor might be more willing to let Tenant default, and Landlord might mitigate that risk by having Guarantor actually sign the Lease. Guarantor’s fear of suffering shame if it defaulted on the Lease might help protect Landlord’s cash flow more than if Tenant, a mere foreign subsidiary of Guarantor, signed the Lease.

[36.29] VII. CLOSING DOCUMENTS

In addition to the Guaranty, the Lease and any Lease-related documents, the transaction may require these closing documents:

- A. Consent to obtain copies of Guarantor’s tax returns from tax authorities. (This requirement is atypical but not insane.)
- B. Copy of Guarantor’s driver’s license or passport, if an individual.

- C. Corporate documentation (formation, authorization, internal approvals, etc.) for an entity.
- D. Due diligence searches and information on Guarantors.
- E. Financial statements and (to facilitate future enforcement of a judgment) information to identify assets and liabilities. Guarantor will typically delay delivering these items until the last minute, hoping Landlord will be so anxious to close the deal that Landlord won't pay much attention or ask many questions.
- F. If multiple Guarantors exist, then an indemnification and contribution agreement among them, and suitable language in Tenant's organizational documents to address the consequences of payments under the Guaranty.
- G. Any other special arrangements to reimburse Guarantor if Guarantor needs to pay under the Guaranty, at least to the extent those arrangements go beyond Guarantor's automatic common-law claims against Tenant.
- H. Opinion of counsel, in rare and special cases, relating to corporate matters but not enforceability.¹² A Landlord might more likely obtain an opinion for an "unusual" Guarantor such as a governmental entity, a nonprofit, a small business investment company, a credit union or other financial institution, a foreign entity, an entity subject to special regulatory restrictions, or the like. Even in an ordinary partnership, a partner may lack authority to sign a guaranty on behalf of the partnership unless the partnership agreement expressly allows it.
- I. Waiver of conflicts, if necessary, reflecting the fact that the same counsel represents both Tenant and Guarantor, whose interests may conflict.

12 The general absence of opinions of counsel in leasing transactions, including Guaranties, does not seem to have produced an epidemic of invalid or unauthorized Leases or Guaranties.

[36.30] VIII. POST-SIGNING ADMINISTRATION

Once the Lease transaction has closed and the Guaranty is in place, the existence of a Guaranty requires Landlord to consider a few special matters in administering the Lease and otherwise. Some of these administrative suggestions apply to all legal documents, not just Guaranties.

[36.31] A. Amendments, Etc.

If Landlord and Tenant agree to amend (or extend, etc.) the Lease, Landlord should insist that Guarantor consent and confirm the continued effectiveness of the Guaranty, and also acknowledge that the Lease and the Guaranteed Obligations have been redefined to include the changes to which Guarantor consented. That's true even though the Guaranty waives any requirement for Guarantor consent.

[36.32] B. Change of Address; Other Notices

If Landlord receives a notice of a change of Guarantor's address, Landlord should update its records. If any other notice arrives from Guarantor, Landlord should pay attention. And if Guarantor or Landlord moves, it should remember to send a change of address notice. If Guarantor appointed a corporate service company as its agent for the Guaranty, Guaranty should also notify that company of the new address.

[36.33] C. Lines of Communication

Aside from administering the words of the Guaranty, Landlord would be well advised to maintain good relations and lines of communication with Guarantor and Tenant. If Landlord ever needs anything from them, it will help if Landlord readily knows who to call; has spoken to them before, and recently; and has handled any of their previous requests in an expeditious and reasonable way.

[36.34] D. Loan Closings

For a future mortgage loan on the property, Landlord or its lender may (should) require an estoppel certificate from Guarantor, not just Tenant. Landlord should handle that as part of the closing process. It may take longer than an ordinary tenant estoppel certificate.

[36.35] E. Renewal and Extension

This Guaranty, like most other lease guaranties, covers any “renewal” or “extension” of the guaranteed Lease. If that Lease expires and Landlord and Tenant sign a new lease, is that a renewal or extension of the old Lease? Probably not. Therefore, if Landlord wants to preserve (or have any hope of preservation) the benefit of the Guaranty, any extension or renewal transaction should not be documented as a new lease, but instead as an extension or renewal of the old Lease.

[36.36] F. Reporting

Obtain periodic financial statements, estoppel certificates, litigation searches, credit check updates, background investigation updates, etc. If Guarantor authorized Landlord to obtain copies of tax returns from the tax authorities, periodically exercise that right. If Landlord anticipates a sale or refinancing, Landlord may wish to pay particular attention to enforcing Guarantor’s reporting obligations.

[36.37] G. Termination of Guarantor

Landlord should check periodically that Guarantor has not died, become disabled, filed bankruptcy, liquidated, lost its corporate (or other entity) status, or taken any other action that would constitute a Lease default or limit the utility of the Guaranty. If one of these events does occur, Landlord may have a relatively short time in which to act to protect itself. If a Guarantor dies, for example, Landlord may need to file a claim relatively quickly in Guarantor’s estate. The Lease may, as suggested above, give Landlord certain rights and remedies upon Guarantor’s death, etc.

[36.38] H. Workout Negotiations

If the transaction gets into trouble and Landlord and Tenant sign a pre-negotiation agreement, Guarantor should also sign it. Guarantor should participate in any workout discussions, as Guarantor may be the most likely source of a financial solution to the problem.

[36.39] IX. BASE CASE: FULL GUARANTY OF LEASE¹³

This **GUARANTY** (the “Guaranty”) is made as of _____, 201__ (the “Guaranty Date”) by _____, a _____, whose address is _____ (with its successors and assigns, “Guarantor”),¹⁴ for the benefit of _____, whose address is _____ (with its successors and assigns, “Landlord”). This Guaranty uses terms before defining them. An Index of Defined Terms follows the signatures. Guarantor signs and delivers this Guaranty based on these facts:

A. Landlord is about to enter into a _____ Lease (as further defined below, the “Lease”) with _____ (with its successors and assigns, “Tenant”), dated on or about the Guaranty Date.¹⁵

B. The Lease initially demises premises consisting of _____ (as modified from time to time in accordance with the Lease or by agreement between Landlord and Tenant, the “Premises”).

C. Guarantor directly or indirectly owns a substantial percentage¹⁶ of the equity interests of Tenant, or is a principal of Tenant.

D. The Lease will therefore benefit Guarantor.

E. Landlord would not enter into the Lease unless Guarantor signed this Guaranty.

13 One might adjust the title of the document, to prevent confusion, misunderstandings, and bad assumptions about the Guaranty's scope. For example, it could be a Full Guaranty, Lease Guaranty, Limited Guaranty or Good-Guy Guaranty. On the other hand, such gradations may invite arguments and theories about what the guaranty was “really” intended to cover. Those issues don't arise if it's just a “Guaranty” and someone has to read it to figure out what it means. As a psychological matter, Guarantor may derive comfort from a more limited title for the document.

14 If multiple Guarantors exist, they will typically sign the same document rather than each sign a separate Guaranty. This prevents needless multiplication of documents and can simplify enforcement. The optional provisions after this model Guaranty include some for multiple Guarantors.

15 One could also identify the leased premises here, but it seems unnecessary. It should suffice to identify the Lease.

16 One could specify the percentage as a matter of extra care, but it seems unnecessary and just creates extra work. And what if the percentage is inaccurate?

NOW, THEREFORE, in exchange for \$100 and other valuable consideration,¹⁷ receipt of which Guarantor acknowledges, and to induce Landlord to enter into the Lease, Guarantor agrees:

[36.40] A. Definitions

Any term defined in the Lease has the same meaning in this Guaranty, except as expressly modified or superseded here.¹⁸ This Guaranty also uses these terms:

1. “Guaranteed Obligations” means all liabilities and obligations of Tenant under the Lease,¹⁹ in each case whether or not Tenant’s notice or cure period, if any, has ended.²⁰ If a Guaranteed Obligation arises only after notice to Tenant but Landlord cannot legally give notice to Tenant, then Landlord may at its option instead notify Guarantor. The Guaranteed Obligation shall then be determined, for this Guaranty, as if Landlord had notified Tenant. If the Lease gives Tenant a right to contract, expand, extend or renew, or to acquire the Premises or an interest in Landlord, then the “Guaranteed Obligations” include Tenant’s obligations from an exercise of that right, whether or not Guarantor consents.²¹ The Guaranteed Obligations also include all obligations of Tenant to Landlord relating

17 If Guarantor delivers the Guaranty separately, well after the Lease closing, then issues could arise on consideration. In those cases one may need to do more than recite consideration, instead explaining for example that Landlord agreed to accept the Guaranty in exchange for a Lease amendment or a forbearance in Lease enforcement. In any case, Landlord’s counsel should make sure Landlord can satisfy ordinary contractual requirements for delivery of consideration.

18 The “base case” Guaranty contains all its own definitions, so one can delete the previous sentence, using it only when additional defined terms have crept into the document. One may, however, prefer to delete some lesser definitions in this document and rely on definitions in the Lease. In that case, one would keep this sentence. One might also adjust defined terms to match those in the Lease (e.g., “Attorneys’ Fees” rather than “Legal Costs”).

19 This language works for a full guaranty. Some Landlords like to add a laundry list of “Guaranteed Obligations,” such as obligations to pay rent, escalations, utilities, and construction costs; to comply with law; to provide insurance; to remove liens; etc. This seems unnecessary. What is unclear or inadequate about referring to “all” obligations under the Lease? If Landlord wants to include a list, or if the Guaranty is just a partial guaranty of the Lease, please see the menu of “Guaranteed Obligations” offered below for a partial guaranty. If Landlord leaves something out by mistake, does that implicitly diminish the scope of “Guaranteed Obligations”? And what about performance obligations that Guarantor cannot perform? For example, what if a performance obligation requires a special license that Tenant has but Guarantor does not? Landlord would typically not care about these questions or their answers.

20 One could state that the Guaranty of “all” obligations ends on a Termination Date, in which case it could become a broad form of good-guy Guaranty and require some conforming changes. Sample language appears in the optional provisions below.

21 Not everything in this sentence would apply in a typical space lease. Trim as appropriate.

to the Premises and arising under landlord-tenant law, such as liability for holdover rent, damages, use and occupancy payments, and rent for month-to-month occupancy after the Lease ends.

2. “Insolvency Law” means Title 11 of the United States Code, or other or successor state or federal statute on assignment for benefit of creditors, appointment of a receiver [(excluding one appointed at the request of a Leasehold Mortgagee)]²² or bankruptcy, composition, insolvency, moratorium, reorganization, trustee appointment or similar matters.

3 “Insolvency Proceeding” means any proceeding (or appointment), voluntary or involuntary, under Insolvency Law.

4. “Landlord Remedies” means Landlord’s rights and remedies under the Lease or law, including Insolvency Law, including any right to terminate the Lease, evict Tenant, collect damages for default and apply or not apply any security deposit or letter of credit Tenant delivered.

5. “Lease” means: (a) the Lease, as initially defined above, as amended,²³ assigned, extended or renewed from time to time,²⁴ whether or not with Guarantor’s consent; and (b) Tenant’s obligations to Landlord under law regarding the Premises, including after the expiration or termination of the Lease as defined above. The “Lease” shall be defined without regard to any: (i) Insolvency Proceeding; (ii) resulting limitation, modification, reinstatement, rejection or termination of the Lease or Tenant’s obligations; or (iii) exercise of Landlord Remedies.

6. “Legal Costs” means Landlord’s actual reasonable costs of collection and legal representation for any actual or threatened: (a) Tenant default under any Guaranteed Obligation; (b) Guarantor default or Landlord claim under this Guaranty; or (c) Proceeding. Those costs include

22 Add this bracketed language for a ground lease.

23 One expects to also see “modified.” But is “modified” any different from “amended”? “Extended” and “renewed” may in fact be different concepts, hence both appear.

24 Typically, a Guaranty supports not only the original Lease but amendments, extensions, renewals, and so on, whether or not the Lease provides for them. At least that’s what it says. If Guarantor does not in fact control Tenant (or stops controlling Tenant because Tenant assigns to a third party), Guarantor may want to limit the Guaranty to cover just the original Lease, not any future transactions, or perhaps not any renewals, extensions or expansions. In that case, Landlord will want to state that any future amendment, etc., does not vitiate Guarantor’s liability for the original Lease. Instead, Guarantor merely has no incremental liability (or benefit) as a result of the amendment, etc. In any event, counsel should make sure Guarantor understands the scope of its potential liability. For an unsophisticated or forgetful Guarantor, this could require written advice to Guarantor.

reasonable²⁵ attorneys' fees, disbursements and other charges billed by Landlord's attorneys, court costs and costs of process servers, private investigators and all other personnel whose services are charged to Landlord in connection with Landlord's receipt of legal services.²⁶ Legal Costs also include all other costs of collection.

7. "Proceeding" means any action, arbitration, counterclaim, litigation or other proceeding on, arising out of or relating to interpretation or enforcement of this Guaranty or the Lease, including a Tenant or Guarantor Insolvency Proceeding and any exercise of Landlord Remedies.²⁷

8. "Tenant" means: (a) Tenant as defined above; (b) any estate created through a Tenant Insolvency Proceeding; (c) any liquidator, receiver or trustee of Tenant or any of its property; (d) any similar person or officer, appointed in any Insolvency Proceeding or otherwise and (e) any heir, successor or assign of Tenant.

[36.41] B. Guaranty of Guaranteed Obligations

Guarantor absolutely, irrevocably and unconditionally guarantees Tenant's timely payment [and performance]²⁸ of all Guaranteed Obligations. Guarantor covenants that Tenant will pay [and perform]²⁹ all Guaranteed Obligations when and as the Lease requires.³⁰ If Tenant does not do

25 A court will often infer the word "reasonable" whether or not the parties include it, but if it's not there Guarantor will ask for it and Landlord will typically agree. So here it is. And perhaps it creates an unnecessary hook on which Tenant can hang issues in a Proceeding. But the hook is there anyway, in all likelihood.

26 Landlord may want to add: "If Landlord uses in-house counsel, "Legal Costs" shall include the estimated value of the time of those attorneys based on billing rates of Landlord's outside counsel."

27 Guarantor will want to limit this definition to anything arising from the Guaranty, so it excludes anything arising from the Lease or Landlord Remedies under the Lease. That argument may make sense if the Guaranty covers less than all obligations under the Lease. But if the Guaranty covers all Tenant obligations under the Lease, then it would include Tenant's obligations regarding any Proceeding or exercise of Landlord Remedies.

28 Landlord may not care about performance, just payment. Performance raises issues about access. Landlord may prefer to cure any performance defaults and send a bill. In that case, delete all references to the Guaranty covering performance. Limit it to payment.

29 See previous comment.

30 Guarantor may ask that if Tenant does not pay or perform, Landlord will give Guarantor notice, and then Guarantor will have, e.g., 30 days to cause Tenant to pay or perform before Guarantor must.

that, then Guarantor shall.³¹ For any Guaranteed Obligation, Guarantor shall pay all damages³² and losses that Landlord suffers and the Lease or governing law entitles Landlord to recover, including Landlord's Legal Costs, because Tenant fails timely to pay or perform. Guarantor's liability under this Guaranty is primary, not secondary, in the full amount of the Guaranteed Obligations, including interest, default interest, late fees³³ and costs and fees (including Legal Costs) relating to the Guaranteed Obligations. Any unpaid Guaranteed Obligation shall bear interest from the date it accrues until the date paid, both before and after entry of judgment, at the higher of: (a) the interest rate that applies after default under the Lease; or (b) the judgment rate. If Landlord obtains a judgment against Tenant for any Guaranteed Obligation, then Guarantor shall on Landlord's demand pay it and Landlord's Legal Costs of collecting it.

[36.42] C. Landlord's Exercise of Landlord Remedies

Landlord may enforce this Guaranty against Guarantor independently of, and with or without enforcing, any Landlord Remedy, and without regard to any event in any Proceeding with Tenant. Any Guaranteed Obligation and Guarantor's primary personal liability for it shall not decrease if: (a) Tenant abandons, surrenders or vacates the Premises or is subject to an Insolvency Proceeding; (b) Landlord exercises any Landlord Remedy or enforces this Guaranty; (c) Landlord fails to do so or delays in doing so; (d) Landlord obtains a judgment against anyone; (e) the Lease ends; or (f) any other circumstance occurs except actual payment and performance.³⁴ Nothing in this paragraph limits Landlord's obligation to credit Guarantor for any sums actually collected on account of the Guaranteed Obligations.

31 What about nonmonetary obligations that require access to the Premises? Does Landlord implicitly allow Guarantor to enter the Premises for that purpose? Or does Guarantor need to work out access with Tenant, the party with the right to possession? Though these questions are interesting, they would seem to be Guarantor's problems rather than Landlord's. If Landlord worries about them, Landlord may want to address them, but it seems unnecessary, especially in a "short form" Guaranty.

32 One could include a list of damages; for example: "direct, indirect, incidental, and consequential." Usually an obligor will want to exclude some of these.

33 If the Lease, and hence the Guaranteed Obligations, do not already provide for a late fee and default interest, consider providing for them in the Guaranty.

34 Adjust if the business deal contemplates a Termination Date for the Guaranty.

[36.43] D. No Offset

The Guaranteed Obligations are not subject to counterclaim, deduction, defense, offset or reduction of any kind, including any arising or purportedly arising under the Lease or from the landlord-tenant relationship under the Lease, except actual payment or performance. If Landlord holds a security deposit: (a) Landlord need not apply it toward the Guaranteed Obligations; (b) Landlord may continue to hold or apply it, in accordance with the Lease, as Landlord determines; and (c) it does not limit the Guaranteed Obligations.³⁵ If Landlord holds a letter of credit, Landlord may draw on it or not, in Landlord's sole discretion subject to the terms of the Lease.

[36.44] E. Changes in Lease

Without notice to or consent by Guarantor, in Landlord's discretion and without prejudice to Landlord or in any way limiting or reducing Guarantor's liability under this Guaranty, Landlord may but shall have no obligation to: (a) grant extensions of time, renewals or other modifications; (b) amend the Lease by agreement with Tenant; (c) accept or make compositions or other arrangements or file or not file a claim in any Insolvency Proceeding; and (d) otherwise deal with Tenant and anyone else related to the Lease as Landlord sees fit. Guarantor's liability under this Guaranty shall continue even if Tenant's obligations under the Lease are altered or terminated in any way or if any Landlord Remedy is in any way impaired or suspended with or without Guarantor's or Landlord's consent. A Lease assignment, even with Landlord's consent, does not limit this Guaranty.³⁶

[36.45] F. Waivers of Rights and Defenses

Guarantor waives any right to require Landlord to proceed against Tenant or anyone else or pursue any Landlord Remedy for Guarantor's benefit. Landlord may exercise in its sole discretion any right or remedy against anyone without impairing this Guaranty. Guarantor waives diligence and every demand, protest, presentment and notice, including notice of acceptance, accrual, creation, dishonor, extension, modification, nonpayment, protest or renewal of any Guaranteed Obligation.

35 Guarantor and Tenant may think Landlord should first use the security deposit before claiming under the Guaranty. Landlord will of course feel otherwise and will note that if Landlord does apply the security deposit, then Tenant and Guarantor will have an immediate obligation to replenish it, so they shouldn't care.

36 Tenant and Guarantor may negotiate for a release of liability if an assignment meets certain tests. See suggested concessions to Guarantor, following this Model Document.

[36.46] G. Nature of Guaranty

This is a guaranty of payment, not collection. Guarantor's liability is not conditioned or contingent on the Lease's enforceability or validity. If any Guaranteed Obligation is or becomes void or unenforceable, Guarantor's liability under this Guaranty shall continue as if all Guaranteed Obligations were and remained legally enforceable.

[36.47] H. Miscellaneous

Guarantor waives any defense because Landlord failed to obtain or perfect any security interest. The parties waive jury trial in any proceeding.³⁷ Nothing in this Guaranty may be amended, terminated or waived without Landlord's written consent. This Guaranty contains all (and supersedes all prior) agreements between the parties on the matters this Guaranty covers. In entering into this Guaranty, Guarantor does not rely on any representation, promise or other assurance by Landlord. Nothing Landlord said or did, except entering into the Lease, in any way induced Guarantor to enter into this Guaranty. The words "include" or "including" shall be interpreted as if followed by "without limitation." Landlord may give notice under this Guaranty in accordance with the notice procedures in the Lease.³⁸

[36.48] I. Additional Documents

Guarantor shall within 10 days after Landlord's request sign and deliver a certificate as Landlord reasonably requests directed to such addressee(s) as Landlord reasonably requires confirming: (a) this Guaranty and its continued status and validity; (b) the fact that it has not been waived or amended; (c) the current identity of Guarantor, Landlord and Tenant; (d) whether Guarantor has received notice of assignment; (e) whether Guarantor has any defenses and, if so, what they are; (f) if an attornment occurs under any nondisturbance agreement signed by Tenant, then the new landlord will also be entitled to the benefit of this Guaranty but not be bound by any amendment or waiver of this Guaranty made by

37 Particularly outside New York, a jury trial waiver often appears in **ALL CAPITAL LETTERS, BOLD TYPE**. Any jury trial waiver could also include this language: "Neither party shall seek to consolidate any Proceeding involving this Guaranty with any Proceeding in which jury trial has not been waived." Although that language seems right, it is not market standard.

38 Should those procedures allow email notices? Cautious lawyers say no, because of potential issues of proof. Those same lawyers often regret their caution the first time they need to give a formal notice under the document in question. Pressure for verifiable notices by email will probably continue to build.

Landlord without the requisite mortgagee consent; (g) Guarantor knows of no facts inconsistent with any simultaneous estoppel certificate delivered by Tenant; and (h) other matters as Landlord reasonably requires. So long as Tenant is not in default under the Lease, Landlord shall not request more than two such certificates in any calendar year.³⁹ Landlord may from time to time without notice as Landlord deems appropriate: (a) obtain updated credit reports or other information on Guarantor; and (b) investigate Guarantor and Guarantor’s credit, property and background.

IN WITNESS WHEREOF, Guarantor has executed this Guaranty as of the Guaranty Date.⁴⁰

GUARANTOR

_____, in his or her individual and personal capacity
Residence Address:⁴¹

GUARANTOR

_____, a _____

By: _____, a _____, its _____

By:

Name: _____

Title: _____

39 The preceding sentence is optional but reflects a common concession by Landlord.

40 Break the signature page so it will at least include this paragraph of text. The previous page can be a “short page” ending with, e.g., “No Further Text on This Page.” The signature page could then include language like: “Signature Page for Guaranty Signed by _____ for Lease [Dated _____] Between _____ and _____.” Marc Dreier’s contribution to this Model Guaranty is duly noted.

41 To underscore the “personal” nature of the Guaranty, Landlord might ask Guarantor to provide its social security number and driver’s license information, plus a copy of the latter. If the Guaranty includes blanks for those items, Landlord should make sure Guarantor fills them in; leaving them blank could invite theories and claims. Guarantor will generally procrastinate about providing any of this information, and will try not to provide it at all by forgetting about it. If Landlord wants it, Landlord’s counsel should insist on obtaining it well before closing, and tracking its absence on the closing checklist.

ACKNOWLEDGMENT⁴²

STATE OF _____)
 COUNTY OF _____) ss:
 _____)
 _____)

On the _____ day of _____ in the year 201____, before me, the undersigned, personally appeared _____, personally known to me or proved to me on the basis of satisfactory evidence to be the individual(s) whose name(s) is (are) subscribed to the within instrument and acknowledged to me that he/she/they executed the same in his/her/their capacity(ies), and that by his/her/their signature(s) on the instrument, the individual(s), or the person upon behalf of which the individual(s) acted, executed the instrument.

 Notary Public

[36.49] X. PARTIAL GUARANTY

For a partial guaranty, change the definition of “Guarantied Obligations” in the base Guaranty to capture only whatever Tenant obligations Guarantor has agreed to guaranty. This will represent a business negotiation in each case. Landlord can always suggest reasons why the Guaranty should cover just about any Tenant obligation. See, for example, the expansion of nonrecourse carveouts in real estate financing.

Any attempt to limit the Guaranty to certain “Guarantied Obligations” could cause disputes over line drawing. For example, if the Guaranty covers Tenant’s construction obligations, does that also cover some maintenance and repairs? If it relates to Tenant’s end of term obligations, does that only mean obligations that specifically arise at the end of the term, or also Tenant’s obligations to be in general compliance with the Lease at the end of the term? Guarantor might argue for a limited reading of “obligations at the end of the term.” One can mitigate these issues by referring to

⁴² Use the right acknowledgment. Although a guaranty will not always include an acknowledgment, their use has become more prevalent. An acknowledgment can mitigate issues of proof, though probably not likelihood of fraud. After all, why would a fraudster stop at the signature block? A requirement for an acknowledgment will create logistical and procedural issues for an offshore Guarantor. Those issues will often require lead time, and sometimes a trip to the United States Consulate, to handle correctly. In many countries, having a document notarized entails an expensive, tedious and lengthy visit to a public official called a “notary.” Counsel may also need to educate any Guarantor that Guarantor can’t sign the Guaranty and then send it to counsel with the expectation that counsel will notarize it.

specific Lease sections⁴³ or by foreseeing them and trying to prevent them.

The Guaranteed Obligations might also reduce over time, potentially to zero, if Guarantor and Tenant meet certain conditions. Language to that effect follows the menu of Guaranteed Obligations.

Menu of Guaranteed Obligations. For defining the “Guaranteed Obligations” under a partial Guaranty, consider this menu, but bear in mind that many of these items are “off market,” assuming it is possible to define “market”:

A. “*Guaranteed Obligations*” means these obligations of Tenant under the Lease.⁴⁴

1. *Construction.* Tenant’s obligations under Lease Section ____, including Tenant’s obligations under Section ____ to remove mechanics’ and other liens.⁴⁵
2. *Contests.* Tenant’s obligation to pay or perform any Contested Matter if Tenant’s Contest fails.
3. *Demolition.* Tenant’s obligation not to commence or perform any demolition or construction except as the Lease allows.
4. *Deposits.* Tenant’s obligations to make, replenish or increase any deposit the Lease requires.
5. *End of Term.* Tenant’s obligation to surrender possession of the Premises when and as the Lease requires, and in the condition the Lease requires, at the end of the Term (including any premature end because of an Event of Default or a surrender of the Premises) and Tenant’s obligation under the Lease to indemnify Landlord, or otherwise make any payment to Landlord on account of Tenant’s breach of any obligation under the Lease on those matters.

43 Section number references create the risk that they will become incorrect as the Lease changes during negotiations. The author prefers to use (and refer to) suitable defined terms in the Lease.

44 This Guaranty defines the Lease, once, in a manner that disregards any Tenant Insolvency Proceeding. One doesn’t need to keep saying that.

45 Try to create and refer to suitable defined terms in the Lease rather than Section references, which will inevitably become wrong as the parties negotiate the Lease.

6. *Environmental Matters.* Tenant's obligations under Lease Section ____.
7. *Expenses.* Tenant's obligations under the Lease to pay utilities, management fees and operating expenses for the Premises.
8. *Insurance.* Tenant's obligations to maintain insurance under Lease Section ____, and if Tenant fails to perform those obligations then this Guaranteed Obligation shall include an obligation to pay any amounts that an insurance carrier would have paid if Tenant had performed its obligations to maintain insurance.⁴⁶
9. *Judgment.* Payment of any judgment Landlord obtains against Tenant for breach of any Guaranteed Obligation.
10. *L/C.* Tenant's obligation to maintain, extend and replace the L/C from time to time.
11. *Legal Costs.* Payment of Landlord's Legal Costs in enforcing the Guaranteed Obligations against Tenant or Guarantor.
12. *Liens.* Tenant's obligations regarding mechanics' and similar liens.
13. *Rent.* Tenant's obligation to pay all "Rent," which means any and all payments that the Lease requires Tenant to make as Fixed Rent, Additional Rent, interest, default interest, late charges, per diem damages or administrative fees, holdover rent, or otherwise, and any and all damages and other sums otherwise payable by Tenant under the Lease or for or on account of Tenant's default under the Lease or Lease termination or in any Tenant Insolvency Proceeding⁴⁷. "Rent" also includes any payments Tenant must legally make for use, occupancy or possession of the Premises (after the Lease ends), or in substitution for any payments under the Lease, or otherwise under the terms of the Lease, or after its rejection or premature termination. Rent and any damages for nonpayment of Rent shall be calculated without regard to any deferral, limitation or reduction that might

46 Guarantor should try to limit the Guaranteed Obligations to payment of premiums, arguing that Landlord should maintain its own backup coverage in any case. Landlords typically reject that argument.

47 The remaining language in this subparagraph sometimes appears in Guaranties but probably adds words without adding value.

apply under 11 U.S.C. § 502(b)(6) or otherwise in a Tenant Insolvency Proceeding.⁴⁸

14. *Subleases.* Tenant’s obligation not to enter into below-market or statutory subleases, as provided for in Lease Section ____.

Limitation of Liability. Notwithstanding anything to the contrary in this Guaranty, the aggregate dollar amount of the Guaranteed Obligations, and Guarantor’s liability for the Guaranteed Obligations, shall never exceed the sum of: (a) \$_____ ⁴⁹ plus (b) Landlord’s Legal Costs in enforcing the Guaranteed Obligations against Tenant and Guarantor.

Application of Payments. To the extent Tenant makes any payment under the Lease, Landlord shall credit it as Landlord determines. For example, Landlord may credit it first against any Tenant obligation under the Lease that does not also constitute a Guaranteed Obligation, regardless of how Tenant characterized the payment.

[36.50] XI. GOOD-GUY GUARANTY

For a Good-Guy Guaranty, one could start with either a partial Guaranty (mix and match as suggested above) or a full Guaranty (“all” means “all” Lease obligations). Either way, one would then say liability ends on a “Termination Date,” subject however to Landlord’s rights on Recovered Payments.

A. Definitions

1. “Tenant Occupant” means Tenant and any person occupying or claiming any Premises by or through Tenant, except to the extent Land-

48 For a partial Guaranty or good-guy Guaranty, Guarantor should worry that this very broad definition of Rent will capture too much. Any Lease typically says that if Tenant commits an Event of Default and the Lease terminates, then Tenant owes damages based on an acceleration of some component of rent that would otherwise become due after termination. A partial or “good guy” Guarantor will want to avoid liability for those damages.

49 One could express this as a multiple of the monthly Fixed Rent at the time of determination, or in some other formulaic way. One could also have a fixed number, but adjust it based on the Consumer Price Index (CPI).

lord has agreed in writing that such person may remain after the Lease ends.⁵⁰

2. “Termination Date” means the date [__ days after the date] when Tenant has met these conditions: (a) all Tenant Occupants have vacated the Premises and delivered possession of the entire Premises⁵¹ in the condition the Lease requires; (b) Tenant has given Landlord at least __ days prior written notice of Tenant’s intention to do so;⁵² (c) all Tenant Occupants have surrendered the Lease under surrender documentation in form and substance reasonably satisfactory to Landlord;⁵³ (d) Tenant has performed all its Lease obligations arising from any construction Tenant initiated; and (e) all Rent accrued under the Lease to date has been paid, and all other obligations of Tenant accrued to date under the Lease (excluding any obligations calculated in whole or in part by any reference to obligations accruing or arising after the Termination Date) have been paid or performed.⁵⁴

50 This language covers nondisturbance agreements and pick-up leases. If a Subtenant is in default beyond cure periods under its Sublease, then it will typically lose nondisturbance protection. Landlord may want any such bad Subtenant to constitute a Tenant Occupant. If Tenant enters into subleases without nondisturbance protection, Tenant should remember that if any such subtenant remains, or fails to deliver the required surrender documentation, no Termination Date can occur. Tenant should keep this in mind when: (a) negotiating Subtenant nondisturbance protections in the Lease; (b) evaluating possible Subtenants; and (c) writing Subleases and Sublease guaranties.

51 For a large space, Tenant might seek some wiggle room on the “entire” Premises. For example, if a Subtenant remains in a corner of one floor, Tenant might still have the right to achieve a Termination Date for three other floors, all vacant. Or Tenant’s holdover exposure might be limited to just the subleased space, or in some other way.

52 This notice requirement does not always apply. If a good-guy Guaranty does contemplate Tenant or Guarantor will give prior notice of Tenant’s departure, what happens if Tenant doesn’t move out as scheduled? Often Landlord will establish draconian per diem damages, but this seems excessive as long as Tenant moves out reasonably soon after the scheduled date, and otherwise goes away in peace.

53 Guarantor may want to attach a required form of Surrender Agreement, to prevent any future discussions or uncertainty if Tenant ultimately decides to surrender. Landlord will want to make sure the Surrender Agreement only relates to Tenant’s surrender of possession, and does not in any way limit Landlord’s rights to recover damages under the Lease.

54 Guarantor can reasonably object to this clause “d,” as it is unnecessary to create the incentives that a good-guy guaranty is supposed to create, and exposes Guarantor to potentially open-ended liability even after giving up and surrendering the Premises—the desired behavior that this Guaranty sought to incentivize. Landlord will feel otherwise, probably strongly.

[36.51] XII. REPRESENTATIONS AND WARRANTIES

Many legal documents require the obligor to make representations and warranties to confirm facts about itself, the real property in question and other matters. One could argue that in most cases--at least for a “full” Guaranty of all obligations under the Lease—representations and warranties don’t give the obligee much incremental benefit. Still, the obligor just might go to the trouble of confirming they are correct and disclosing any inaccuracies. Guaranties typically do not include representations and warranties, but of course they sometimes do. If Landlord wants to include them, here is some sample language.

[36.52] A. Representations and Warranties

Guarantor acknowledges, represents and warrants as follows, and acknowledges that Landlord is relying on these assurances in entering into the Lease and accepting this Guaranty.⁵⁵

1. *Accuracy of Facts.* The recitals of this Guaranty are correct.
2. *Authority to Contract.* Guarantor has full power, authority and legal right to execute, deliver and perform its obligations under this Guaranty. Guarantor has taken all necessary actions to authorize this Guaranty, and has duly authorized, executed and delivered it.
3. *Formation.* Guarantor is an entity duly organized, validly existing and in good standing under the laws of an American state.
4. *Guarantor’s Financial Statements.* Guarantor’s most recent financial statements delivered to Landlord on or before the Guaranty Date⁵⁶ were prepared in accordance with sound accounting practices consistently applied. They correctly depict Guarantor’s financial condition

55 Sometimes the corporate representations and warranties about Guarantor will also cover Tenant. For a partial Guaranty, that represents a backhanded expansion of the scope of the Guaranty. For a full Guaranty, it doesn’t matter. The menu of representations and warranties offered here is fairly typical for any transactional document. The fact that most Guaranties don’t include these representations and warranties does not seem to have caused terrible problems for holders of Guaranties. One could include the same representations and warranties in the Lease. Whether the representations and warranties appear in the Guaranty or the Lease, one can easily expand them without limit beyond those suggested here.

56 The parties may want to identify those financial statements by date. Add them to the closing checklist. Guarantor, especially if weak, will typically not rush to deliver financial statements, hoping Landlord will be “so pregnant” by the time of signing that Landlord will pay no attention to them.

as of their date. Since then, no material adverse change has occurred in Guarantor's condition. Guarantor is solvent. Delivery of this Guaranty on the Guaranty Date does not render Guarantor insolvent.

5. *Lease Representations and Warranties.* Tenant's representations and warranties in the Lease are correct in all material respects.⁵⁷
6. *No Conflict.* The execution, delivery and performance of this Guaranty will not violate any provision of any law, regulation, judgment, order, decree, determination or award of any court, arbitrator or governmental authority, or of any mortgage, indenture, loan or security agreement, lease, contract or other agreement, instrument or undertaking to which Guarantor is a party or that purports to bind Guarantor or any of its assets.
7. *No Legal Action Pending.* "Legal Action" means any litigation, arbitration, investigation or administrative proceeding of or before any court, arbitrator or governmental authority: (a) regarding this Guaranty or (b) against or affecting Guarantor's property or assets. No Legal Action is pending or, to Guarantor's knowledge, threatened against Guarantor or any of its assets. Guarantor shall notify Landlord of any future Legal Action within five days after Guarantor becomes aware of it.
8. *No Misstatements.* No information, exhibit or report that Guarantor gave Landlord in connection with this Guaranty contained as of its date, or, if there is no such date, the Guaranty Date, any material misstatement of fact or omitted to state a material fact or any fact necessary to make any statement in it not materially misleading.
9. *No Third Party Consent.* Guarantor's execution of, and payment and performance under, this Guaranty are not contingent on any unobtained consent, license, permit, approval or authorization of, exemption by, notice or report to, or registration, filing or declaration with any person or governmental authority.
10. *Tax Returns.* Guarantor has filed all tax returns it must legally file, except to the extent any deadline(s) have been validly extended.

⁵⁷ This represents a "grab," a backhanded expansion of the Guaranty. See earlier comments on having Guarantor make representations and warranties about Tenant corporate matters. As a comment going in the other direction, Landlord might expand the various representations and warranties to cover not only Guarantor but also Tenant.

Guarantor has paid all taxes due on those returns and any assessments made against it.

11. *Tenant's Financial Condition.* Guarantor is fully aware of Tenant's financial condition. Guarantor delivers this Guaranty based solely on its own independent investigation and based in no part on any representation or statement by Landlord. Guarantor is not relying on, nor expecting, Landlord to give Guarantor any information on Tenant's financial condition.⁵⁸
12. *Valid Obligation.* This Guaranty constitutes a legal, valid and binding obligation, enforceable against Guarantor in accordance with its terms.⁵⁹

[36.53] XIII. MULTIPLE GUARANTORS

When multiple Guarantors exist, new issues arise. The next few paragraphs offer sample language to deal with them. Are the multiple Guarantors jointly and severally liable? (Usually yes.) Does each Guarantor make any representations or warranties about the others? (Usually, no. Each Guarantor should insist on that.) As with anything else in this model Guaranty, the appropriateness of the following language will depend on the circumstances. Also, multiple Guarantors will usually want to sign a reimbursement and indemnification agreement among themselves, a mutual-aid pact, so that if Landlord claims against one Guarantor, the other(s) must pay their share(s). The author can provide a template for such an agreement. Finally, think about how to tailor Events of Default triggered by Guarantor-related events. If one Guarantor runs into trouble but the others are just fine, should that constitute an Event of Default? (Probably not.) What if one Guarantor fails to deliver required financial reports, but the others do timely deliver their reports? If one Guarantor dies or becomes disabled, but all the others are alive and well, should that constitute an Event of Default? (Probably not.) Of course it all depends on the relative strength of the various Guarantors.

58 This proposition may seem rather obvious, but the California courts once decided that a holder of a Guaranty has an obligation to inform Guarantors about financial risks relating to their principals.

59 And what if Guarantor is lying about this? Does it change anything? If the Guaranty is not enforceable, then neither is this paragraph.

[36.54] A. Joint and Several Liability

If more than one person signs this Guaranty, then every signer shall be jointly and severally liable as “Guarantor” under this Guaranty. Guarantor shall indemnify Landlord on any claims arising from any dispute between or among Guarantors, plus Legal Costs. Landlord may, at its option, proceed against any one or more Guarantor(s) in any order without proceeding against other any Guarantor(s). Landlord may settle its claims against Guarantor(s) without, as a result, impairing Landlord’s rights against any other Guarantor(s).

[36.55] B. Notices and Service

Each Guarantor irrevocably appoints each Guarantor as its agent for receipt of notices and service of process. If Landlord gives any notice to any Guarantor, or serves any process on any Guarantor, then Landlord shall be deemed to have given that notice or served that process on all Guarantors.⁶⁰

[36.56] C. Counterparts

This Guaranty may be executed in counterparts.⁶¹ If any Guarantor fails to execute this Guaranty, that does not limit any other Guarantor’s liability.

[36.57] XIV. GUARANTOR FINANCIAL MATTERS

If Guarantor’s credit motivated Landlord to enter into the Lease, what happens if Guarantor’s credit later suffers? Nothing, usually. Landlord makes its decision at Lease inception, signs the Lease and then lives with the risk that Guarantor will suffer financial reverses.

Even under those circumstances, Landlord may still want to receive regular financial reports on Guarantor. If Guarantor merely delivers summary financial statements, they don’t help Landlord much if Landlord can’t act on any adverse information. But Landlord might also require

60 This may make Guarantors uncomfortable. Why can’t Landlord serve process on a Guarantor the same way Landlord would serve process on any other defendant in any action? Special language on service of process on Guarantor may amount to another example of irrational exuberance in trimming back a Guarantor’s rights and protections.

61 One could add: “Delivery of this Guaranty by electronic (including scanned pdf) or facsimile transmission shall have the same effect as delivery of original signatures.” Do we really need that language or will general legal principles adequately cover the issue?

Guarantor to deliver identifying information for Guarantor's assets—both at inception and periodically after that—to help Landlord chase Guarantor if the transaction ever gets into trouble. As a practical matter, though, how likely will those schedules of assets be complete, informative and useful?

In a minority of cases, Landlord goes a step further and requires Guarantor to meet a certain financial standard throughout the Lease term. If Guarantor no longer meets the standard, Landlord can call an Event of Default. This makes great sense for Landlord—assuming the courts will enforce that Event of Default—but imposes on Guarantor and Tenant a risk they cannot really control, with draconian consequences.

Here is sample language:

[36.58] A. Financial Information⁶²

Within __ days after each calendar year, Guarantor shall give Landlord Guarantor's complete financial statements as of the end of that year. Within __ days after Landlord's request, made up to once a year, Guarantor shall deliver schedules of assets, identifying Guarantor's assets in reasonable detail.⁶³ Guarantor shall file its tax returns on or before the last day (after any valid extensions) Guarantor must do so without penalty. Within 15 days after each such filing, Guarantor shall give Landlord a copy of Guarantor's complete filed tax returns. [Guarantor shall also, promptly on request, give Landlord any other financial or other information on Guarantor as Landlord reasonably requests.]⁶⁴

62 If Guarantor is a public company, financial reporting could raise some special issues. For example, Guarantor will not want to provide (and Landlord might not want to receive) material non-public information. On the other hand, any public information will usually be available online – at least as long as Guarantor remains a public company. One could limit the reporting obligations accordingly.

63 This is intended to help Landlord chase Guarantor later.

64 Any obligation to deliver financial statements should also trigger obligations of confidentiality, which should appear directly in the Lease rather than require negotiation of a future confidentiality agreement. Sometimes Landlord will go a step further and require Guarantor to sign a consent (in the form the tax authorities require) so Landlord can obtain copies of Guarantor's tax returns directly from the tax authorities. This is not market for lease guaranties, but one often sees it in some areas of commercial lending.

[36.59] B. Guarantor Financial Standard⁶⁵

Guarantor shall, so long as this Guaranty has not been terminated or released: (a) meet the Guarantor Financial Standard; and (b) not Transfer any property or asset or take any other action if, after that Transfer or other action, Guarantor would no longer meet the Guarantor Financial Standard.⁶⁶

[36.60] XV. RECOVERED PAYMENTS⁶⁷

Any holder of a Guaranty may worry that the principal (here, Tenant) will pay a Guaranteed Obligation and then soon commence an Insolvency Proceeding, persuading the court that Tenant's payment constituted a preference or a fraudulent transfer. Some Guaranties address that hypothetical circumstance, by allowing the beneficiary of the Guaranty to "claw back" the Guaranty as soon as the court "claws back" the payment in question. Here is some suggested language:

- A. *Definition.* A "Recovered Payment" means any payment that Landlord: (a) received from Guarantor or Tenant on account of a Guaranteed Obligation or as a condition to a Termination Date; but (b) must return or "disgorge" for any reason, for example because a court decided it constituted a preference or fraudulent transfer. The Recovered Payment shall include: (a) Landlord's reasonably projected interest and other charges on the Recovered Payment until the date of reimbursement by Guarantor and (b) Landlord's Legal Costs in determining the existence and amount of that Recovered Payment.
- B. *Landlord's Disgorgement of Payments.* If Landlord is required to return or "disgorge" any Recovered Payment, then Guarantor's obligations under this Guaranty shall continue and remain in full force and effect as if Landlord had never received the Recovered Payment.

65 This paragraph is optional depending on the business understanding, and not often seen. If this paragraph is included, one must define the Guarantor Financial Standard either in this Guaranty or in the Lease. See the definition of "Satisfactory Guarantor" in § 39.89 for possible language. For a Lease of any significant term, Landlord should think about adjusting the Guarantor Financial Standard for inflation. And what happens if Guarantor fails to meet the Guarantor Financial Standard? Does that constitute an Event of Default? Is there a cure period to allow Guarantor to make more money? Must Tenant post cash security or a letter of credit? All of this belongs in the Lease, not (just) in the Guaranty.

66 Does clause "b" give Landlord anything Landlord did not already have by requiring Guarantor to meet the Guarantor Financial Standard at all times?

67 The first paragraph is typical and often appears in "full" guaranties. The second paragraph could be regarded as overkill. Without the second paragraph, though, Landlord has no (possible) protection from a degradation of Guarantor's financial condition.

If Guarantor purports to revoke this Guaranty, or if this Guaranty otherwise terminates, before Landlord has a claim against Guarantor under the previous sentence, then that termination or purported revocation shall not limit Landlord's rights against Guarantor. Guarantor shall promptly pay Landlord the amount of any Recovered Payment. Guarantor's liability under this Guaranty shall continue until (a) all periods have expired within which Landlord could be required to make any Recovered Payment; (b) Guarantor has reimbursed all Recovered Payments; and (c) all other conditions to termination of this Guaranty have been met.

- C. *Recovery Motions.* If, in any Tenant Insolvency Proceeding, any party claims Landlord must repay any Recovered Payment (a "Recovery Motion"), then Guarantor shall pay Landlord on demand an amount equal to the claimed Recovered Payment, as increased from time to time through accrual of interest and other fees (a "Recovery Security Payment"). If Guarantor pays a Recovery Security Payment and continues to perform its Guaranty obligations when and as required, then Landlord shall, at Guarantor's request, allow Guarantor to defend the Recovery Motion at Guarantor's expense (including Landlord's Legal Costs) on Landlord's behalf, all in a manner reasonably satisfactory to Landlord, provided this does not in Landlord's judgment cause Landlord to incur any cost, expense, liability or other detriment of any kind, including any adverse effect on any other actions by Landlord in the Tenant Insolvency Proceeding. To the extent Guarantor's defense succeeds, Landlord shall return the Recovery Security Payment. If the defense fails, Landlord shall apply the Recovery Security Payment to reimburse Landlord for the Recovered Payment.⁶⁸

[36.61] XVI. SPECIAL MORTGAGEE PROTECTIONS

Sometimes Landlord uses a Lease as a vehicle to create a stream of high-quality payments ultimately backed by Guarantor, supporting substantial financing. In these cases, the Lease itself may purport to "demise" something that isn't really separately demisable, such as the fixtures in a store. The transaction is really just a financing backed by Guarantor. The store fixtures aren't really very good real property collateral, but the Guaranty from the corporate parent may make the transaction work. In those cases, the mortgagee will worry even more than usual about preserving

⁶⁸ This paragraph rarely appears, even when a Guaranty addresses possible disgorgement of payments. It is quite creative and off market. But it makes sense as a mechanism to protect Landlord if Tenant initiates a Disgorgement Motion.

and protecting the stream of incoming “rent” payments. Language offered here will help Landlord mitigate that concern. Ordinarily neither Landlord nor its typical real property mortgagee would expect to see any of this language.

Guarantor acknowledges Landlord has mortgaged or collaterally assigned (or intends to mortgage or collaterally assign) the Lease, this Guaranty, all payments and obligations arising under the Lease and this Guaranty and Landlord’s entire interest in the Premises, to _____ (“Mortgagee”).⁶⁹ Guarantor has received notice of that assignment and acknowledges its validity and effectiveness. That assignment, and any later assignment, does not require Guarantor’s consent. Notwithstanding anything to the contrary in the Lease or this Guaranty, unless and until Mortgagee has released of record its interest in this Lease:

1. *Effect on Guaranty.* Landlord’s assignment of the Lease shall be deemed, without any further action by anyone, to include a collateral assignment of this Guaranty to Mortgagee or, from and after a Foreclosure Transfer,⁷⁰ an outright assignment to any party that acquires the Fee Estate through a Foreclosure Transfer.
2. *No Impairment.* This Guaranty may not be amended, modified or waived, in whole or in part, without Mortgagee’s prior written consent.
3. *Continuation of Guaranty.* From and after any Foreclosure Transfer, this Guaranty shall, in accordance with its terms, continue to apply to the Guaranteed Obligations for the benefit of Successor Landlord⁷¹, but only until the Termination Date. Guarantor shall not assert against Successor Landlord any claim, defense, counterclaim or offset that the Lease or a separate nondisturbance agreement would prohibit Tenant from asserting against Successor Landlord.

69 One could also provide generically for future Fee Mortgages rather than a specific Fee Mortgage a specific Fee Mortgagee.

70 In the definitions, add: “*Foreclosure Transfer*” means any (a) foreclosure sale (or trustee’s sale, assignment in lieu of foreclosure, bankruptcy sale, or similar transfer) affecting the Fee Estate; or (b) a Fee Mortgagee’s exercise of any other right or remedy under its Fee Mortgage (or Law) that divests Landlord of the Fee Estate.

71 In the definitions, add: “*Successor Landlord*” means any party that becomes owner of the Fee Estate through a Foreclosure Transfer.

4. *Direct Enforcement.* Mortgagee may enforce directly against Guarantor (and give notices under) this Guaranty with no need for any confirmation, consent or joinder by Landlord.
5. *Redirection Notice.* If Mortgagee so directs in writing (a “Redirection Notice”), then Guarantor shall pay to Mortgagee, as Mortgagee directs, all payments this Guaranty requires, and shall not make those payments to Landlord. Payments made to Landlord in violation of or after a Redirection Notice shall not bind Mortgagee. Any Redirection Notice shall be irrevocable unless and until Mortgagee notifies Guarantor otherwise in writing. Guarantor shall disregard any instructions from Landlord inconsistent with a Redirection Notice.⁷²

[36.62] XVII. ENFORCEMENT

If the Guaranty goes into litigation, Landlord will want it to contain a few provisions to make that litigation go faster and better. Some of those provisions appear in the “base” model Guaranty, such as a jury trial waiver. Here are a few more provisions Landlord might add.

In the event of any Proceeding:

- A. *Commercial Division.* If that Proceeding is heard in the New York State Supreme Court Commercial Division, then the parties consent and agree to application of the Court’s accelerated procedures, Uniform Rules for the Supreme and County Courts (currently, the Rules of Practice for the Commercial Division, Section 202.70(g), Rule 9).
- B. *Confidentiality.* The parties shall promptly enter into and submit to the court (with a request to be “so-ordered”) a Stipulation and Order for the Production and Exchange of Confidential Information in the form promulgated by the Association of the Bar of the City of New York Committee on State Courts of Superior Jurisdiction.

[36.63] XVIII. MISCELLANEOUS—NONBUSINESS

The miscellaneous provisions that follow consist of Guaranty “boilerplate” that sometimes appears but does not seem strictly necessary. One might call these provisions “overkill,” although they will occasionally make a difference. They generally relate to weird hypothetical eventualities that rarely occur, although arguably they “could” occur and hence

⁷² The loan documents should limit Mortgagee’s right to give a Redirection Notice. Tenant and Guarantor will not want to get involved in those limitations.

“should” be addressed. And that is how any type of legal document gets longer and longer—never shorter—over time and how the “base” Guaranty can easily double in length.

[36.64] A. Consent to Jurisdiction

Any Proceeding to enforce this Guaranty may be brought in any state or federal court located in the State with subject matter jurisdiction. Guarantor irrevocably accepts and submits to the nonexclusive personal jurisdiction of each such court, generally and unconditionally for any such Proceeding. Guarantor shall not assert any basis to transfer jurisdiction of any such proceeding to another court. A final judgment against Guarantor in any Proceeding shall be conclusive evidence of Guarantor’s liability for the full amount of that judgment. Any such judgment may be enforced in any other jurisdiction, either inside or outside of the United States, by suit on the judgment. Nothing in this paragraph limits Landlord’s right to enforce this Guaranty in any court with jurisdiction.

[36.65] B. Death or Disability

If Guarantor dies or becomes disabled or incompetent, then, whether or not Tenant is in default under the Lease, Landlord may: (a) make a present claim against Guarantor’s estate in an amount equal to Landlord’s reasonable estimate of Guarantor’s maximum full liability under this Guaranty, measured as if Tenant had defaulted under the Lease beyond applicable cure periods; and (b) require Guarantor’s executor or other personal representative to escrow that amount or any other amount Landlord reasonably determines would be appropriate to cover any possible future claims under this Guaranty.

[36.66] C. Tenant Insolvency Proceeding

If Tenant is subject to any Insolvency Proceeding, then Landlord may, on demand, require Guarantor to deposit with Landlord, as security for Guarantor’s payment and performance, an amount equal to _____. Guarantor shall comply with any such demand within 10 days. Landlord shall apply any such deposited funds against Guarantor’s obligations under this Guaranty, when and as they arise. If a Termination Date occurs, then Landlord shall refund the unapplied amount of the deposit.

[36.67] D. Debt Collection

Guarantor acknowledges that none of Guarantor's obligation(s) under this Guaranty constitute(s) a "debt" under the United States Fair Debt Collection Practices Act, 15 U.S.C. § 1692a(5). Landlord and its counsel do not need to comply with that Act if they make any demand or start a Proceeding to enforce this Guaranty.⁷³

[36.68] E. Demand on Guarantor

Whether or not Landlord has requested payment or performance of any Guaranteed Obligation from Tenant, Landlord may at its option demand that Guarantor pay or perform any Guaranteed Obligation then accrued without demanding that Tenant do so. Guarantor shall promptly comply with any such demand.

[36.69] F. Further Assurances

Guarantor shall execute and deliver such further documents, and perform such further acts, as Landlord reasonably requests to achieve the intent of the parties as expressed in this Guaranty, provided in each case that Landlord's requests are consistent with this Guaranty and the Lease.

[36.70] G. Maximum Guaranteed Amount

Notwithstanding anything to the contrary in this Guaranty, if a court determines that Guarantor's obligations under this Guaranty would otherwise be unenforceable to any extent because of the amount of that Guarantor's liability, then notwithstanding anything else in this Guaranty to the contrary, the amount of that Guarantor's liability under this Guaranty shall be reduced to the maximum amount that is enforceable. That limitation of liability shall in no way limit anyone else's liability.

[36.71] H. Notices

All notices, requests and demands under this Guaranty shall be given in writing at the address in the opening paragraph in accordance with the notice provisions of the Lease. Guarantor and Landlord may each change its address for notices, to any other address within the United States, by notice to the other. Notices shall become effective as the Lease states.

⁷³ If this statement is inaccurate, Guarantor's acknowledgment won't change that. Therefore Landlord and its counsel should consider possible application of FDCPA and not rely on Guarantor.

[36.72] I. Other Guaranties

This Guaranty is in addition to and independent of any: (a) guaranty(ies) executed by any other person(s) and (b) other guaranties of Tenant's obligations executed by Guarantor in favor of Landlord.

[36.73] J. Reimbursement and Subrogation Rights

Guarantor waives⁷⁴ any right to be reimbursed by Tenant for any payment(s) Guarantor makes on account of the Guaranteed Obligations. Guarantor acknowledges that Guarantor has received adequate consideration for execution of this Guaranty by Landlord's entering into the Lease, which benefits Guarantor, as a principal of Tenant. Guarantor does not require or expect, and is not entitled to, any right of reimbursement against Tenant as consideration for this Guaranty. Guarantor shall have no right of subrogation against Tenant or Landlord, and no right of contribution against any other person, unless and until: (a) that right of subrogation does not violate (or otherwise produce any result adverse to Landlord under) any Law, including any Insolvency Law; (b) all Guaranteed Obligations have been paid in full and all other performance required under the Lease has been rendered in full to Landlord; and (c) all periods within which any Person can claim against Landlord for a Recovered Payment have expired with no such claim (that deferral of Guarantor's subrogation and contribution rights, (the "Subrogation Deferral"). To the extent that a court determines Guarantor's Subrogation Deferral is void or voidable for any reason, Guarantor agrees: (a) Guarantor's rights of subrogation against Tenant or Landlord and Guarantor's right of subrogation against Tenant's assets shall at all times be junior and subordinate to Landlord's rights against Tenant and Tenant's assets; (b) Guarantor's right of contribution against any other person shall be junior and subordinate to Landlord's rights against that other person; and (c) Guarantor shall not file a claim in any Tenant Insolvency Proceeding without Landlord's consent.

[36.74] K. Scope of Lease Obligations

Each reference to the "Lease" also includes Tenant's obligations when Tenant occupies the Premises as: (i) a "holdover tenant"; (ii) a "statutory tenant"; or (iii) as the beneficiary under any other rent regulation, mandatory arbitration or other scheme that continues the landlord-tenant rela-

⁷⁴ Guarantor will prefer merely to subordinate and defer any rights against Tenant to Landlord's rights. Language later in this paragraph on the Subrogation Deferral suggests how a subordination and deferral would look.

tionship in a manner not contemplated by the express terms of the Lease. As of the Guaranty Date, however, nothing mentioned in clause “ii” or “iii” now applies.⁷⁵ The “Guarantied Obligations” shall be determined without regard to any (a) Tenant Insolvency Proceeding or (b) determination or limitation that applies to Tenant in any such Insolvency Proceeding, including any limit on Landlord’s recovery under 11 U.S.C. § 502(b)(6) or any similar provision.

[36.75] L. Security

If at any time Tenant is in default under the Lease beyond applicable cure periods, or is the subject of any Insolvency Proceeding, Guarantor shall, on Landlord’s written request, deliver to Landlord cash, a letter of credit or other security satisfactory to Landlord in an amount equal to 110% of Landlord’s reasonable estimate of the amount of Landlord’s claim against Tenant as a result of Tenant’s default.⁷⁶

[36.76] M. Miscellaneous

No course of dealing, trade usage, or parol or extrinsic evidence shall modify this Guaranty or waive any Landlord right. If any court decides that any provision of this Guaranty is unenforceable, then the balance of this Guaranty shall remain fully effective. This Guaranty is an instrument for the payment of money only under Civil Practice Law and Rules 3213 (CPLR).⁷⁷ New York law governs this Guaranty, its interpretation and enforcement and the relationship between the parties.⁷⁸ Guarantor confirms that the recitals of this Guaranty are true and correct. The Lease and this Guaranty are a commercial transaction. Neither is entered into for personal, family, household or agricultural purposes. This Guaranty is executed and delivered to benefit Landlord and its successors and assigns,

75 This concept makes sense but the vast majority of Lease Guaranties seem to get by without it.

76 This is nonstandard but could enable Landlord to act aggressively against Guarantor upon default.

77 Delete preceding sentence for Guaranty of performance. Even for a Guaranty of payment, don’t assume it helps much.

78 Guaranties often require Guarantor to waive the statute of limitations, perhaps because as long as Guarantor is waiving things, the statute of limitations seems like a good thing to add to the list. One might describe this as irrational exuberance in Guarantor waivers. Why should a Guarantor lose the benefit of a general principle of civil procedure that applies to all other obligors under all other contracts? No one expects Landlord, Tenant or any other contracting party to waive statutes of limitation. Why should Guarantor? Such waivers may not be enforceable anyway, but that’s not a reason for Guarantor to accept them.

and no one else. This Guaranty shall bind Guarantor and its administrators, assigns, executors, heirs and successors.

[36.77] XIX. DESIGNATION OF AGENT FOR SERVICE

Language like this sometimes appears, especially for foreign Guarantors.

[36.78] A. Initial Designation

Guarantor irrevocably designates and appoints _____,⁷⁹ whose address is _____, in the Borough of Manhattan, City of New York, as Guarantor's agent ("Agent") to receive, accept and acknowledge, for and on behalf of Guarantor and its property: (a) demands for performance under this Guaranty or the Lease; (b) any notice regarding this Guaranty; and (c) service of any legal process, summons, notices and documents for any Proceeding, including all notices required to institute a Proceeding in any court or in any other way required to confer personal jurisdiction over Guarantor in any court (item "c" being referred to as "Service"). Service may be made on Agent in accordance with the procedures of the court where the Proceeding is pending. Service or demand on Agent shall constitute good and sufficient service and demand on Guarantor for all purposes, including to obtain personal jurisdiction over Guarantor and its property, wherever located, for any Proceeding.

[36.79] B. Preservation of Agent's Status; Replacement of Agent

Guarantor shall take all actions necessary to continue Agent's designation in full force and effect. If Agent becomes unable to act as Agent for any reason, then Guarantor shall forthwith irrevocably designate a replacement Agent satisfying the requirements of this paragraph that would apply to any replacement Agent. Upon written notice to Landlord (but no more often than once every six months), Guarantor may substitute in place of Agent any one other person. If Agent changes its address, then Guarantor or Agent shall promptly notify Landlord. Agent must always have a full-time business office in [New York City].

⁷⁹ Counsel should generally hesitate to accept this appointment as it can only produce grief. Guarantor should appoint a corporate service company and then make sure the corporate service company always has Guarantor's correct address.

[36.80] C. Means of Service

Guarantor irrevocably consents and agrees to Service in any Proceeding by mailing copies of such Service by registered or certified mail, postage prepaid or by third party overnight delivery service such as FedEx,⁸⁰ to Agent as described above or to Guarantor at Guarantor's address stated in this Guaranty or to any other address of which Guarantor shall have given notice to Landlord or to Agent. Service in accordance with this paragraph on Guarantor or Agent shall constitute valid and effective personal service on Guarantor. Any such Service shall be effective upon dispatch as evidenced by the receipt from the Postal Service or delivery service. Any failure of Agent to notify Guarantor of any Service shall not impair or affect the validity of that Service or any judgment rendered in any Proceeding based on it.

[36.81] D. No Limit on Landlord

Nothing in this Guaranty or the Lease limits Landlord's right to (a) bring any Proceeding in any court where Landlord could otherwise validly do so; (b) serve process in any way law allows; or (c) give notice in any way this Guaranty allows.

[36.82] XX. CONCESSIONS TO GUARANTOR

When a Guarantor negotiates a Guaranty, Guarantor may want to seek concessions to prevent unexpected or uncontrollable liability, particularly given that many Guaranty forms seem to go quite far in imposing broad obligations on Guarantor. Here are provisions a Guarantor might add to a Guaranty along these lines. In rare cases, Landlord might include some such concessions in the first draft Guaranty. These provisions all work better in the Lease itself, because Landlord signs the Lease but not the Guaranty, but: (a) Landlord can say in the Lease that Landlord agrees to its obligations under the form of Guaranty attached as an exhibit; and (b) Guarantor will want to protect itself from a Lease amendment that might eliminate these Guarantor protections.

80 Language like this often appears in Guaranties. But the rules of civil procedure do provide reasonable means of serving process. A careful Landlord will probably not rely on language like this paragraph anyway. And a careful Guarantor will argue, legitimately, that this entire paragraph represents another example of a Landlord's irrational exuberance in trimming a Guarantor's rights in a way that goes beyond waivers of case law principles that unreasonably prevent a Landlord from achieving its reasonable expectations as the result of obtaining a Guaranty. On balance, the author disfavors this paragraph, but recognizes that many Guaranties include similar language.

[36.83] A. Assignment to Guarantor

Tenant may assign this Lease to Guarantor without Landlord's consent, provided that: (a) Guarantor assumes this Lease by an instrument reasonably satisfactory to Landlord; (b) at the time of assignment, Guarantor cures all monetary Defaults; (c) with reasonable diligence after the assignment, Guarantor cures all nonmonetary Defaults; and (d) Tenant (assignor) and Guarantor (assignee) deliver an Estoppel Certificate and a waiver of any claims against Landlord.⁸¹

[36.84] B. Confidentiality

To the extent that this Guaranty or the Lease requires delivery to Landlord of any information about Guarantor, Landlord shall maintain the confidentiality of that information, in accordance with the same procedures Landlord would employ for its own information that it desired to keep confidential.⁸²

[36.85] C. Mutual Attorney Fees

If Guarantor prevails in any Proceeding with Landlord, then Landlord shall pay Guarantor's Legal Costs.⁸³

[36.86] D. New Lease⁸⁴

If (a) Landlord terminates the Lease for an Event of Default; and (b) Guarantor fully pays and performs all defaulted obligations of Tenant

81 The waiver of claims may be excessive.

82 One can easily convert these few lines into a few pages, but the few lines say it all. In any case, Landlord will want to avoid any obligation to "enter into a confidentiality agreement" as the price of receiving financial reports down the road. Those agreements can be very difficult to negotiate, if one side or the other wants them to be difficult to negotiate.

83 In the "base case" Guaranty, "Legal Costs" is defined to mean only Landlord's attorneys' fees. One would need to adjust that definition.

84 This paragraph and the next one are optional and reflect concessions a Guarantor might sometimes seek. Giving a Guarantor a New Lease sounds bizarre and rarely appears. Landlords will presumably hesitate to give a New Lease to an Affiliate of a Tenant that defaulted. It may, however, actually help Landlord enforce the Guaranty by showing that the relationship is balanced and reasonable. But Landlord may prefer to decide whether to offer a New Lease only when Landlord enforces the Guaranty. It may make sense to make the New Lease Option something Landlord can choose to initiate. Moreover, Landlord might reasonably argue that if Guarantor wants a New Lease, Guarantor can achieve exactly that result by having Tenant assign the old Lease to Guarantor when Guarantor cures Tenant's defaults. Guarantor is hardly in the same position as a leasehold mortgagee, because Guarantor presumably controls Tenant whereas a leasehold mortgagee does not control its leasehold mortgagor.

under the Lease (not merely the Guaranteed Obligations under this Guaranty),⁸⁵ within 15 days after Lease termination, then upon full completion of all that payment and performance Guarantor shall have the right (the “New Lease Option”) to enter into a new lease for the Premises with Landlord for what would have been the remaining Term of the Lease, on the executory terms of the Lease as it existed before termination (a “New Lease”). To exercise the New Lease Option, Guarantor must, within five Business Days after Lease termination: (x) notify Landlord that Guarantor exercises the New Lease Option, which notice must be accompanied by payment of all sums due under the Lease at termination; and (y) cure all existing Tenant defaults under the Lease, as if the Lease continued. If Guarantor exercises its New Lease Option then Landlord shall promptly prepare at Guarantor’s expense and give Guarantor a New Lease. Guarantor shall sign and return the New Lease within five Business Days after receipt or shall be deemed to have waived the New Lease Option. Any New Lease Option shall be subject and subordinate to Tenant’s claims and any possessory rights of Tenant or anyone claiming through Tenant. Landlord shall make no representation, warranty or covenant of quiet enjoyment under any New Lease.⁸⁶

[36.87] E. Notice and Opportunity to Cure

Landlord shall give Guarantor notice, simultaneous with notice to Tenant, of any Tenant default for which Landlord intends to exercise Landlord Remedies. Guarantor may cure that default on Tenant’s behalf. Landlord shall accept that cure from Guarantor.⁸⁷

[36.88] F. Preserved Defenses

Notwithstanding anything to the contrary in this Guaranty, Guarantor does not waive, and reserves and may assert, any claim, counterclaim, defense or offset that Tenant could validly assert against Landlord arising only from: (a) Landlord’s acts or omissions, including Landlord’s breach

85 This parenthetical applies only if the Guaranteed Obligations consist of less than all the obligations under the Lease.

86 This New Lease Clause may require consent from Landlord’s lender.

87 Guarantor may also want some additional time to cure, similar to the rights of a leasehold mortgagee. That may be excessive.

of the Lease;⁸⁸ (b) the express terms of the Lease; or (c) Tenant's actual payment and performance in accordance with the Lease. In no event shall the Guaranteed Obligations exceed Tenant's express obligations under the Lease on the same matters (plus Legal Costs), except to the extent Tenant's obligations are diminished, limited or terminated through any: (x) Tenant Insolvency Proceeding; or (y) judicial determination that they are unenforceable, in whole or in part, for any reason except those in clauses "a" through "c" of this paragraph.

[36.89] G. Release on Assignment

If Tenant assigns the Lease in compliance with the Lease (except an Affiliate Transaction),⁸⁹ then Landlord shall release Guarantor from this Guaranty (and return the original Guaranty marked "CANCELLED" or deliver a lost document certificate in ordinary and customary form) if Tenant or the assignee: (a) pays by certified check all Guaranteed Obligations then accrued and outstanding; (b) cures all Defaults; and (c) gives Landlord a new Guaranty in the same form as this one, signed and acknowledged by a Satisfactory Guarantor.⁹⁰ That replacement Guaranty must also cover existing undischarged Guaranteed Obligations, if any.⁹¹ A "Satisfactory Guarantor" means a person that, based on Landlord's reasonable confirmation: (a) has a net worth at least equal to [the net worth of Guarantor] [on the Commencement Date] [at the time] [___ times then annual Fixed Rent]; (b) is a person with whom United States persons may legally do business; (c) is subject to the jurisdiction of

88 Landlord may regard clause "a" as very broad, and want to trim it back. On the other hand, if the Lease requires Landlord to do or not do something, and Landlord violates that requirement, and Tenant could have asserted a defense as a result, why shouldn't Guarantor have the same defense?

89 The parties will need to adjust this paragraph based on the negotiated business deal. What type of assignment (and new Guarantor) will get the former Guarantor off the hook? The Lease will set conditions for the permitted assignment, such as no uncured default; completion of construction; prior notice; assumption by the assignee; and criteria the assignee must meet. Those are all beyond the scope of this model Guaranty. The conditions to any release will vary depending on the space, Tenant, Guarantor and market conditions.

90 Rather than define a Satisfactory Guarantor, Landlord would prefer to require: "a replacement Guarantor satisfactory to Landlord in all respects, in Landlord's sole and absolute discretion, including creditworthiness." Without an objective definition of Satisfactory Guarantor, though, the right to replace Guarantor doesn't give Tenant/Guarantor anything more than they would have if the Guaranty were silent. And a "reasonable" Landlord would typically agree to a later substitution of Guarantor, absent extraordinary circumstances, so Landlord isn't really giving up much by agreeing to an objective definition of Satisfactory Guarantor.

91 Tenant may object to this sentence. Landlord's response will depend on circumstances.

_____ and not entitled to any sovereign, diplomatic or other immunity (unless waived in a manner reasonably satisfactory to Landlord); and (d) _____.⁹²

[36.90] H. Termination of Guaranty

If [at any time no undischarged Guarantied Obligations remain or can later arise,⁹³] [Tenant has never been in default under the Lease, beyond applicable notice and cure periods, as of the date _____ months after the Guaranty Date,] then Guarantor's liability under this Guaranty shall terminate, subject to Landlord's rights under this Guaranty on Recovered Payments. At Guarantor's or Tenant's request, Landlord shall promptly confirm that termination of liability in writing⁹⁴ and return the original of this Guaranty marked "Canceled" or deliver a [notarized certificate] [lost document certificate and indemnity] in customary form, reasonably satisfactory to the parties, to that effect. Landlord's failure to comply with the previous sentence shall not limit the effect of any termination of this Guaranty.

92 Add any deal-specific criteria the Satisfactory Guarantor must meet.

93 If Tenant could remain liable under the Lease even after it ends, Landlord should hesitate to define the circumstances under which Landlord will release Guarantor. For example, even after the Lease ends, Landlord could incur liability for which Tenant (and Guarantor) must indemnify.

94 Landlord could argue that under these circumstances the Guaranty is a nullity and Guarantor has no need for a written confirmation. But Guarantors often want one anyway, for essentially the same reason Landlords want lien waivers from potential mechanics' lien claimants even if Tenant has delivered proof of payment.

CHAPTER THIRTY-SEVEN

LEGAL ISSUES, PRACTICES, AND PRACTICALITIES FOR LETTERS OF CREDIT IN COMMERCIAL LEASES, WITH A SAMPLE LETTER OF CREDIT AND COMMENTARY

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* An earlier version of this Chapter appeared as an article in *Bloomberg Law Reports – New York Law*, Vol. 1, No. 1, at 14. That article has been reprinted here, in updated and modified form, with permission. The author acknowledges with thanks the editorial contributions and comments of Leah Fang, a colleague at the author’s previous law firm; Robert G. Harvey, formerly of McKee Nelson LLP; Alfredo R. Lagamon, Jr., of Ernst & Young LLP; Donald H. Oppenheim; other reviewers; and finally one particular reviewer who represents primarily tenants (“Anonymous Tenant’s Counsel”). Anonymous Tenant’s Counsel refused to be identified because this person believes this model L/C overly favors Landlords, but Anonymous Tenant’s Counsel nevertheless offered many extraordinarily useful, careful, and thoughtful suggestions. Blame only the author for any misstatements or misjudgments in this chapter. Copyright © 2017 Joshua Stein (joshua@joshuastein.com).

[37.0] I. INTRODUCTION

When negotiating a prospective business transaction, one party may doubt the credit of another party. To solve that problem, the party with dubious credit (here, an “*Applicant*”) will sometimes give the skeptical party (a “*Beneficiary*”) a standby letter of credit (an “*L/C*”) to back Applicant’s obligations. As a typical example, particularly for purposes of this book, when a commercial landlord (“*Landlord*”) wants security from a tenant (“*Tenant*”) under a commercial lease (“*Lease*”), Tenant will often, as applicant, deliver an L/C to Landlord, as Beneficiary.

To obtain that L/C, Tenant will ask a creditworthy third party, typically but not necessarily a bank (“*Issuer*”) to issue the L/C to Beneficiary. If the Lease or other transaction ever goes into default, Beneficiary can submit to Issuer a document called a “sight draft.”¹ Here, Beneficiary demands that Issuer pay the amount specified in the sight draft, up to the amount of the L/C. This is called “drawing upon” the L/C. When Issuer issues an L/C, Issuer agrees to pay Beneficiary in response to valid sight drafts. Beneficiary can use the proceeds of any draw upon the L/C to cure Applicant’s default, or may retain the proceeds to the extent governing law and documentation allows.²

Issuer will look to Applicant to reimburse any payment Issuer makes in response to any sight draft that conforms to the L/C. Toward that end, Applicant and Issuer will enter into an agreement (a “*Reimbursement Agreement*”). In any Reimbursement Agreement, Issuer agrees to issue the L/C in exchange for a fee, and Applicant agrees to reimburse Issuer for any drawings that Beneficiary makes upon the L/C (in compliance with the L/C), with interest. The Reimbursement Agreement may actually

1 Some authority suggests the drawing document should consist of a “demand” for payment rather than a “draft,” because a “draft” has special meaning in banking law, which sometimes leads to unusually exacting technical requirements. As long as the required form of the document is attached to the L/C as an exhibit and Beneficiary complies with the form, this distinction should not make a difference. In the author’s experience, L/C’s and people who deal with L/C’s refer to “sight drafts” even if they shouldn’t. For more on this topic, see Carter H. Klein, *Standby Letter of Credit Rules and Practices Misunderstood or Little Understood by Applicants and Beneficiaries*, 40 U.C.C.J. 125 (Fall 2007).

2 If any genuine default exists, Beneficiary will typically prefer to apply the proceeds to cure it, as opposed to leaving the proceeds in some escrow or cash collateral account where they may tempt a creditors’ committee.

appear in (or tie to) a larger revolving credit agreement between Applicant (or its parent company) and Issuer.³

If Applicant never defaults, then Beneficiary never draws upon the L/C, and eventually returns it, consents to its cancellation, or lets it expire without submitting a sight draft. Although that outcome is nearly universal, lawyers write Leases and structure L/C to prevent surprises when the exceptions arise.

When Applicant delivers an L/C in a Lease or other real estate transaction, typically no one anticipates that Beneficiary will ever draw upon the L/C. That fact makes such an L/C a “standby” L/C⁴ under L/C parlance.

This Chapter discusses a number of issues, many specific to commercial space leasing, that arise when any Beneficiary accepts a standby L/C to back an obligation.⁵ This Chapter concludes by offering a model L/C, suitable to back Tenant’s obligations under a Lease or almost any other obligation that might require credit enhancement.⁶ It may be overoptimistic to offer such a model, as most L/C issuers insist on using their own model, which typically covers almost all the same ground though not as clearly and simply and with different bells and whistles (optional provisions).

This Chapter and its model L/C mostly focus on Beneficiary’s agenda. Because an L/C constitutes a fairly standard document, one could also use

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- 3 To the extent that Applicant asks Issuer to issue any L/C, Issuer will regard that transaction as a contingent drawdown under the revolving credit agreement. Hence Issuer will block availability under the revolving credit agreement to the extent of all funds available under the L/C. In exchange for bearing the credit risk implied by Issuer’s issuing the L/C, i.e., the risk of having to pay sight drafts upon the L/C and seek reimbursement from Applicant, Issuer will charge a fee that generally equals the margin that Issuer would add to the London Interbank Offered Rate (shorthand for Issuer’s cost of funds, “LIBOR”) for funds actually drawn under the revolving credit agreement. That spread compensates Issuer for credit risk and perhaps gives Issuer some profit, but does not compensate Issuer for the actual use of funds. If Issuer paid a draw upon the L/C, the fully loaded interest rate under the revolving credit agreement would compensate Issuer for (a) cost of funds (LIBOR); plus (b) Applicant’s credit risk and profit (the spread).
 - 4 In contrast, import/export transactions use “commercial” L/Cs, where everyone expects Beneficiary to draw upon the L/C in the ordinary course.
 - 5 The possibility of a Tenant bankruptcy can create thorny issues in this area, at least if the L/C exceeds a year’s rent. Those issues are discussed in another Chapter.
 - 6 Because of the “independence principle” of L/Cs, a standby L/C should require relatively little customizing regardless of the transaction for which the parties use it. Any L/C should simply confirm Issuer’s unconditional promise to pay Beneficiary if Beneficiary presents a compliant sight draft. Just about everything specific to the particular transaction belongs elsewhere.

this model L/C, with care, when acting for Issuer⁷ or Applicant.⁸ Any such use should take into account, among other issues, those flagged in the footnotes of this model L/C. This model L/C was not intended for use as a nonstandby or “commercial” L/C, although it could readily be adapted for that purpose.

[37.1] II. SUBSTANTIVE COMMENTS

Drawing Conditions. If possible, any L/C should not require Beneficiary to provide any certification, prior notice, or third-party verification to draw upon the L/C. As an extreme example of language that any Beneficiary would reject out of hand, an optimistic Applicant once proposed to the author⁹ that any Draw Documents must include this statement:

7 Issuer cares less about the form of the L/C than about the form of the Reimbursement Agreement (either part of the revolving credit agreement between Issuer and Applicant, or a separate agreement). Issuer should stand ready to issue any L/C at all so long as: (a) it’s just an L/C and not, for example, also an agreement to build a house or to dance a jig; (b) the form of L/C and its drawing requirements match Issuer’s operating procedures; (c) the drawing conditions are simple and clear enough so Issuer’s clerical personnel can reliably honor or dishonor a sight draft without parsing words in great detail, involving counsel, or risking liability to either Beneficiary or Applicant; and (d) Issuer is comfortable with Applicant’s credit and the airtight nature and reliability of any Reimbursement Agreement. Issuer can and must treat the issuance of the L/C as an unconditional commitment to make a loan to Applicant at an unpredictable future moment—tomorrow, the next day, nine months from now, whenever Beneficiary draws upon the L/C (at any time before expiry), whether or not Applicant remains creditworthy at that moment or Issuer otherwise would still like to make such a loan. If the conditions listed earlier in this footnote are satisfied, the substantive terms and conditions of the L/C merely determine the timing of Issuer’s loan disbursement. Thus, if Applicant tries to blame Issuer for introducing off-market complexities or conditions into an L/C, Beneficiary should often take Applicant’s claims with a bushel of salt.

8 For a Lease, Applicant would be Tenant. Applicant might also consist of Tenant’s principals or, in the “New Economy” or dotcom world, the venture capitalists that backed Tenant. This Chapter treats the whole group as Applicant, disregarding any issues within the group. Any Applicant will in most cases want to defer, frustrate, and complicate – and ideally prevent entirely – any L/C draw. This Chapter offers plenty of clues for how to do exactly that. A careful Beneficiary, particularly if represented by the author, will try very hard to reject Applicant’s proposals, regardless of how rational, reasonable, earnest, and well thought through they may sound.

9 Anonymous Tenant’s Counsel argues that (a) these drawing conditions are “not so horrible, just snug”; (b) any Landlord can readily meet these conditions; and (c) in any case, at least when Anonymous Tenant’s Counsel reviewed this Chapter, Tenants have the upper hand in Lease negotiations. (Point “c” actually constituted a great argument for most of Anonymous Tenant’s Counsel’s positions summarized in these footnotes, but is now out of date as of 2016, at least for the moment.) Hence Anonymous Tenant’s Counsel, when representing Tenant, would push hard to obtain exactly these drawing conditions and would expect to succeed. Landlord’s counsel would regard this language as an exercise in fantasy, creativity, and overly aggressive and off-market lawyering. “It’s off market” is always an interesting argument. As its subtext, it implies that the proponent of the “off market” position does not know what they’re doing and lacks experience.

Beneficiary represents, warrants, and certifies, under penalty of perjury, that: (a) Applicant has defaulted in performing these obligations under the _____ dated _____ between Applicant and Beneficiary (the “Agreement”): _____; (b) such default was not excused by any failure or nonperformance by Beneficiary under the Agreement; (c) Beneficiary has properly given notice of Applicant’s default¹⁰ to Applicant and all other parties entitled to such notice, at the addresses shown and in the forms attached as Exhibits hereto, all in full compliance with Lease requirements; (d) after the giving of such notice, any and all cure periods under the Lease have expired; (e) Beneficiary has given Applicant and _____ a copy of the form of this certification and notice that Beneficiary intends to submit Draw Documents; and (f) at least _____ business days has elapsed since such notice.¹¹

Pre-Existing Debt. An L/C delivered to back pre-existing debt may raise issues in Applicant’s insolvency or bankruptcy. Avoid accepting an L/C under those circumstances, at least not without fully considering bankruptcy issues. In some instances, the parties can structure the use of an L/C in a way that will minimize these issues.

Negotiation of L/C Forms. To Beneficiary, the purpose of an L/C is usually to provide cash-equivalent security. Beneficiary should not readily agree to bear even “small risks” in the name of compromise and accommodation. The L/C should remain airtight notwithstanding any negotiated changes. Beneficiary should always have the equivalent of a cash deposit, at least until L/C expiry.

10 If Applicant were subject to bankruptcy proceedings, any such notice to Applicant would violate the automatic stay. This does not limit the grounds on which Beneficiary should object to almost every line of the proposed language.

11 Beneficiary and its counsel assume that Applicant wants notice and a waiting period so Applicant can try to enjoin or otherwise prevent Issuer from honoring Beneficiary’s draw upon the L/C, or conceivably file bankruptcy in the hope that it might frustrate Landlord’s drawing upon the L/C. Anonymous Tenant’s Counsel argues that Issuer will notify Tenant of any draw anyway before paying Landlord’s sight draft, so requiring Landlord to give prior notice does not give Tenant anything it does not already get anyway. And it gives Tenant, with certainty, a short window of time in which to try to educate Landlord on why Landlord should not draw upon the L/C, enabling Tenant to prevent unjustified surprises and emergencies. Landlord would argue, among other things, that Tenant should rely on its understanding with Issuer about prior notice. Landlord will typically draw a line in the sand on the “prior notice” issue and expect to get away with it, subject always to market conditions.

Tenant Concerns. Any Tenant may worry that Landlord may draw upon the L/C wrongfully, or wrongfully apply the proceeds of a rightful draw on the L/C. Tenant's concerns track any Tenant's concerns when Landlord holds a large cash security deposit. To respond to those concerns, Tenant may insist that a third party, such as Landlord's lender ("*Lender*"), if a reliable institution, hold the proceeds of any L/C draw pending resolution of any dispute. Tenant may also demand the right to offset rent if Landlord misuses the L/C. Because that right loses value as the remaining Lease term diminishes, Tenant may insist that the amount of the L/C drop over time. Tenant may make this request anyway as a business matter. Tenant might also mitigate its concerns by asking that Lender hold and control the L/C even before Landlord (or Lender) makes any draw upon the L/C – a common Lender request for large L/Cs, and a deal structure that raises issues beyond the scope of this book. If Tenant seriously worries about Landlord's possible misuse of the L/C, Tenant may want to consider dealing with some other Landlord instead.

[37.2] III. INDUSTRY STANDARD PRACTICES FOR L/Cs

In 1998, the International Chamber of Commerce released a set of standards designed specifically for standby L/Cs, the International Standby Practices ("*ISP*"), offering a more tailored alternative to the earlier Uniform Customs and Practice for Documentary Credits, International Chamber of Commerce Publication No. 500 (as updated in 2007 in Publication No. 600, "*UCP*"). UCP relates to L/Cs generally, both standby and commercial.¹² ISP can be read in well under an hour. Unlike UCP, ISP is written in ordinary and straightforward English.

Footnotes in the model L/C highlight some consequences of using ISP rather than UCP. In addition to those consequences, ISP eliminates the need for some language often seen in L/Cs, and includes these provisions worth noting:¹³

12 Uniform Commercial Code Article 5 also governs L/Cs. UCP and ISP modify and supplement (and largely override) the legal provisions that would otherwise govern. The Official Comments to Article 5 play an unusually important role in its interpretation.

13 ISP also contains many other noteworthy provisions. Anyone who works with standby L/Cs should buy and read ISP. It is available at modest cost from its issuer, the International Chamber of Commerce, store.iccwbo.org (search for "Standby"). The fact that ISP eliminates the need for certain language does not mean that such language is harmful. Typically, the unnecessary verbiage, if reinstated, makes Beneficiaries comfortable and does no harm.

- *Issuer's Funds.* Some L/Cs say Issuer must pay from its own funds. ISP § 1.10(a)(iv) eliminates any need to say that.
- *Irrevocable/Unconditional.* Many L/Cs insert the word “irrevocably” to modify Issuer’s agreement to pay a drawing made upon an L/C. ISP eliminates the need for that word. ISP § 1.06(a). Similarly, ISP §§ 1.06(a) and 1.10(a) eliminate the need for an L/C to say it is “irrevocable and unconditional.”
- *Bad Amendments.* Some L/Cs include a statement like this, often just before the signature: “If any amendment adversely affects Beneficiary, it shall not become effective without Beneficiary’s written consent.” ISP §§ 1.06(b) and 2.06(c) eliminate the need for such a statement. ISP § 7.01 gives a Beneficiary similar protection for any possible L/C cancellation. Hence this model L/C does not mention these points.
- *Partial Transfer.* ISP § 6.02(b)(ii) says any L/C “may not be partially transferred,” eliminating the need for any such limitation in the L/C.
- *Closed Office.* If Issuer’s office for presentation of the L/C is closed on the last business day when Beneficiary can present the L/C, then the L/C will automatically remain in effect until 30 days after the office reopens. ISP § 3.14(a). Issuer need not, however, notify Beneficiary of the reopening. Beneficiary will need to figure out for itself.¹⁴

If an L/C “worked” for UCP, then switching to ISP requires no significant changes to the L/C text, though it allows some minor deletions. As the main change, one must replace references to UCP with references to ISP. Nothing in ISP requires any magic language that a well written UCP L/C would not already contain. ISP may matter more in administering, drawing upon, and otherwise living with L/Cs after issuance. ISP was

14 Beneficiary could, conceivably, ask Issuer to agree, in the L/C, to give notice of reopening, but such provisions typically do not appear in an L/C. Could Issuer remember to give that notice under all affected L/C’s?

designed specifically for standby L/Cs. Thus, for a standby L/C, it makes more sense to use ISP than UCP.

[37.3] IV. POINTS NOT COVERED

This model L/C seeks to achieve minimalism and simplicity, consistent with the usual goal of keeping any L/C as short and simple as possible. Any party to an L/C transaction, or its counsel, can readily think of ways to complicate and lengthen any document, including any L/C, sometimes based on the circumstances of a particular transaction and other times driven by personal taste or bad experiences. Here are some examples of nonstandard provisions that the parties may want to add to an L/C for a particular transaction or to address particular concerns.

Changes in Amount. The parties may want to build into the L/C future reductions in its face amount. In a Lease, for example, the required security might drop over time.¹⁵ Beneficiary will want to assure that this reduction takes place in a way that does not imperil Beneficiary's security if problems arise. This entire issue is best addressed in the underlying documentation (e.g., the Lease) between the parties. That documentation should allow Applicant to amend the L/C to reduce its amount, but each amendment should still require Beneficiary's formal written consent. This way, Beneficiary can protect itself against "stealth" L/C reductions that no longer should occur, for which Applicant failed to satisfy all conditions, or for which Beneficiary failed to pay enough attention.

Tenant would argue that if the parties have negotiated a "burn-down" of the L/C over time, then it should happen automatically, and Tenant should not find itself at the mercy of an uncooperative, slow, or overly punctilious Landlord. As a practical matter, Tenant may very well have cash-collateralized its L/C, and if the business deal contemplates a partial release of the L/C, then Tenant should receive back some of its cash collateral automatically. Tenant would argue that the burden should rest on Landlord to take action to stop the automatic reduction of the L/C. The very notion of automatic reduction may worry Landlord.

Special Protections. Beneficiary may worry about some risks that an L/C creates, and might want to mitigate them by adding additional (nonstandard) provisions to the L/C or the underlying contract documents. These

15 Tenant may, for example, worry about Landlord credit issues near the end of the term. Even part way through the term, Tenant can reasonably argue that Landlord's credit exposure has diminished over time, entitling Tenant to reduce the amount of the L/C. Having Lender hold the L/C can help solve this problem, if accompanied by appropriate protections.

risks might include the possibilities of: (a) an injunction or temporary restraining order preventing a draw upon the L/C; (b) Issuer's insolvency or closure; (c) Applicant's insolvency; and (d) Applicant's payment of the L/C-backed obligation, after which Beneficiary releases the L/C, after which Applicant files bankruptcy and its estate seeks to claw back the payment. Though these risks have actually "hit" L/C Beneficiaries in various reported cases, they are generally not regarded as major risks and likely to recur. Provisions to address these risks have traditionally not appeared in L/Cs, and hence this model L/C does not include them. Counsel could craft them as appropriate or desired in particular cases. The author can provide sample language.

Multiple Beneficiaries. If multiple parties have an interest in the proceeds of an L/C, they must agree how to protect their respective interests. As a common example in commercial real estate transactions, Landlord's Lender may want to control the drawing process and proceeds of an L/C that replaced a cash security deposit, particularly a large cash security deposit.¹⁶ Restrictions on assignability of L/Cs, the requirements for perfection of a security interest, Lender's general need to protect its security, Tenant's concerns about the use of the L/C and its proceeds, and the practical mechanics of any L/C create a robust three-party agenda among Tenant, Landlord, and Lender. Full and proper resolution of that agenda can require a complex and sophisticated (and tedious) three-party agreement, a matter beyond the scope of this Chapter.¹⁷

Notice of Transfer. Although a Beneficiary cannot transfer an L/C easily,¹⁸ this model L/C solves that problem by saying Beneficiary can freely transfer the L/C upon notice to Issuer, provided that Issuer can legally do business with the transferee.¹⁹ Should Beneficiary also notify Applicant of the transfer? If so, that point belongs in the Lease or other underlying agreement, not the L/C.

16 If an L/C replaces a large security deposit, Landlord and Lender would like to try to recharacterize an L/C as something other than a security deposit or a substitute for one. If they say it enough times, maybe it will be true. If the security deposit or L/C exceeds a year's rent, Landlord would be well advised to have the Guarantor (either a very creditworthy party or a single-purpose entity) rather than the Tenant deliver it.

17 The author can provide a sample agreement on request. As a "lite" solution to this problem, Landlord might give Lender the original L/C and a signed drawing certificate. Of course, Landlord could still terminate the signer's authority and notify Issuer of that termination. A Lender might mitigate that risk through a tailored nonrecourse carveout.

18 ISP § 6.02(a) states that a standby L/C "is not transferable unless it so states."

19 For example, anti-money-laundering law and the USA PATRIOT Act prohibit certain financial institutions (all likely Issuers) from doing business with certain persons.

Lost L/C. As a fundamental expectation in commercial real estate transactions, Beneficiary must present an original L/C to draw upon it.²⁰ If Beneficiary cannot locate the original, Beneficiary loses.²¹ The original L/C therefore matters far more than an original promissory note.²² Widespread awareness of the importance of original L/Cs means that any Beneficiary focuses very carefully on storing, tracking, and knowing where to find original L/Cs. The requirement for an original also facilitates the reliable transfer and collateral assignment of L/Cs, and the reliable perfection of security interests in L/Cs. But it also creates a huge pitfall for any Beneficiary.

A Beneficiary concerned about this pitfall could propose language in the L/C to address it. For example, Beneficiary might try to remove any requirement to deliver the original L/C when drawing upon it. Any such proposal would not be market standard, at least in commercial real estate, but Issuers do sometimes agree to it.²³

Without going as far as entirely removing the requirement for an original, this language (similar to the procedures for lost notes or lost cashier's checks) might help mitigate a Beneficiary's concern:

(a) *Reissuance Package.* At Beneficiary's request at any time before the Expiry Date or whenever this L/C requires Beneficiary to deliver to Issuer the original of this L/C (the "*Original*"), Beneficiary may deliver the following to Issuer (collectively, a "*Reissuance Package*"):

(1) *Status of Original.* Either (i) if the Original has been damaged or mutilated, then the damaged or mutilated

20 If Issuer has amended the L/C, the same requirements apply to any amendments.

21 ISP provides, for example: "If an original standby is lost, stolen, mutilated, or destroyed, the issuer need not replace it or waive any requirement that the original be presented under the standby." ISP § 3.12(a).

22 Mortgage lenders routinely misplace, destroy, or lose most promissory notes. The 2008 financial crisis and subsequent litigation demonstrated the prevalence of this problem and the delay and spurious issues it can cause.

23 Not requiring an original of the L/C may raise its own issues. For example, Beneficiary will want to prevent a fraudulent draw upon the L/C. As one solution, the L/C might specify the exact account into which Issuer will fund the proceeds of any draw. That might leave open the risk that someone could improperly request an amendment of the L/C to change the account number – a risk that might increase if that person didn't need to deliver the original L/C to obtain an amendment.

Original, or (ii) if the Original has been lost, misplaced, or destroyed, then Beneficiary's certification to that effect;

(2) *Indemnity*. Beneficiary's indemnity in ordinary and customary form against any claims or drawings that may be made against Issuer on account of the Original, expiring 60 days after the then-current Expiry Date (the "*Indemnity*"); and

(3) *Bond*. Unless Beneficiary's credit is reasonably satisfactory to Issuer, a bond or other security for the Indemnity.²⁴

(b) *Effect of Reissuance Package*. After Beneficiary delivers a Reissuance Package to Issuer:

(1) *Drawing*. If Beneficiary is otherwise entitled to draw upon the L/C, then Beneficiary may do so as if Beneficiary had submitted the Original; and

(2) *Replacement Original*. Issuer shall, upon request (except to the extent that Beneficiary simultaneously draws upon the L/C), reissue the Original simultaneously with receipt of, and in exchange for, the Reissuance Package. Any such reissued Original shall be deemed the Original L/C for all purposes.

Nonconforming Draw. General principles of entropy may cause: (a) any Beneficiary to wait until the last minute to draw upon an L/C; (b) that last-minute drawing to be defective, because drawing an L/C can turn out to be more difficult than Beneficiary expected; and (c) Beneficiary to lose out as a result, because Beneficiary does not have time for a "do over." To respond to that possibility, one could add this language, which can help a Beneficiary, but is utterly nonstandard:

If (a) Beneficiary attempts to draw upon this L/C in the last ____ Banking Days before the Expiry Date and (b) Beneficiary's Draw Documents are for any reason incomplete, ineffective, defective, or incorrect, or incorrectly

24 Consider deleting clause (3), at least as long as Beneficiary has not transferred the L/C. Any requirement for a bond will incur significant costs and create issues if Beneficiary ever actually must deliver a Reissuance Package.

presented, then the Expiry Date shall automatically be extended (but only once) until the date ____ Banking Days after Issuer first notified Beneficiary of occurrence of (b), including a reasonably detailed explanation of all deficiencies.

Effect of Nonrenewal. This L/C includes “evergreen” language, so that the expiry date automatically renews every year. That structure has become quite common, eliminating the need to require annual renewals and the attendant risk of Issuer’s forgetting to monitor the renewals. In theory, this language allows Issuer to avoid incurring credit risk for more than a year at a time, thereby keeping bank regulators happy. But an evergreen structure also creates evidentiary issues: Beneficiary cannot easily prove (or satisfy itself) the L/C remains in effect after the stated initial expiry date. The model L/C accompanying this Chapter includes language to require Issuer to confirm the current expiry date of the L/C from time to time.²⁵ Beneficiary’s risk of missing a nonrenewal notice amounts to substantially the same risk as Beneficiary’s forgetting about the expiry date and letting the L/C expire without being drawn. Both represent any Beneficiary’s single largest pitfall in accepting an L/C.

Deemed Draw at Expiry. Beneficiary may want the L/C to say that if the L/C expires (especially an expiration because Issuer blocked an automatic “evergreen” renewal) and has not been drawn upon, then Beneficiary will be deemed automatically to have drawn upon the L/C the moment before it expired (much like the treatment of exchange-traded options). From Landlord’s perspective, this would seem a perfectly reasonable and appropriate way to eliminate the biggest pitfall in accepting any L/C – the risk that it will expire without being drawn upon when it

25 If Issuer fails to provide the confirmation, Beneficiary would want the right to draw upon the L/C. The Lease or other underlying agreement would need to cover this point.

should have been. Such measures rarely appear, though.²⁶ This language, which is entirely nonstandard, should adequately protect Beneficiary:²⁷

Effective on any Expiry Date,²⁸ Beneficiary shall automatically be deemed to have validly presented to Issuer fully conforming Draw Documents for the entire remaining amount of this L/C. Issuer shall then, both before and after the Expiry Date:

(a) *Obligation to Pay.* Be irrevocably and unconditionally obligated to pay the entire amount of this L/C to Beneficiary;

(b) *L/C Proceeds.* Hold the proceeds of such deemed draw solely for Beneficiary's benefit, pending Beneficiary's written directions on disbursement, and promptly comply with such written directions;

(c) *Required Documents.* Be entitled to require, simultaneously with such disbursement (solely to complete Issuer's files), that Beneficiary present either (i) Draw Documents in the form this L/C would otherwise require; or, at Issuer's option, (ii) the original of this L/C and Beneficiary's consent to its cancellation.

26 Tenant might worry that an automatic draw upon expiration could create exposure for Tenant if, for example, Tenant has just delivered a replacement L/C but Issuer hasn't yet realized that this has occurred. If one wanted to provide for automatic draws on expiry, it would be easy enough to address Tenant's concern.

27 The author has never seen such language in an L/C. Anonymous Tenant's Counsel worries that the proposal in text may not be consistent with the fundamental theory of standby L/Cs; in other words, automatic draws under any circumstances are just not part of the vocabulary of L/Cs. But why not? The author would argue that any expiry of an L/C without a draw (unless Beneficiary has consented to termination of the L/C) will always correlate with circumstances where Beneficiary should receive a cash deposit, at least in temporary substitution for the L/C. Thus, the concept of automatic payment merely protects Beneficiary from falling into a trap, and nothing prevents the parties from agreeing to precisely such an arrangement.

28 An earlier version of this model L/C offered language deeming a draw to have occurred as soon as Issuer sends or Beneficiary receives any Nonrenewal Notice. Anonymous Tenant's Counsel described that concept as "just nuts" and argued "you can't do that." Anonymous Tenant's Counsel considered it elementary and obvious that Tenant should always get notice of nonrenewal and should have an opportunity to solve any problem before Landlord precipitously goes ahead and draws the L/C. Anonymous Tenant's Counsel says Tenant should not find itself in a position where Landlord holds Tenant's cash and Tenant has to "beg" to get it back. The author found those arguments persuasive, and thus the suggested language now defers any deemed draw until an actual Expiry Date has occurred (either because the L/C specifies a hard Expiry Date or because Issuer elects not to renew an "evergreen" L/C). Given industry standards and Issuer expectations, however, the entire debate remains academic.

Expiry Reminder. Along similar lines, and just as rare, the L/C might obligate Issuer to remind Beneficiary 30 days before the L/C expires that it is about to expire (for example, because of the impending outside Expiry Date of an evergreen L/C). Failure to deliver the reminder notice would extend the Expiry Date.²⁹

Transfer Fees. Issuer will typically expect to collect a transfer fee if Beneficiary ever transfers the L/C (for example, if Landlord sells or refinances the building). Beneficiary will want Applicant to bear this fee. If Applicant is willing to do so (perhaps subject to some limit on frequency), then the Lease or other underlying agreement would incorporate that concept and let Beneficiary draw upon the L/C if Applicant does not pay. As an alternative, Beneficiary might insist that Issuer address all fees in the reimbursement agreement with Applicant, and leave Beneficiary out of it. In that case, Beneficiary might request this language in the L/C:

Issuer shall look solely to Applicant to pay any fee for any transfer of this L/C. Such payment is not a condition to any transfer.

Beneficiary can solve this problem by saying in the Lease or other agreement that if the Issuer requires Beneficiary to pay a transfer fee and Applicant doesn't pay it, then Beneficiary can draw the L/C.

[37.4] V. SOME ISSUES TO CONSIDER

Beneficiary and its counsel will want to think about these issues when Beneficiary accepts an L/C.

Escrow. Try not to place any L/C in escrow. If a dispute arises about the underlying transaction, Applicant may try to direct the escrowee (sometimes called escrow agent) not to draw upon the L/C. In that case, the escrowee may “freeze” while the L/C expires. On the other hand, one can probably eliminate this risk through appropriate drafting in the escrow documentation, with a suitable acknowledgment from the escrowee and all other parties. One could also provide for a “deemed draw” upon expiry, as suggested above.

²⁹ In a transaction the author handled in the second half of 2008, Beneficiary requested such comfort. With difficulty, Applicant eventually convinced Issuer to agree to provide a reminder notice before the outside expiry date. While the parties spent time and legal fees dealing with this and other similar creative issues, the stock market and commercial real estate market began their collapse. Applicant decided not to proceed at all. In perfect hindsight, Beneficiary might have done better by taking the less-sophisticated L/C that Applicant offered, dropping this and all other creative and cutting-edge issues, and just closing the deal.

Expiry. The “expiry date” (not “expiration date” in L/C usage) of any L/C should be at least 30 days, preferably up to 90 days, after the last day by which Applicant must perform the obligation that the L/C backs. Give Beneficiary some time to draw upon the L/C if necessary – twice, if necessary, just in case the first draw doesn’t get it right. Depending on the circumstances, Beneficiary might need some time to calculate Tenant’s final rent bill under the Lease, or Tenant’s last rent check might bounce. Beneficiary will not want to feel pressured during that process, and Applicant will not want Beneficiary to “jump the gun” and submit a sight draft under the L/C. The L/C expiry date should give Beneficiary enough time to pull together a final bill that Landlord knows will be reliably final and confirm that any other loose ends have been fully tied up.

Signing Procedures. Make the drawing procedures particularly simple and direct so they do not create issues. For example, if Landlord is a joint venture with complicated signing authority, don’t require Landlord to sign Draw Documents. Instead, state that any designated venturer may sign them. Keep the Draw Documents as simple as possible – ideally just a sight draft and the L/C, without a drawing certificate or third-party evidence of anything. The more flexible the L/C offers about who may sign Draw Documents, and what they must include, the easier and quicker the L/C will be to draw upon if the need ever arises (and the less likely Beneficiary will need to try more than once to achieve a successful draw). This may make a great deal of difference when any Beneficiary actually tries to draw upon the L/C, often a few days before the expiry date. On the other hand, the easier an L/C is to draw upon, the more one must consider the risk of fraudulent diversion of the proceeds. As a fraud prevention measure, the L/C might designate exactly how Issuer must disburse the proceeds of any draw.³⁰

Beneficiary’s Address. If Issuer ever sends any Nonrenewal Notice, or other notice, Issuer will send it to Beneficiary at Beneficiary’s address stated in the L/C. Beneficiary must know when it has received such a notice, and act upon it. If Beneficiary is a large organization, any such notice may get lost. Therefore, Beneficiary’s address should include information that will help prevent this from happening. Particularly for a long-term L/C, Beneficiary should avoid having L/C notices go to specific individuals. Instead, the address of the notice recipient should refer to a position, such as “Attention: Director of West Coast Leasing,” and an

30 Looking ahead, fraud-related issues like these may attract more attention from all parties to business transactions than in the past.

identification number for the particular lease or contract.³¹ The L/C might also require any notices to go to two or more recipients, with a copy to designated counsel. If any notice recipient relocates, the parties must remember to correct the L/C notice address and make appropriate mail forwarding arrangements, and then remember to renew those arrangements when they expire. If Beneficiary replaces its counsel, Beneficiary should remember to tell Issuer, in compliance with any notice procedures under the L/C. These concerns become even more important than usual for notices under an evergreen L/C, with the risk of early and unexpected nonrenewal.

[37.5] VI. OTHER DOCUMENTATION

Anyone using this model L/C should also consider these documentation issues for the overall transaction, including items and exhibits they must attach to the L/C.

Underlying Obligation. An L/C merely secures an underlying obligation. The underlying documentation (e.g., the Lease) should clearly describe that underlying obligation and clearly allow the L/C beneficiary to draw upon the L/C under appropriate circumstances³² without satisfying burdensome conditions or drawing requirements. Applicant will want to be able to reduce or replace the L/C, and may want some flexibility about the form of future replacements. The author can provide standard contract language for use when an L/C backs any obligation. Some of these provisions are non-obvious. To avoid bankruptcy risks relating to Applicant, Beneficiary would in theory prefer a “direct pay” L/C, so that Beneficiary never accepts payment directly from Applicant, but instead only from Issuer (by drawing upon the L/C), even if Applicant would otherwise pay the obligation in the ordinary course without a default. Such an L/C might no longer be considered a “standby” L/C.

31 To avoid issues, the L/C should state that any notice will not be effective unless it contains all the required information.

32 Beneficiary would want those circumstances to include: (a) an Event of Default under the Lease or other agreement; (b) Issuer downgrade; (c) Issuer's failing to maintain an office in a particular place where the L/C can be drawn; (d) Applicant's failing to pay any cost of transferring or re-issuing the L/C when necessary; (e) other possible impairment of the L/C; (f) Applicant's or possibly some other person's (e.g., a guarantor's) bankruptcy (or similar event), even if not enforceable against Applicant as an Event of Default; and (g) upcoming L/C expiry (e.g., within 60 days) unless Applicant has satisfactorily renewed or replaced the L/C. Before Beneficiary draws upon the L/C, Applicant will seek notice and opportunity to cure at least some of these circumstances, many of which do not constitute a default under the Lease or otherwise reflect adversely on Applicant/Tenant. Beneficiary should resist, but should agree to release the L/C proceeds if Applicant somehow cures the problem and restores the L/C after Beneficiary drew upon the L/C.

Additional Exhibits to L/C. One could attach to any L/C exhibits setting forth the required forms of certain additional ancillary documents. Those could include: (a) drawing certificate, which would require Beneficiary to certify the circumstances that entitle Beneficiary to draw upon the L/C; and (b) termination certificate. This model L/C omits a form of drawing certificate because a Beneficiary should try to reject the entire concept of any drawing certificate. This model L/C omits a form of termination certificate because it rarely causes trouble. If anyone wants to include a termination certificate, they certainly can. It just creates some extra work and offers an easy opportunity to complicate and lengthen any document unnecessarily. The author can provide sample termination certificates. One might argue that even the two exhibits attached to this model L/C are neither crucial nor worth the time they might take to prepare and negotiate.

Where's the L/C? Counsel to Beneficiary must determine how best to hold the L/C (for example, in a vault). Establish a clear written record and a receipt showing who received the L/C after closing, and who will monitor it. Distribute that written record to everyone who might need to find the L/C. File a copy in each place where someone might look for the L/C, including the closing document set for the transaction. When Beneficiary assumes counsel holds the L/C, counsel should be ready to show, beyond question, that someone else dropped the hot potato.

Reimbursement Agreement. Issuer will confirm that its Reimbursement Agreement is in place before Issuer issues an L/C.³³ To the extent that the expiry date of an L/C does not coincide with the expiration/termination date of Applicant's revolving credit agreement, Issuer may find itself in a somewhat awkward position if an L/C remains outstanding at that point. When the credit agreement expires, it should require Applicant to cash collateralize any open L/Cs, or arrange replacement L/Cs from the new revolving lender.³⁴ The credit agreement might also excuse Issuer from issuing any L/C whose expiry date postdates the scheduled termination date of the credit agreement.

33 Beneficiary may sometimes want to be a party to the Reimbursement Agreement, or at least receive copies of notices under the Reimbursement Agreement or related revolving credit agreement. This might allow Beneficiary to monitor any possible problems involving Applicant. One might also describe the concept as an example of lawyers thinking too hard.

34 This assumes the absence of a credit crisis at that particular moment. If Applicant anticipates needing to replace an L/C because of a change in Applicant's revolving lender, the underlying document (e.g., the Lease) will need to give Applicant that right. Otherwise the outgoing revolving lender may need to leave its L/C outstanding, and then back that L/C with a new L/C in its favor issued by the incoming revolving lender.

Other Reimbursement Obligations. The Reimbursement Agreement between Issuer and Applicant does not exhaust the reimbursement issues that lurk behind any L/C. If Applicant reimburses Issuer for a draw, should Applicant have any rights against anyone else? For example, if Applicant constitutes only one of several partners of Tenant, should the other partners agree to reimburse some share of any reimbursement payment Applicant might make to Issuer? Are those partners creditworthy? Should the reimbursement obligation come from the other partners' ultimate owners or principals? And how should the partnership agreement treat any payments Applicant makes to Issuer, and any reimbursements of those payments? Does Applicant (if not actually Tenant) want any right to participate in negotiations that might precede a draw upon the L/C? The parties should negotiate and sign appropriate documents to deal these issues when Applicant obtains the L/C and gives it to Beneficiary.

Noncompliant L/C. The Lease might say that Landlord may accept an L/C that does not fully meet Landlord's requirements, with Tenant obligated to fix it quickly. If Tenant does not, then Landlord can draw. Such provisions may save time and trouble during the L/C issuance process for a closing. If Landlord accepts a noncompliant L/C, then Landlord must remember to follow through and fix it, often easier in theory than practice.³⁵ As a far superior alternative, Landlord should insist on seeing a draft of the L/C well before the Lease signing date, and all parties should encourage Issuer not to actually "issue" the final L/C until Landlord has actually approved the draft. (Premature issuance seems to be quite common, and sometimes leads to discussions about multiple issuance fees.)

Tickler File Entry. Place reminders of any upcoming expiry date(s) on a calendar and in an appropriate "tickler" file. Remind the client to do the same, preferably in writing. Allocate this responsibility in an unambiguous way, to avoid claims that counsel agreed to monitor the upcoming expiry date and the need to draw upon the L/C, unless counsel intends to assume such responsibility, usually inadvisable. If counsel does remind Landlord of an upcoming expiry date, counsel should also remind Landlord that counsel does not assume responsibility to remember future expiry dates.

35 See Joshua Stein, *After the Closing: A Legal Tragedy That Didn't Need to Be*, ABA Prob. & Prop. J. (Nov./Dec. 2001), at 54. Another version of that article appears as Chapter 16 of Joshua Stein, *A Practical Guide to Real Estate Practice* (2001).

[On Letterhead or L/C Letterhead of Issuer.]

LETTER OF CREDIT³⁶

Date: _____, 201_

_____ (“Beneficiary”)

Attention: _____

L/C No.: _____

Ladies and Gentlemen:

_____ (“*Issuer*”) establishes³⁷ in favor of Beneficiary the irrevocable³⁸ Letter of Credit numbered as identified above (as validly amended and extended from time to time, the “*L/C*”) for an aggregate amount of \$_____, expiring at __:00 p.m. on _____ or, if that day is not a Banking Day, then the next succeeding Banking Day (that date, as extended from time to time, the “*Expiry Date*”). “*Banking Day*” means a weekday except a weekday when commercial banks in _____ are authorized or required to close.

Issuer authorizes Beneficiary to draw upon Issuer for the account of _____ (“*Applicant*”), under the terms and conditions of this *L/C*.

Funds under this *L/C* are available by presenting these documents (the “*Draw Documents*”): [(a) the original *L/C* and (b)]³⁹ a signed sight draft

36 This model *L/C* should be used only by attorneys familiar with *L/C* procedures and admitted to practice in the jurisdiction whose law governs this *L/C*. Any such attorney may obtain an editable version of this model *L/C* from the author. The author provides no assurances about the enforceability or sufficiency of this model *L/C*, either generally or for specific transactions.

37 Issuers often write *L/C*s in the first person plural, drifting into and out of the third person. Consistent use of the third person seems more appropriate.

38 ISP makes this word unnecessary, but Beneficiaries like it.

39 Almost every *L/C* requires Beneficiary to deliver the original *L/C* when drawing. Without such a requirement, one would want to add a statement like: “Beneficiary need not present the original of the *L/C*.” This approach could simplify Beneficiary’s life, but it is off market and could introduce potential for confusion or even fraud. See also the further introductory comments about lost *L/C*s.

[substantially]⁴⁰ in the form of Exhibit A, with blanks filled in and bracketed items provided as appropriate. Beneficiary need not provide any other evidence of authority, certificate, or documentation.⁴¹

Beneficiary must present Draw Documents at Issuer's office at _____⁴² on or before the Expiry Date by personal presentation, overnight courier such as FedEx, or messenger,

Beneficiary may also present Draw Documents on or before the Expiry Date by fax to (____) ____-____. Issuer may change its fax number by written notice to Beneficiary identifying this L/C by number.⁴³

Beneficiary may also present Draw Documents on or before the Expiry Date by scanning such Draw Documents and submitting the entire scan image (in PDF, JPG, TIF or other widely accepted graphic format) as an attachment to an email message sent to _____@_____ or _____@_____,⁴⁴ with "read receipt" requested. Issuer may change its email address by written notice to Beneficiary identifying this L/C by number. If Beneficiary submits Draw Documents by email in accordance with this paragraph and all such email messages are returned

40 Unlike ordinary contract law, L/C practice typically does not tolerate "substantial compliance." Issuer may favor the standard of "strict compliance," which has traditionally governed L/C practice. There is, however, some movement from "strict" to "substantial" compliance, even in the world of L/C's. *See, e.g.*, UCP Articles 14 and 16. As a compromise, the L/C could say: "Typographical errors shall not constitute discrepancies unless they refer to the date, amount, or identifying number of this L/C."

41 ISP negates any requirement for any "solemnity, officialization, or any other formality." ISP § 4.12(a). In general, if a signature looks like it complies with the L/C, then ISP treats it as compliant. ISP § 4.07. This eliminates any need to refer to the "purported" signature of Beneficiary. One might argue that the preceding sentence in the model L/C adds no value, but it may give comfort to Beneficiary.

42 Beneficiary wants to draw locally. The L/C should specify a street address. The underlying Lease will often require that any L/C must allow Beneficiary to draw upon the L/C within a specified geographical area. In practice, major Issuers move their letter of credit counters from time to time, and many L/C's cannot be drawn in New York. Beneficiaries will have to deal with this problem, although can reasonably demand that they can draw their L/C's within the Continental United States.

43 Beneficiary will at some point present an L/C by visiting a website and typing the L/C number and a password. That point (or any point close to it) has not yet been reached at time of writing. L/C practice favors adherence to market standards and custom — more so than almost any other area of banking or legal practice. Such adherence means that change comes slowly. One can still usually present an L/C by fax. But now that the rest of the business world has largely eliminated fax as a means of communication, this paragraph seems rather optional, particularly if the parties include the next paragraph.

44 It would seem desirable to use generic email addresses, such as presentation@issuer.com, rather than email addresses of specific individuals.

as undeliverable (or Landlord fails to receive even one “read receipt” within two Banking Days), then: (a) the Expiry Date shall automatically be extended until the date ___ Banking Days after the attempted submission of Draw Documents, if the Expiry Date would otherwise occur within such extension period; (b) by any other means of submission this L/C allows, Beneficiary shall promptly resubmit Draw Documents and notify Issuer of the failed draw and any resulting extension of the Expiry Date;⁴⁵ and (c) Issuer shall promptly specify at least two valid email addresses for future submissions of Draw Documents.

After any electronic presentation, but not as a condition to its effectiveness, Beneficiary shall with reasonable promptness deliver original Draw Documents by any other means.⁴⁶

Issuer will on request issue a receipt for Draw Documents.

Issuer agrees, irrespective of any claim by any other person, to honor drafts drawn under and in conformity with this L/C, within the maximum amount of this L/C, presented to Issuer on or before the Expiry Date, provided Issuer also receives on or before the Expiry Date any other Draw Documents this L/C requires. Issuer shall pay this L/C [only] by [check or wire transfer] [wire transfer to this account: _____] [check payable to the order of Beneficiary and delivered to _____].⁴⁷

If Beneficiary presents proper Draw Documents to Issuer on or before the Expiry Date, then Issuer shall pay under this L/C at or before this time (the “*Payment Deadline*”): (a) if presentment is made at or before noon of any Banking Day, then the close of such Banking Day; and (b) otherwise,

45 This paragraph is entirely new, and the author has not actually used it in any L/C. It seems reasonable, however, to provide for submission of Draw Documents by email. The length of the paragraph suggests that email submissions are not issue-free.

46 This paragraph is optional.

47 Nothing in the preceding sentence is mandatory. Specificity about payment mechanisms can reduce risk of fraud. Beneficiary may want the right to change payment mechanisms, but this may increase the risk of fraud.

the close of the next Banking Day.⁴⁸ Issuer waives any right to delay payment beyond the Payment Deadline.

If Issuer determines that Draw Documents are not proper, then Issuer shall so advise Beneficiary in writing, within one Banking Day after the Payment Deadline.⁴⁹

Partial drawings are permitted. This L/C, as reduced, shall survive any partial drawings.⁵⁰

Issuer shall have no duty [or right] to inquire into the validity of or basis for any draw under this L/C or any Draw Documents. Issuer waives any defense based on (any claim of) fraud.⁵¹

[The Expiry Date shall automatically be extended by one year (but never beyond _____ [the “*Outside Date*”])⁵² unless, on or before the date 90 days before any Expiry Date, Issuer has given Beneficiary notice that the Expiry Date shall not be so extended (a “*Nonrenewal Notice*”). Issuer shall promptly upon request confirm any automatic extension of the Expiry Date under the preceding sentence by amending this L/C. Any

48 Tenant and Issuer may argue that the language in text establishes too short a deadline. A requirement for one-day turnaround is “nuts,” according to Anonymous Tenant’s Counsel. “It’s a bank; they don’t do my stinky standby L/C as their main piece of business.” Anonymous Tenant’s Counsel argues, saying that a short deadline does not give Landlord any meaningful practical benefit. Landlord would, of course, disagree. As of 2016, the author has noticed a trend toward longer Payment Deadlines, sometimes up to four Banking Days after presentation. This trend underscores the importance of drawing upon an L/C well before the Expiry Date.

49 This deadline seems short, but is it excessively so? ISP § 5.01(a) says Issuer must give notice of dishonor “within a time after presentation of documents which is not unreasonable.” Three business days meets the test; more than seven does not. ISP § 5.01(a)(i). Any notice of dishonor “shall state all discrepancies upon which the [dishonor] is based.” ISP § 5.02. Thus, the L/C need not state that requirement.

50 ISP § 3.08 makes this paragraph unnecessary. If Beneficiary might make partial draws, though, Beneficiary might not want to rely on ISP, and will probably want to see this language. It does no harm.

51 The preceding sentence is highly nonstandard, but not entirely beyond the realm of L/C practice. ISP leaves the matter to whatever law would otherwise govern. ISP § 1.05(c). Landlord would argue that most claims of “fraud” just relate to the validity of the draw – not genuine “fraud” at all – and should not involve Issuer or defer payment of the L/C. Anonymous Tenant’s Counsel argues that if in fact Issuer can determine that a draw is fraudulent, then Issuer should not pay it; Issuer should not waive that defense; and Landlord shouldn’t care because Landlord won’t do anything fraudulent anyway. The discussion ultimately may go back to the meaning of “fraud,” a term that can often mean whatever a creative lawyer wants it to mean, including any breach of contract or even just “not playing nice” if the creative lawyer can make it sound bad enough.

52 For a Lease, this date will occur perhaps 90 days after the scheduled expiration date of the Lease, so Landlord can calculate and bill any final escalations that Tenant might owe.

such amendment is not required for the automatic extension to be effective. Issuer need not give any notice of the Outside Date.]

[Beneficiary may from time to time transfer this L/C to any transferee (the “*Transferee*”), provided that such transfer does not violate any legal requirement that governs Issuer. Beneficiary or Transferee shall consummate such transfer by delivering to Issuer the original L/C and a Transfer Notice [substantially]⁵³ in the form of Exhibit B, signed by Beneficiary, designating Transferee.⁵⁴ Upon any transfer: (a) all references to Beneficiary shall automatically refer to Transferee, who may then exercise all rights of Beneficiary; and (b) if requested, Issuer shall promptly reissue or amend this L/C (simultaneously with the surrender of this L/C to Issuer) in favor of Transferee as Beneficiary.]

Any notice to Beneficiary shall be in writing and delivered by hand (or by overnight (one night)⁵⁵ delivery service such as FedEx), with proof of delivery, at the above address. [As a condition to the effectiveness of any notice, Issuer shall deliver a copy of it, by the same means, to: _____.]⁵⁶ Beneficiary may change any notice address or addressee by written notice to Issuer. Issuer will upon request confirm the change.

This L/C is subject to: (a) International Standby Practices, ISP98, International Chamber of Commerce Publication No. 590 (“*ISP*”); and (b) to the extent not inconsistent with *ISP*, the law of the State of [New York].

Very truly yours,

[Issuer Signature]

53 See earlier comments on not using this word in L/C practice.

54 The use of a transfer form is not strictly necessary, but will certainly simplify and speed along any future transfer. When Beneficiary wants to sell or refinance the building – often on an expedited basis — Beneficiary will be glad to see a sample transfer form attached to the L/C, rather than face the burden of tracking down Issuer’s requirements.

55 Courts have sometimes interpreted “overnight” to mean something other than just one night.

56 Issuers often object to giving copies of notices to counsel.

EXHIBIT A

FORM OF SIGHT DRAFT

[Beneficiary Letterhead]

TO:

[Name and Address of Issuer]

SIGHT DRAFT

AT SIGHT, pay to the Order of _____, the sum of _____ United States Dollars (\$_____). Drawn under [Issuer] Letter of Credit No. _____ dated _____.

[Beneficiary directs Issuer to pay the proceeds of this Sight Draft solely to this account of Beneficiary:⁵⁷ _____.]

[Name and signature block, with Beneficiary signature.]

Date: _____

⁵⁷ Typically any L/C Proceeds go directly to Beneficiary's account. If Beneficiary or Lender wants the proceeds to go elsewhere, this would require, at a minimum, a document assigning the proceeds or at least an irrevocable designation of a Lender-controlled account to receive the L/C Proceeds. Any such arrangement still might not allow Lender itself to draw upon the L/C. As the introductory comments note, the parties may need a three-party agreement to give Lender enough control over the L/C.

EXHIBIT B

FORM OF TRANSFER NOTICE

[Beneficiary Letterhead]

TO:

[Name and Address of Issuer]

(“*Issuer*”)

TRANSFER NOTICE

By signing below, the undersigned, Beneficiary (the “*Beneficiary*”) under Issuer’s Letter of Credit No. _____ dated _____ (as amended, the “*L/C*”), transfers the L/C to this transferee (the “*Transferee*”):

[Transferee Name and Address]

Beneficiary: (a) encloses the original L/C; (b) directs Issuer to reissue or amend the L/C in favor of Transferee as Beneficiary; and (c) represents and warrants Beneficiary has made no assignment, encumbrance, or transfer of the L/C remaining in effect.

[Name and signature block, with Beneficiary signature.]⁵⁸

Date: _____

58 Transfer Notices often require a bank guaranty of the transferor’s signature. That requirement does not seem to apply to sight drafts.

CHAPTER THIRTY-EIGHT

AN UPDATE ON THE BANKRUPTCY LAW OF LARGE LETTERS OF CREDIT FOR LEASES

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A tenant under any commercial lease will often deliver a letter of credit in place of a cash security deposit as a way to give the landlord comfort that the tenant will perform its obligations under the lease. If that letter of credit (L/C) exceeds a year's rent and the tenant (Tenant) later files bankruptcy, then the landlord (Landlord) may find to its surprise that the L/C does not give Landlord the security for Tenant's obligations that Landlord expected. And Landlord's mortgage lender (Lender) may share Landlord's concerns.

These issues took center stage during the dotcom boom and subsequent bust around the turn of the twenty-first century. But the same issues can arise whenever Landlord accepts an L/C that exceeds a year's rent. One might expect to see more such L/Cs, at least in some markets, as all participants in real estate transactions refocus on fundamentals such as credit quality and credit enhancement.

Landlord's problems with taking a large L/C all trace back to 11 U.S. Code § 502(b)(6) (U.S.C.). That section of the Bankruptcy Code applies only to Landlords under real property leases. It potentially limits the amount of any claim¹ that Landlord can assert in Tenant's bankruptcy "for damages resulting from the termination of a lease of real property"² (the Claim Cap). Absent the Claim Cap, Landlord could assert a claim in Tenant's bankruptcy for whatever damages Landlord could assert in state court. The Claim Cap disallows some part of those damages in bankruptcy—potentially a very substantial part.

If Landlord's damages do not exceed one year's rent, the Claim Cap creates no problem or issue, and bankruptcy law will typically allow Landlord to file a claim for the entire amount of Landlord's damages.³ If, however, Landlord's damages exceed that level, Landlord may find that the Claim Cap limits Landlord's claim. More specifically, Landlord's claim arising from Tenant's breach of the lease will be capped at whichever of these two alternatives is lower: (1) 15% of the remaining rent

1 Submission and acceptance of a claim does not, of course, in and of itself assure payment. It merely begins the discussion.

2 11 U.S.C. § 502(b)(6). Landlords may therefore try to characterize their claims as something else, a technique this Chapter explores later.

3 See § 502(b)(6)(A).

under the lease⁴ or (2) three years' rent.⁵ Landlord can also include in its claim any unpaid rent due before Tenant filed.⁶ The Claim Cap seeks to prevent Landlord's claim from excessively diluting or crowding out the claims of other unsecured creditors.⁷

After the Claim Cap shrinks Landlord's claim, Landlord then joins the throng of unsecured creditors who typically receive pennies on the dollar for their claims. Landlord potentially suffers four times: first, if the lease defines or limits Landlord's damages; second, if state law further limits Landlord's claim; third, if the Claim Cap then further diminishes Landlord's claim; and fourth, if Landlord, with its diminished claim, becomes an unsecured creditor and might get paid only partially, just like any other unsecured creditor. Maybe Congress does not like Landlords.

Can Landlord avoid these problems by taking a huge security deposit? Suppose, for example, that Tenant gave Landlord a cash security deposit of \$5X, but the Claim Cap limited Landlord's claim in Tenant's bankruptcy to \$2X. What happens? Tenant's bankruptcy estate could force Landlord to disgorge \$3X, the excess cash security deposit above the Claim Cap.

Landlord might intuitively think it can solve that problem by taking an L/C instead of cash as Tenant's security deposit. Under the same facts, if Landlord held an L/C for \$5X instead of cash in the same amount, could Tenant's bankruptcy estate force Landlord to hand over (or "disgorge"⁸) any L/C proceeds in excess of \$2X? Recent case law compels precisely

4 This piece of the formula will go down over time. Thus, although an L/C for more than a year's rent may not at lease signing cause a Claim Cap Problem, *see infra* note 9 and accompanying text, such an L/C can start to create a Claim Cap Problem as the remaining lease term drops. Landlord will often agree, however, that Tenant can reduce the amount of the L/C over time as well, thus preventing a creeping Claim Cap Problem. (One problem for Landlord prevents a second problem.)

5 *See* § 502(b)(6)(A).

6 Bankruptcy law measures the Claim Cap as of the earlier of the date when Tenant filed bankruptcy or the date when Landlord repossessed the leased premises. *See* § 502(b)(6). The preceding summary of the Claim Cap ignores certain issues involving definitions and calculations not important in this Chapter.

7 *See* Jennifer L. Nassiri, *Letters of Credit and Lease Rejection Damages Under Section 502(b)(6)*, DLA Piper, News & Insights, June 2006, <https://dlapiper.com>.

8 Use of the word "disgorge" in this context demonstrates how word choices and labels can dictate outcomes. If Tenant or its trustee in bankruptcy were instead asking a court to require Landlord to forfeit the benefit of a freely negotiated security package, the use of the latter words to describe the relationship might help dictate the opposite result. Other words that can drive outcomes sometimes include *fair*, *the public interest*, *greedy*, *progressive*, *reform*, and *change*.

this result (from Landlord's perspective, the Claim Cap Problem).⁹ In other words, taking an L/C does not eliminate Landlord's risk of seeing the Claim Cap diminish Landlord's claim to \$2X.

What if Landlord does not actually convert the \$5X L/C into cash or at least has not done so when Tenant files bankruptcy? If and when Landlord eventually draws upon the L/C and converts it into cash, does the cash then become a security deposit subject to the Claim Cap? Could Tenant's estate then recover the excess cash proceeds beyond the Claim Cap?¹⁰ If Landlord has not yet drawn upon the L/C—has not yet converted the L/C into cash—can Landlord ignore the Claim Cap? Does the answer depend on whether Landlord draws upon the L/C before or after Tenant's bankruptcy filing?

Until 2001, Landlord would not have thought that the Claim Cap could prevent Landlord from retaining the full proceeds of Tenant's L/C. In the one case that considered the Claim Cap Problem before 2001,¹¹ the court easily ruled for Landlord. Although the court did not go into great detail about the facts or analysis or indicate whether it thought the Claim Cap even applied, the decision included these Landlord-friendly comments:

The letter of credit at issue is a tripartite agreement that gave the landlord upon demand the right to obtain payment from a third party for which the debtor may be ultimately liable, but which the trustee cannot recover. . . .

[N]either the letter of credit nor its proceeds were property of the debtor's estate, and therefore the trustee may not . . . recover them.¹²

Practitioners and commentators, including the author, considered the *Farm Fresh* result intuitively obvious and appropriate.¹³ They focused

9 See *In re PPI Enters. (U.S.), Inc.*, 324 F.3d 197 (3d Cir. 2003).

10 See Anton N. Natsis, Joseph M. Davidson, & Michael S. Greger, *Structuring Deals with High-Tech Tenants—The Good, the Bad and the Ugly*, 18 Cal. Real Prop. J. 4 (Summer 2000) (also discussing further structuring issues).

11 *In re Farm Fresh Supermarkets of Md., Inc.*, 257 B.R. 770 (Bankr. D. Md. 2001).

12 *Id.* at 772.

13 See, e.g., Kimberly S. Winick, *Tenant Letters of Credit; Bankruptcy Issues for Landlords and Their Lenders*, 9 Am. Bankr. Inst. L. Rev. 733, 764 (2001) ("Where the lease is supported by a letter of credit, the landlord's recovery for damages upon rejection should not be limited by section 502(b)(6).").

ostensibly on the “independence principle” underlying all L/Cs and concluded, logically enough, that no Landlord holding an L/C should need to worry about the Claim Cap Problem.¹⁴ The independence principle at the foundation of all L/C transactions should mean that when Landlord accepts an L/C, that L/C creates a two-party relationship purely between Landlord and the issuer of the L/C (Issuer), which does not involve Tenant in any way. Thus, any Claim Cap Problem should belong entirely to Issuer, not Landlord.

These practitioners believed that the Claim Cap should limit only Landlord’s claims against a debtor in bankruptcy—a topic with no relevance at all to a Landlord’s right to draw upon an L/C or to apply the proceeds of such a draw, because both take place outside Tenant’s bankruptcy and arise only under the Landlord-Issuer relationship.¹⁵ A minimally reported Delaware case reached exactly that conclusion in 2001.¹⁶

The world changed in 2000 and 2001 when dotcom Tenants began their famous meltdown. As part of that meltdown, many new dotcom companies found themselves in bankruptcy—soon after they had just signed large leases that were expensive and difficult to negotiate, and often required huge L/Cs, given the state of the market at the time.

The cases that arose out of the dotcom meltdown showed that the Claim Cap Problem is real. Perhaps unsurprisingly, the bankruptcy courts protected the dotcom debtors.¹⁷ In those cases, Landlords learned that the independence principle did not give them the armor they thought it gave them, and did not shift to L/C issuers the credit risk implied by the Claim Cap. Some Landlords learned they had to disgorge any “excess” L/C proceeds to the bankrupt estate—a most unwelcome surprise.¹⁸

The law in this area evolved quickly. Three circuit courts and a bankruptcy appellate panel took up the Claim Cap Problem. Some of the decisions were not necessarily bad for Landlords, but none was good for Landlords.

14 *See id.*

15 *See id.*

16 *In re Darwin Networks, Inc.*, 2001 Bankr. LEXIS 1689, at *1 (Bankr. D. Del. 2001) (granting landlord summary judgment on section 502(b)(6) issue). The reported decision contains no facts or discussion. Copies of the underlying court papers (public documents) are on file with the author, whose firm represented a party in the dispute.

17 *See In re PPI Enters. (U.S.), Inc.*, 324 F.3d 197 (3d Cir. 2003) and other cases discussed below.

18 *See id.*

In 2003, the Third Circuit decided one of these cases, *In re PPI Enterprises, Inc.*¹⁹ Solow—Landlord—drew upon the L/C and wanted to keep all the proceeds.²⁰ Going beyond the L/C, Solow also tried to assert a claim, subject to the Claim Cap, for unpaid rent against Tenant—PPI Enterprises (PPIE).²¹ The court credited Landlord’s L/C proceeds against Landlord’s allowable claim.²² The court regarded the L/C as being identical to a cash security deposit and called Landlord’s position an attempt at an “end run around § 502(b)(6).”²³

The decision emphasized substance over form, focusing on the parties’ intent to use the L/C in place of a cash security deposit. The lease contained some language that invited the court to treat the L/C as being really a security deposit, just like a cash security deposit. For example, the lease described the L/C as being “in lieu of . . . cash security” that Tenant would replenish with cash if Landlord drew upon the L/C.²⁴ To the court, it was “clear the parties intended the [L/C] to operate as a security deposit.”²⁵ Therefore, the court treated the L/C proceeds as a security deposit and offset them against the Claim Cap.²⁶

The court feared that if it allowed Solow to keep the L/C proceeds and also make a bankruptcy claim up to the Claim Cap, that result could leave PPIE’s other creditors out in the cold—precisely the injury that Congress enacted 11 U.S.C. § 502(b)(6) to prevent.²⁷ Solow could achieve double payment and more. He could keep all the L/C proceeds—free of the Claim Cap—and Issuer could assert a claim in PPIE’s bankruptcy for that entire amount.²⁸ At the same time, Solow could file a claim, up to the

19 324 F.3d 197 (3d Cir. 2003).

20 *See id.* at 201.

21 *See id.*

22 *See id.* at 210.

23 *See id.* at 209.

24 *Id.* at 210.

25 *Id.*

26 This result was the holding of *Oldden v. Tonto Realty Corp.*, 143 F.2d 916 (2d Cir. 1944), half a century before. *Oldden* and some later legislative history support the notion that a debtor Tenant can reach its cash security deposit. Landlord “will not be permitted to offset his actual damages against his security deposit and then claim for the balance under this paragraph. Rather, his security deposit will be applied in satisfaction of the claim that is allowed under this paragraph.” H.R. Rep. No. 95-595, at 353–54 (1977); S. Rep. No. 95-989, at 63 (1978).

27 *See supra* note 23, at 14.

28 *See id.*

Claim Cap, in PPIE's bankruptcy.²⁹ The court stated, however, that it "need not decide the underlying question" regarding the interaction between L/Cs and the Claim Cap because of the parties' clear intent in this case.³⁰

Given the practical economic reality of the transaction and the words of the lease, the characterization of the L/C as a substitute for a cash security deposit in *Solow* hardly seems bizarre.

Although another court reached the same result, its approach suggested a somewhat more friendly view toward Landlord. In *In re Mayan Networks Corp.*,³¹ Landlord again received an L/C, in the amount of \$648,966, "as security for the faithful performance by [Debtor] of all [Debtor's] obligations."³² This language, as in *Solow*, made the L/C sound like a substitute for a cash security deposit. To back the L/C, Tenant deposited with Issuer more than \$650,000.³³ When Tenant defaulted, Landlord drew upon the L/C.³⁴

The bankruptcy court subtracted the L/C proceeds from Landlord's capped claim.³⁵ The Bankruptcy Appellate Panel for the Ninth Circuit agreed. The panel even went a step further, treating all L/C proceeds as a cash security deposit that the estate could recover from Landlord to the extent it exceeded the Claim Cap.³⁶

The court focused on how Landlord's L/C draw affected the debtor-Tenant's estate.³⁷ Even though the L/C itself was not property of Tenant's estate,³⁸ a draw triggered creation of an equivalent liability for the estate.³⁹ Thus the court found no difference between a cash security

29 *See id.*

30 *Id.*

31 306 B.R. 295 (B.A.P. 9th Cir. 2004).

32 *Id.* at 297 (alteration in original).

33 *See id.* at 297.

34 *See id.*

35 *See id.*

36 *See id.* at 301.

37 *See id.*

38 *See id.* at 299.

39 *See id.* at 300-01.

deposit and an L/C, the only actual distinction between them being the location of the money.⁴⁰

The decision turned almost entirely on the fact that Tenant had made a cash deposit with Issuer to back the L/C⁴¹—a line of inquiry that the independence principle would suggest should make no difference at all. To the contrary, the logic of the independence principle would suggest allowing Landlord to draw upon the entire L/C, with Issuer facing the burden of having to give up part of the cash deposit backing the L/C. It was Issuer, after all, who should have assumed all risks and burdens of Tenant’s creditworthiness and possible bankruptcy, and how any such bankruptcy might affect the L/C.

Two years later, the Ninth Circuit again focused on whether Tenant had posted a cash deposit to back its L/C. In *In re AB Liquidating Corp.*,⁴² Landlord accepted a \$1 million L/C instead of a cash security deposit.⁴³ A year later, Tenant filed bankruptcy and rejected the lease.⁴⁴ Applying the Claim Cap, Landlord asserted a claim for \$2 million against Tenant’s estate.⁴⁵ Landlord also drew upon the entire L/C.⁴⁶

Tenant tried to reduce Landlord’s claim by the \$1 million that Landlord had drawn under the L/C.⁴⁷ Following the *Mayan Networks* logic, the Ninth Circuit agreed with the Bankruptcy Appellate Panel that when a debtor’s property fully collateralizes an L/C, as was the case here, the L/C is just like a cash security deposit and the court will reduce Landlord’s claim against the debtor-Tenant.⁴⁸

Mayan Networks and *AB Liquidating Corp.* leave open a crucial question: What if a debtor does not deliver cash collateral for the L/C? The *Mayan Networks* decision may offer Landlords some hope. The court said that if a debtor does not deliver cash security for an L/C, then the relation-

40 See *id.* at 301.

41 See *id.*

42 416 F.3d 961 (9th Cir. 2005).

43 See *id.* at 962.

44 See *id.*

45 See *id.*

46 See *id.* at 963.

47 See *id.* at 961.

48 See *id.* at 965 n.3.

ship among Landlord, Tenant, and Issuer more closely resembles a third-party guarantee.⁴⁹ Under that structure, if the guarantor (Issuer) paid the guaranteed obligation, the Claim Cap should not limit those payments by Issuer (treating Issuer as a guarantor).⁵⁰

The *Mayan Networks* decision focuses, at least in dicta, on how the L/C structure affects the debtor's estate. If an L/C draw does not hurt the debtor's estate, then the court might treat it like a "third-party guarantee" not subject to the Claim Cap.⁵¹ Conversely, as in *Mayan Networks*, if cash collateral backs an L/C and Landlord draws on the L/C, then the resulting use of cash collateral will reduce cash otherwise available to the debtor, thus hurting the estate and the other creditors, and supporting the court's adverse treatment of Landlord.⁵²

The same bankruptcy appellate court had reached much the same result in an earlier case, *In re Condor Systems, Inc.*⁵³ There, an employee held an L/C, but Issuer had no security.⁵⁴ When the employee drew upon the L/C, the court decided that a limit on employee claims in bankruptcy (similar to the Claim Cap) did not apply because the L/C draw did not diminish employer's estate.⁵⁵ This case, however, concerned an L/C in the employment context governed by § 502(b)(7), thus limiting its direct relevance to leases.⁵⁶

49 *In re Mayan Networks Corp.*, 306 B.R. 295, 300 (B.A.P. 9th Cir. 2004).

50 *See id.* (citing *In re Modern Textile, Inc.*, 900 F.2d 1184 (8th Cir. 1990); *Bel-Ken Assocs. Ltd. P'ship v. Clark*, 83 B.R. 357 (D. Md. 1988); *Things Remembered, Inc. v. BGTV, Inc.*, 151 B.R. 827 (Bankr. N.D. Ohio 1993)).

51 *See id.* An ordinary guarantee does not impair the debtor's estate, because it does not increase the debtor's total liabilities. It merely converts a debtor's direct liability (to a creditor who holds a guarantee) into a reimbursement liability (to the guarantor who paid the direct creditor).

52 *See id.*

53 *In re Condor Sys., Inc.*, 296 B.R. 5 (B.A.P. 9th Cir. 2003).

54 *See id.*

55 *See id.* at 18–19; *In re Mayan Networks*, 306 B.R. at 300 (citing *In re Condor Sys., Inc.*).

56 *See In re Condor Sys., Inc.*, 296 B.R. at 8. The court stated: "we agree . . . that § 502(b)(6) provides an unreliable analogy for § 502(b)(7), and thus view security deposits on leases as distinguishable." *Id.* at 18. The court also stated, though: "[i]t does not follow, however, that every letter of credit or other third-party guarantee constitutes a security deposit. Rather, even in the landlord-tenant arena, parties must intend that it be a security deposit." *Id.* at 19. Thus, where the parties do not intend an L/C to operate as a security deposit, the logic of *In re Condor* may apply, so proceeds from such an L/C might not reduce the amount allowed under the Claim Cap.

The decision nevertheless suggests that the independence principle still lives, at least to some degree and in some contexts. The court stated that if an L/C is not intended to be a security deposit under a lease,⁵⁷ “the obligation to pay is direct and primary as between [Issuer] and [Landlord] and is . . . ‘independent’ of performance, or lack thereof, by anyone else” and that “settled letter of credit law requires [Issuer] to pay [Landlord], even if [Tenant] is broke.”⁵⁸

In 2005, the Fifth Circuit took up these issues and embarked on an entirely different analytical journey. In *In re Stonebridge Technologies, Inc.*,⁵⁹ Stonebridge, as Tenant, obtained an L/C for \$1.5 million and backed it by pledging a certificate of deposit.⁶⁰ When Tenant filed bankruptcy and rejected the lease, EOP, as Landlord, drew upon the L/C.⁶¹ Content with the proceeds of the L/C because they exceeded EOP’s damages, EOP did not file a proof of claim for its actual-lease-rejection damages.⁶²

The bankruptcy court found for Tenant’s estate, characterizing the L/C proceeds as a security deposit subject to the Claim Cap.⁶³ The Fifth Circuit, however, decided that EOP could keep the L/C proceeds—regardless of the Claim Cap—because the Claim Cap plays no role if Landlord never files a claim against Tenant’s bankruptcy estate.⁶⁴ Section 502(b)(6) only caps claims against the bankruptcy estate, the court wrote.⁶⁵ In contrast, a draw upon an L/C does not involve a claim against the bankruptcy estate because it concerns contractual rights and duties separate from the relationship of the creditor and the debtor.⁶⁶

57 *See id.* The court noted that “[s]ecurity deposits are peculiar, term-of-art creatures of contract that have a rich history in the specialized field of landlord-tenant law,” and that “[w]here a letter of credit . . . is intended to be a security deposit under a lease, it may be appropriate to analyze the situation as involving a security deposit.” *Id.* at 18.

58 *Id.*

59 430 F.3d 260 (5th Cir. 2005).

60 *See id.*

61 *See id.* at 263.

62 *See id.* at 265.

63 *See id.* at 263–64.

64 *See id.* at 271.

65 *See id.* at 270.

66 *See id.* at 269.

The Fifth Circuit mentioned the independence principle, treating the relations among the parties in a manner consistent with the independence principle and with intuitively obvious expectations about L/Cs outside bankruptcy.⁶⁷ The court suggested this approach when it said Issuer's obligations to Landlord, as beneficiary under the L/C, remain intact so long as Landlord does not alter the relationship with the debtor by filing a claim against the bankruptcy estate.⁶⁸ But the court avoided the more challenging question of what would happen if Landlord did make such a claim.⁶⁹

The travails of another EOP Landlord entity triggered another case in this area in 2007. In *In re Connectix Corporation*,⁷⁰ Landlord—another EOP entity—held an L/C in an amount less than the Claim Cap. Before Tenant filed bankruptcy, Landlord drew the L/C. The bankruptcy court required Landlord to credit the amount of that draw against Landlord's claim in bankruptcy.⁷¹ The court placed significant weight on the facts that: (a) the lease clearly treated the L/C as the equivalent of a security deposit; and (b) Tenant had deposited with Issuer a certificate of deposit (the equivalent of cash collateral) equal to the face amount of the L/C.

Though a significant amount of ink has been spilled recently (including by the author, here and elsewhere) on the Claim Cap Problem, the recent cases do seem to stand for three principles:

67 Likewise evidencing the Fifth Circuit's respect for the independence principle, the court had previously decided *In re Compton Corp.*, 831 F.2d 586 (5th Cir. 1987). There, the Fifth Circuit stated "[i]t is well established that a letter of credit and the proceeds therefrom are not property of the debtor's estate" and that "the independence principle [is] the cornerstone of letter of credit law." *Id.* at 589–90.

68 See *In re Stonebridge Techs., Inc.*, 430 F.3d at 271.

69 Two later L/C cases undercut the notion that Landlord's failure to file a claim somehow limits the court's ability to deal with L/C issues at a Tenant debtor's initiative. See *In re Onecast Media, Inc.*, 439 F.3d 558 (9th Cir. 2006) (bankruptcy jurisdiction for dispute over whether L/C proceeds overcompensated Landlord for its actual damages); *In re Builders Transp., Inc.*, 471 F.3d 1178 (11th Cir. 2006) (similar). Neither of these cases implicated the Claim Cap. Neither decision indicated that Landlord had filed a claim in Tenant's bankruptcy proceeding. Yet the bankruptcy courts were perfectly willing to hear Tenant's claims that Landlord should refund some part of the L/C proceeds. See also Richard Levy, Jr., *Recent Developments in the Bankruptcy Treatment of Letters of Credit Under Commercial Real Estate Leases*, Prac. Real Est. Law., Mar. 2007, at 27, 32.

70 372 B.R. 488 Bankr. (N.D. Cal. 2007).

71 *Id.* at 496, citing *AB Liquidating Corp.* and *Mayan Networks Corp.*

- (1) Whenever Landlord retains a cash security deposit, the bankruptcy courts will first apply the Claim Cap against Landlord's claim, then credit the cash security deposit against Landlord's remaining claim.⁷²
- (2) Courts will treat L/Cs as security deposits when Tenants give Issuer cash security. The presence of an actual cash deposit (even in Issuer's hands) makes the whole arrangement too much like a cash security deposit to treat it as anything else.
- (3) If the lease shows the parties intended to use an L/C in place of a cash security deposit, this increases the likelihood a court will apply the Claim Cap. Any suggestion that the L/C replaces or substitutes for a cash security deposit will raise a red flag.

The *Mayan*, *AB Liquidating Corp.*, *PPI*, and *Connectix* decisions agree on all the points above.⁷³ Courts will not allow Landlords to end-run the Claim Cap by restructuring cash security deposits as L/Cs, or by having some third party (Issuer) hold Tenant's cash in a way that really just benefits Landlord. The courts have looked behind such arrangements, scrutinizing the overall relationship among the parties to see how the L/C operates in deciding whether to subject the L/C proceeds to the Claim Cap. Courts have done this based on the perceived congressional rationale that the Claim Cap was designed to prevent Landlords' claims from depleting Tenant debtors' estates to the detriment of other creditors.⁷⁴

These decisions leave open one major question: How will the courts treat non-collateralized L/Cs? Will the courts treat them as sufficiently remote from the debtor Tenant to establish a third-party guarantor relationship—as the *Mayan* court suggested? Or will the courts still view them as just another form of cash security deposit? (Those who argue that a security deposit is a security deposit—regardless of form, including an L/C—would also argue that the absence of collateral for the L/C should make no difference.) If courts choose the latter path and treat even an unsecured L/C as equivalent to a cash security deposit, the L/C, as a protective tool for Landlords, may well be irreparably injured, at least where Tenant provides the L/C and its amount causes a Claim Cap Problem.

⁷² See *Oldden v. Tonto Realty Corp.*, 143 F.2d 916, 922 (2d Cir. 1944).

⁷³ See *In re AB Liquidating Corp.*, 416 F.3d 961 (9th Cir. 2005); *In re Mayan Networks Corp.*, 306 B.R. 295 (9th Cir. 2004); *In re PPI Enters., Inc.*, 324 F.3d 197 (3d Cir. 2003).

⁷⁴ See, e.g., *In re Stonebridge Techs., Inc.*, 430 F.3d 260, 269 (citing H.R. Rep. No. 95-595 (stating the purpose of the statute was to compensate Landlords but not to permit a claim that would prevent recovery by other creditors)).

Though today's state of the law seems unfavorable for L/C beneficiaries, Landlords should keep in mind a bit of history in the law of L/Cs. This area is marked by a history of occasional "weird" cases that produce unexpected results, usually because a court wants to "do justice" and finds a creative way to do so but does not sufficiently respect the fundamental principles of L/Cs. Such cases are ultimately ignored or discredited in many instances.⁷⁵ It is probably overoptimistic, however, to anticipate the same fate for the Claim Cap Problem cases this chapter discusses.

The Claim Cap Problem can drive the structuring of any lease transaction where the business deal contemplates that Landlord will obtain substantial protection—more than a year's rent—through a cash security deposit or an L/C.⁷⁶

If Landlord plans to obtain a large L/C, Landlord and its counsel should try to structure the transaction in a way that mitigates or even eliminates the Claim Cap Problem. To try to do that, Landlord can choose from a menu of possible techniques, many of them listed below. Some of these techniques overlap and may suggest other techniques or other problems.

None of these techniques is guaranteed to solve the Claim Cap Problem, but the following amount to a reasonably exhaustive (and perhaps exhausting) list of possibilities:⁷⁷

- *Look Behind Reimbursement Arrangement.* As noted above, the courts seem to look less favorably on L/Cs that are backed by cash deposits. Thus, Landlord should try to assure that Issuer has not received a cash deposit or other collateral.
- *Do Not File Claim.* The *Stonebridge* opinion suggests courts may be more willing to respect the independence of Issuer's payment to

75 See *In re Twist Cap, Inc.*, 1 B.R. 284 (Bankr. M.D. Fla. 1979) (enjoining unsecured creditors from drawing upon L/Cs because it would indirectly hurt debtor); see also *Celotex Corp. v. Edwards*, 514 U.S. 300 (1995) (enjoining draws upon surety bonds much like L/Cs, to prevent financial chaos for debtor); *In re Powerine Oil Co.*, 59 F.3d 969, 969–71 (9th Cir. 1995) (obligor paid an L/C-backed obligation; creditor released L/C; obligor filed bankruptcy; court required creditor to "disgorge" those payments as "preferences").

76 In addition to the Claim Cap Problem, Landlord may also need to consider state-law limitations on how Landlord can use L/C proceeds.

77 Lender may care a great deal about: (1) which technique Landlord chooses and (2) how Lender obtains a perfected and reliable security interest in, and practical ability to control, Landlord's rights. Any structure should consider Lender's agenda and might require a tri-party agreement among Landlord, Lender, and Tenant. For more on this topic and a sample document, see Chapter 39.

Landlord if Landlord does not file a claim, thus creating a relationship between itself and the bankruptcy proceeding.⁷⁸ Because Federal Rule of Bankruptcy Procedure 3004 authorizes a debtor to file a claim on behalf of a creditor, though, this theory of “Landlord uninvolvement” seems unlikely to have much practical impact.⁷⁹ Some post-*Stonebridge* cases also suggest Landlord cannot excuse itself from the bankruptcy process so easily.⁸⁰

- *Guaranty Backed by L/C.* The *Mayan* decision suggests that if an L/C draw will not diminish Tenant’s estate, then the L/C proceeds will not be subject to the Claim Cap because the L/C will, in effect, amount to a third-party guaranty relationship,⁸¹ which is exactly the result that the independence principle should have produced in any event.⁸² To accomplish this, the parties can agree to tie the L/C not to the lease, but instead to a totally independent third-party guaranty of the lease, issued by a third-party guarantor (the Guarantor). Guarantor’s general credit would not back the lease but would simply serve the purpose, Landlord hopes, of protecting the L/C from the Claim Cap.⁸³ If Guarantor itself were to file bankruptcy, then cases indicate that the Claim Cap would limit Landlord’s claim against Guarantor.⁸⁴ But if Tenant and only Tenant filed, it is generally believed that the Claim Cap would not protect the nonbankrupt Guarantor.⁸⁵ Landlord could then

78 See *In re Stonebridge Techs., Inc.*, 430 F.3d at 267–70.

79 See William Medford & Bruce H. White, *Application of § 502(b)(6)’s Lease Rejections: An Update on Damages Cap to Letters of Credit*, 25-2 Amer. Bankr. L.J. 36, 41 (March 2006).

80 See note 69.

81 See *In re Mayan Networks Corp.*, 306 B.R. 295 (9th Cir. 2004).

82 For a succinct summary of this structure and its logic, see Benjamin F. Kursman, *Cash Is King, Unless a Tenant Goes Bankrupt*, Real Estate New York (May/June 2009), at 30.

83 As a rather obvious alternative, Guarantor’s general credit could replace the L/C (particularly if Guarantor’s general credit would alone support Issuer’s issuance of the L/C).

84 If Issuer took security from Guarantor for the L/C, Landlord would again find itself in a conundrum discussed in text.

85 In other words, if Tenant is in bankruptcy but Guarantor is not, then as a matter of state-law guaranty enforcement, the state court should not give the nonbankrupt Guarantor the benefit of the Claim Cap. This result seems logical, at least from Landlord’s perspective. The author has, however, been advised of occasional state-law cases that hold otherwise and apply Tenant’s Claim Cap to Landlord’s claim against a nonbankrupt Guarantor. Notwithstanding diligent research, the author has not been able to locate any such cases. If any reader is aware of them, a reward of one dollar will be paid for the correct citation(s). No security of any kind is being offered for the making of this payment. Any further discussion of how the Claim Cap applies to a nonbankrupt guarantor lies outside the present discussion. Anyone who proposes to use a guaranty in this context should at least consider this question.

draw upon the L/C based on the nonbankrupt Guarantor's failure to pay rather than because of anything related to Tenant or the lease. Landlord would say, with some basis, that the Claim Cap has no relevance to Landlord's rights against Guarantor or under the L/C. Under this structure, Guarantor would be either: (1) creditworthy enough that bankruptcy is unlikely; or (2) a bankruptcy-remote entity. In either case, Tenant and its principals need not have any interest in, or control of, Guarantor. Perhaps it is best if they do not. Guarantor might even be a third-party bonding company.⁸⁶ To avoid dragging Tenant's bankruptcy back into the picture, one could even require Guarantor to waive any right of reimbursement from Tenant if Landlord draws upon the L/C. In some permutations, this structure amounts to a miniaturized version of structured, off-balance-sheet financing. It may represent a very attractive and workable way to solve the Claim Cap Problem, although Landlord would need to consider the usual suretyship and related issues arising with any guaranty⁸⁷ and consider the vicissitudes that have started to befall similar structures in the larger financial world.

- *No Cash Security.* Landlord could plan to draw upon the L/C only to the extent necessary to cure defaults as and when they occur, never converting the L/C into a cash deposit to back the lease.⁸⁸ Under this strategy, Landlord would avoid creating an attractive pot of money in which Tenant's estate could claim an interest. Instead, the L/C would remain an L/C—undrawn upon to the extent possible—at all times. This approach requires no verbiage in the L/C beyond language that clearly allows partial draws.⁸⁹ It also requires enough flexibility in the lease to assure that whenever Landlord does decide to draw upon the L/C and the circumstances justify it, Landlord will be able to do so—and immediately disburse the L/C proceeds—without violating the lease.⁹⁰ Landlord then would plan to try to persuade the bankruptcy court that the undrawn L/C is something very different from a

86 The bonding company would bring to the transaction the fact that it is highly unlikely to go bankrupt. The L/C itself would not be backed by the bonding company's credit but probably by cash collateral from the bonding company.

87 See generally *In re Mayan Networks Corp.*, 306 B.R. 295; 11 U.S.C. § 502.

88 See Natsis, Davidson & Greger, *supra* note 10 and accompanying text; *contra In re PPI Enters., Inc.*, 324 F.3d 197 (3d Cir. 2003).

89 See, e.g. *In re PPI Enters., Inc.*, 324 F.3d at 209–10.

90 See, e.g., *In re AB Liquid'g Corp.*, 416 F.3d 961 (9th Cir. 2005); *In re Mayan Networks Corp.*, 306 B.R. 295 (9th Cir. 2004).

cash security deposit (it isn't cash or anything like cash!) and should not be subject to disgorgement.⁹¹

- *Do Not Draw.* As a corollary to the preceding measure, Landlord should try very hard to defer any draw under the L/C until after Tenant has filed—and ideally until Tenant has exited—bankruptcy, recognizing that a draw before or during Tenant's bankruptcy creates a very attractive cash target and simply asks for trouble.⁹² Of course, if the L/C is about to expire, Landlord will have no choice but to draw upon it, even if Landlord must do so before Tenant files or during the bankruptcy. But if Landlord can wait until after Tenant files (or better yet until after the bankruptcy is over), this may place Landlord in a better position than if, at any time during the bankruptcy, Landlord held cash constituting the proceeds of a previous draw. A typical Landlord would, of course, want to draw first and ask questions later. Thus the suggestion in this paragraph would require Landlord to display an unusual and perhaps unrealistic level of restraint.⁹³
- *Generous Expiry Date.* To avoid the risk of being forced to draw upon an L/C that is about to expire and hence end up holding a pot of cash that might attract the interest of the bankruptcy court, Landlord might insist that the expiry date of the L/C be no earlier than ninety days or more after the scheduled expiration date of the lease.⁹⁴ In other words, Landlord would refuse to accept the more typical "evergreen" L/C, which creates an annual risk of nonrenewal and conversion to cash. Few Issuers are willing to issue such a long-term L/C, particularly for the types of Tenants that need to deliver these L/Cs.⁹⁵ If Landlord accepted such an L/C, Landlord might want to rethink the circumstances justifying a draw upon on the L/C, based on the wide

91 See *supra* note 8 and accompanying text.

92 See *In re Mayan Networks, Inc.*, 306 B.R. at 298–99.

93 Before Landlord's counsel advises its client to resist its natural instinct, Landlord's counsel should reconfirm that once Tenant files, Landlord will still be able to draw upon the L/C, taking into account the specific lease and the effect of the automatic stay.

94 In Landlord's ideal world, any Tenant bankruptcy would toll the expiry date of the L/C. Few Issuers would accept such concept.

95 As a compromise measure, Issuer might issue a long-term L/C but have the right to replace the L/C at any time with a third-party surety bond or cash collateral at the account party's expense. Any such surety bond probably would be backed by Issuer's cash or credit, but the account party would be obligated to repay immediately any amounts drawn on the bond. This technique gives Issuer benefits equivalent to those of an evergreen L/C without burdening Landlord with a cash deposit. But how would the bankruptcy court treat the surety bond? Would it raise the Claim Cap Problem all over again?

variety of bad events that might occur over a very long lease term. Additional triggers might include Tenant bankruptcy (whether or not already a default under the lease); an Issuer downgrade; other issues relating to the L/C (such as Issuer's failure to maintain a convenient office to draw upon the L/C); or even Tenant's failure to meet certain financial tests. In the event of any such draw, what would Landlord do with the L/C proceeds? As suggested above, Landlord may prefer to hold an L/C that Landlord has not yet drawn upon but could draw upon at any time.

- *Immediate Use of L/C Proceeds.* If any default occurred under the lease, the lease could allow Landlord to draw upon the entire L/C, but use the proceeds first to cure Tenant's default and then only to prepay rent at the back end of the lease (and for no other purpose). Tenant would have no interest in such proceeds. After such prepayment of rent, Landlord might go a step further and require Tenant to restore the L/C, to restore its full amount as originally intended, but this may be excessive. Would a bankruptcy court treat such a prepayment of back-end rent as anything other than a cash security deposit? Probably not.
- *No Interest in L/C Proceeds.* The lease could include language in which Tenant purportedly disclaims any interest in the L/C proceeds and acknowledges that Landlord holds them free of any rights of Tenant. These words may be rather meaningless to the extent that the lease imposes specific obligations on Landlord regarding use of those proceeds, including an obligation to release L/C proceeds to Tenant under certain circumstances.
- *L/C Independent of Tenant and Lease.* Landlord could insist that the L/C come from anyone other than Tenant. For example, in the case of a dotcom Tenant, Landlord could insist that the L/C come from the venture capitalists behind Tenant, rather than from Tenant itself. Landlord could, as a matter of its own protection, look behind Issuer's reimbursement arrangements for the L/C and insist that the reimbursement obligation fall upon anyone other than Tenant, in a way that gives the reimbursing party no rights of any kind against Tenant.⁹⁶ As noted earlier, the application of the Claim Cap may vary

⁹⁶ The "independence principle" of L/Cs would suggest that such an analysis should be irrelevant, but the courts have performed such analyses anyway and have considered, among other things, whether Tenant's reimbursement obligations were unsecured or backed by cash collateral.

depending on whether, and to what degree, Tenant must reimburse Issuer for any draw made under the L/C.

- *Key Money and Back-End Free Rent.* Tenant might deliver key money and be entitled to equivalent free rent at the end of the term, but only in the form of a refund for the last few months of rent at the end of the term and only if Tenant has not defaulted. A court would probably regard the structure as a slightly disguised cash security deposit.
- *Separate Loan.* The parties might eliminate the cash security deposit (or L/C security arrangements) and add to the transaction an independent tenant improvements loan from Landlord to Tenant, backed by a leasehold mortgage or an L/C, collaterally assigned, if necessary, the Lender.⁹⁷ That loan could even be unsecured, except by the L/C. In that case, the L/C might simply back a separate payment stream from Tenant to Landlord—a promissory note requiring certain payments fully secured by the L/C—having no relation at all to the lease and not secured except by the L/C.⁹⁸ The parties would expressly agree that the payment stream constitutes something other than “rent” and has no connection to the lease. (The Claim Cap applies to claims for “damages resulting from the termination of a lease of real property.”)⁹⁹ In this case, though, the lease and the note might need to be cross-defaulted. Other issues about the interaction of rights and remedies (see, e.g., the earlier discussion on Tenant’s right to a refund of prepaid rent) might ultimately force the parties to tie the two documents together. Any such linkage could reopen the Claim Cap Problem.

97 Any such structure creates its own pile of new issues. Does such a loan create usury problems? Can this loan and the lease safely be cross-defaulted? If so, will a bankruptcy court pay any attention (either in a “good” way or in a “bad” way) to the cross-default? Does such a loan create regulatory or reporting issues for publicly-traded real estate investment trusts (REITs)? “Bad income” for any REIT, public or private? Under income tax regulations, what interest rate must Landlord charge? Does such a loan work, more generally, as a tax and accounting matter? Should Landlord use a separate entity as the tenant-improvement financier, with completely separate documentation? Will a court look beyond the “loan” and treat the entire relationship as a “lease”? How does Lender perfect its position? What if the lease terminates other than because of a Tenant default, such as because of casualty or condemnation? These questions probably just scratch the surface.

98 Lender would, again, probably want to receive a collateral assignment of Tenant’s obligations.

99 11 U.S.C. § 502(b)(6).

- *Do Not Call L/C a Security Deposit.* Collectively, the courts that have considered this issue have emphasized substance over form.¹⁰⁰ If an L/C contains language that makes it look like a mere substitute for a cash security deposit, the courts will in all likelihood treat it as such.¹⁰¹ Therefore, all references to the L/C in the lease should make clear the L/C is something other than—and very different from—a cash security deposit.
- *Other Recharacterization.* One could try other ways to re-characterize the L/C and its proceeds as something other than a subterfuge to replace a cash security deposit. For example, Tenant could agree to reimburse Landlord’s leasing brokerage commissions, vacancy period losses, and tenant improvement costs for the lease—or the next lease of the same space—if the lease terminated early because of a default (the Leasing Expense Reimbursement). The Leasing Expense Reimbursement could formulaically drop over time. One would then treat the Leasing Expense Reimbursement as an obligation entirely independent of the lease and not constituting rent. A separate agreement would govern the Leasing Expense Reimbursement, saying the arrangement has nothing to do with compensation for use and occupancy of real estate, but merely protects Landlord regarding certain leasing expenses. Landlord would need to structure and document this arrangement in a way that negates any argument that it’s really “rent.” For example, Landlord should not characterize any Leasing Expense Reimbursement as “rent” in monthly bills, or have the right to collect it by enforcing the lease. If the lease provides for “rent” adjustments, the formula for those adjustments should disregard the Leasing Expense Reimbursement. The obligor for the Leasing Expense Reimbursement might be a party other than Tenant, such as Tenant’s principals or venture capital backers. In that case, the documents should make very clear that Tenant has no obligation to pay or reimburse this amount or any part of it. The parties undertaking the Leasing Expense Reimbursement would need to waive any indemnity or reimbursement claims against Tenant. Landlord would have no remedies under the lease for nonpayment of Leasing Expense Reimbursement, and the lease would not even mention it.¹⁰² Landlord

100 See generally *In re Mayan Networks Corp.*, 306 B.R. 295, 297 (9th Cir. 2004); *In re PPI Enters., Inc.*, 324 F.3d 197 (3d Cir. 2003).

101 See *In re Mayan Networks Corp.*, 306 B.R. at 297.

102 This strategy is the exact opposite of Landlord’s usual strategy of wanting to label as “rent” each and every obligation in any way related to a lease.

might obtain a leasehold mortgage on the lease to secure the obligation to pay Leasing Expense Reimbursement. Although such a mortgage may, as a practical matter, induce payment of Leasing Expense Reimbursement, its value as credit support seems dubious at best, because of both the unreliable valuation of the collateral and the bankruptcy issues that travel with any secured obligation.

- *Prohibit Cash Security.* The lease could also affirmatively forbid Tenant from converting an L/C into a cash security deposit (such as by allowing the L/C to expire without being renewed). Any such conversion would be an event of default in and of itself. If the L/C expired, Landlord would not merely have the right to draw upon the L/C to create a cash security deposit, but also all remedies for an event of default. This prohibition on a cash security deposit would reflect the logic that because of the Claim Cap Problem, Landlord is better off with an L/C (which might suffer from the Claim Cap Problem)¹⁰³ than with a cash security deposit (which will definitely suffer from the Claim Cap Problem). If Landlord loses the benefits of holding an L/C, then Tenant loses the benefits of holding the lease. Of course, Landlord would then immediately face the Claim Cap Problem if Tenant filed bankruptcy.
- *Personal Guaranty.* Obtain a personal guaranty that simply indemnifies Landlord against any risks arising from the Claim Cap Problem.
- *Limit L/C to One Year's Rent.* As long as an L/C does not exceed one year's rent, no Claim Cap Problem should arise.¹⁰⁴ The Claim Cap formula also sometimes permits a higher maximum claim, though never more than three years rent.¹⁰⁵ Landlord can therefore avoid the whole issue simply by not structuring a transaction that requires an L/C exceeding the Claim Cap. An L/C for one year's rent should always be safe. Or, to the extent that the L/C would exceed the Claim Cap, one could substitute any of the mechanisms suggested above—a mix-and-match solution to the problem but a solution nevertheless. The hybrid nature of such a solution would probably create unnecessary issues, complexity, concerns, and drafting. Landlord and Lender should probably take one road or another, but not more than one. It all depends on context and circumstances, though.

103 *See supra* p.6.

104 *See supra* p.4.

105 *See id.*

- *Take the Risk.* As another possibility, Landlord might not worry about the Claim Cap Problem and simply take the risk and either (1) hope the L/C serves its purpose and Tenant stays out of bankruptcy; (2) hope the courts change their mind and decide that there is no such thing as a Claim Cap Problem for a Landlord that accepts a huge L/C; or (3) recognize that in bankruptcy the L/C will have given Landlord and Lender substantial comfort but not quite as much comfort as they really wanted. This possible response to the Claim Cap Problem ignores a risk (a substantial one) inherent in the structure of the transaction. It requires Tenant to bear the full cost and burden of obtaining an L/C without giving Landlord and Lender the absolute certainty of having the full corresponding benefit of a reliable L/C. In other words, it creates an economic absurdity, which usually implies that the parties can find some alternative and superior solution to the problem. That better solution should give Landlord, Lender, or both, an incremental benefit at no incremental cost to Tenant and should therefore be preferred. The concept of ignoring the problem is, however, by no means uncommon and might be viewed as Landlord's taking a business risk on the lease—a decision that Landlord's Lender might or might not second-guess—in an effort to “get the deal done” because of emergency circumstances that leave little time for consideration of legal niceties.¹⁰⁶ Although Landlord may be willing to tolerate some uncertainty because of these issues,¹⁰⁷ any Lender will probably find them particularly vexatious, because Lender may well want to control any L/C that Tenant delivers and will in any event probably demand more certainty than Landlord might.¹⁰⁸

The fundamental question that the Claim Cap Problem forces the parties to think about is simply the following: How can Landlord, Lender, and Tenant treat the L/C as the functional equivalent of a cash security deposit without actually calling it a security deposit or otherwise giving Tenant an interest in the L/C proceeds? The answer is not necessarily easy

106 As a matter of risk management, Lender's or Landlord's counsel should recognize that business decisions like this one often correlate with short memories. Later, when the risk actually hits, all fingers point to counsel. Therefore, counsel may want to keep a copy of counsel's memo warning of the bankruptcy risks of such a structure.

107 The author would argue, however, that Landlord should not accept such uncertainty any more than Lender should. An L/C should deliver security, not insecurity and issues. If it does not reliably deliver security, then it fails to achieve its central and single purpose. If Landlord is willing to accept a structure that infringes on Landlord's security in the one forum where security most matters, then Landlord did not really care about security in the first place.

108 The interplay between Landlord and Lender—Lender's control of the L/C and its proceeds—would go in a separate three-party agreement of the type presented in Chapter 39.

or straightforward. Similar questions and issues arise, and are regularly solved, throughout secured-lending transactions as a result of the need to consider bankruptcy law, which offers the ultimate test for every business transaction or deal structure.

Stepping back a bit from the details, Landlord may often find that the best solution to the Claim Cap Problem consists of having Guarantor obtain and deliver the L/C to back the guaranty. In many cases, this solution should simply do the job.

Some of the strategies described above hinge upon trying to separate the L/C from the lease, from Tenant, or from both, so Landlord can argue in Tenant's bankruptcy that the L/C has nothing to do with either. But wouldn't Tenant insist on having the right to require Landlord to return the undrawn L/C or prepaid rent under some circumstances? For example, Tenant would probably, and legitimately, want Landlord to return the L/C or its proceeds if: (1) Tenant cures its defaults; (2) Landlord defaults under the lease, and Tenant validly terminates it; (3) the building burns down, and Landlord elects not to restore; (4) the entire building is condemned; or (5) the lease expires under its terms, and Tenant performs all its obligations. In all these cases, Tenant would probably want the L/C returned even if the lease otherwise devotes seventeen pages to the propositions that Tenant has no interest of any kind in the L/C and the L/C has nothing to do with the lease or Tenant's rent.

Would Tenant's rights to the L/C under these circumstances give Tenant enough of an interest in the L/C and its proceeds for the bankruptcy court to say the L/C is really just like a cash security deposit and Tenant's delivery of an L/C doesn't solve the Claim Cap Problem? The answer may be that if Landlord has enough negotiating leverage, Landlord can insist that Tenant give up any right to the L/C or its proceeds under any circumstances and simply bear the risk of losing the L/C under the circumstances listed in the previous paragraph. In the dotcom leasing frenzy of the late 1990s, Landlords might have been able to get away with taking that position (or Tenants might have not noticed it because they were in too much of a hurry to sign their leases),¹⁰⁹ but the commercial leasing market of the early twenty-first century, particularly after mid-2007, seems rather different.

109 For some subsequent history about that marketplace, *see, e.g.*, Joshua Stein, *The Best Strategies for Extricating a Company From Its Long-Term Office Lease Obligations*, Start-Up & Emerging Companies, June 2001, at 1.

Tenant may also insist that if Landlord converts an L/C to cash, then: (1) Landlord can use such cash only to cure Tenant's defaults under the lease, to pay damages for Tenant's default under the lease (precisely the obligation that is subject to the Claim Cap) or both; and (2) Tenant will receive any interest Landlord earns on the cash. Would such requirements also tend to support a claim by Tenant's bankruptcy estate to the L/C proceeds?

Also, if the L/C proceeds are intended to be a security deposit that is not a security deposit, what does state law say about those proceeds? For example, if state law imposes certain requirements about how Landlord holds and applies a security deposit, must Landlord comply with them? What happens if Landlord does not? Would state law recharacterize as a security deposit either the L/C or its proceeds or one of the creative alternative arrangements suggested above?

How do the answers to these questions change if Guarantor delivers the L/C solely to back its guaranty, all in such a way that the L/C has no direct connection to the lease?

When appropriate, Landlord's counsel may want to invest some additional time and effort thinking about these and other questions and otherwise trying to solve any possible Claim Cap Problem.

In the excitement of worrying about the Claim Cap Problem, though, Landlords, Lenders, and their counsel should not lose sight of some other issues that might limit Landlord's ability to draw upon an L/C if Tenant files bankruptcy.

First, Landlord will want to confirm that the lease, or other appropriate documentation, will in fact allow Landlord to draw upon the L/C in the event of a Tenant bankruptcy, even if Tenant is not otherwise in default under the lease.¹¹⁰ Of course, some comments earlier in this Chapter suggest that such a draw might not always be wise. But Landlord would pre-

110 If a lease defines Tenant bankruptcy as a default, such a provision will be unenforceable against a Tenant in bankruptcy. *See* 11 U.S.C. § 365(e). Could Landlord nevertheless rely on it to support a draw upon the L/C? In the alternative, if Landlord wants the ability to draw upon the L/C in the event of a Tenant bankruptcy, should Landlord document that right somewhere outside the lease? In the L/C itself? And should Tenant be a party to that agreement? If not, who should be? *See* Kimberly S. Winick, *Tenant Letters of Credit; Bankruptcy Issues for Landlords and Their Lenders*, 9 Am. Bankr. Inst. L. Rev. 733, 739 (2001) ("The landlord also needs to be able to draw under the letter of credit upon the . . . tenant's bankruptcy. . . . This condition must be stated in the letter of credit in order to be enforceable.").

fer to retain the ability to make such a draw at any time after a Tenant bankruptcy filing.

Landlord should also consider the other conditions and requirements for making a draw, as stated in the lease.¹¹¹ Are those conditions flexible enough to cover every possible circumstance when Landlord might want to make a draw? Will Landlord be able to satisfy those conditions with no involvement or help by Tenant? Will the courts sustain the amount of Landlord's draw? Is the amount of the draw a penalty? Is Landlord's measure of damages enforceable?¹¹²

The use of an L/C makes it possible for Landlord to draw first and discuss later many of the interesting issues this Chapter covers. Landlord should, however, consider these issues when structuring and documenting the lease and the L/C, so the lease can help support a future argument for validity of the L/C and any draw upon the L/C—even aside from the Claim Cap Problem.

111 All drawing conditions and procedures for the L/C should appear in the lease alone and not in the L/C, at least from Landlord's perspective (subject to a possible exception for language allowing Landlord to draw upon the L/C if Tenant files bankruptcy). Once the lease allows a draw upon the L/C, Landlord should be able to draw upon the L/C by submitting the L/C and a sight draft, satisfying no other requirements in the L/C. Sometimes, though, Landlord cannot achieve this desired level of simplicity.

112 Recent developments in the larger financial world have created another set of questions for any Landlord to consider when accepting an L/C. What happens if Issuer fails, or is taken over by the Federal Deposit Insurance Corporation? Does Landlord still have a claim against Issuer? Does the lease require Tenant to replace the L/C under this circumstance? These issues lie beyond the present discussion.

CHAPTER THIRTY-NINE

THE ESSENTIAL GUIDE TO THE MOST IMPORTANT CLAUSE IN A COMMERCIAL LEASE: THE DEFAULT CLAUSE

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[39.0] I. INTRODUCTION

Commercial leases require an effective default clause that allows the landlord to force a tenant to comply with all lease obligations. The default clause commonly provides the procedure for obtaining an eviction or the threat of an eviction for a commercial tenant's violation of the lease. In addition, many default clauses include provisions requiring payments for unpaid rent or other damages, or for violations of non-monetary requirements in the lease, including, but not limited to, required landlord approvals for alterations and subleasing, or for failure to comply with the law and government regulations. A well-drafted default clause should incentivize a tenant to follow the protocols specified in the lease, knowing that an eviction and damages will result from a default. Because in many parts of the state, some more than others, commercial tenants are able to use the court system to delay and manipulate a landlord and its property, much time and money can be saved by negotiating a powerful and effective default clause—one that will motivate the tenant to comply with all of the terms and procedures of the lease, including the requirement for timely vacating the premises upon the expiration date of the lease.

The main objective of any default clause is to give the commercial landlord the legal means either (1) to cause the tenant to cure the breach in an expeditious manner; (2) to swiftly and efficiently obtain a judgment of eviction against a tenant in default of the lease and thus be able to re-let the premises to a new tenant ready and able to pay the rent; or (3) to minimize the landlord's out of pocket losses from the noncomplying tenant's breach of the lease. For these reasons, after the rent clause, the default clause is the most important clause in any commercial lease.

However, even the most frequently used "standard form" commercial leases permit a defaulting commercial tenant either (1) to procedurally stall a summary proceeding that would otherwise end in a swift eviction, or (2) to avoid a summary proceeding altogether by seeking equitable relief and applying for a so-called "*Yellowstone*" Injunction¹ or to use dozens of other defenses and tactics to keep the tenant in possession, often without paying rent. Since the authors started practicing law in commercial landlord-tenant court some decades ago, the courts have become less

1 See *First Nat'l Stores, Inc. v. Yellowstone Shopping Ctr., Inc.*, 21 N.Y.2d 630, 637, 290 N.Y.S.2d 721, 724-25 (1968) where, as a matter of common law, the Court of Appeals, in *dicta*, created a declaratory judgment action that stops the clock on a notice to cure while the parties litigate whether the tenant really is defaulting on the lease. See "Notices to Cure and Avoiding the *Yellowstone* Injunction," *infra*.

tolerant of tenant tricks, and many judges will follow the strict construction of the lease no matter how poorly written.

Simple cases can go on for years of debating or litigating a poorly written default clause. In many cases poorly drafted default clauses frustrate the ability of the landlord to take back the premises and to re-let to a new tenant who would pay rent for the leased space during what, in some cases, can be an unduly lengthy period of litigation. During this period, the tenant in default can take advantage of poorly drafted lease provisions and/or equitable judicial relief to continue in possession without, in some cases, paying any rent or other monies owed under the lease.

Nevertheless, while the consequences of poor drafting can hardly ever be avoided, the parties to a commercial lease may avoid intrusive judicial revision of their lease agreement by negotiating lease terms expressly intended to preclude such judicial activism.² New York courts have consistently enforced lease provisions that produce harsh results for one party to the lease “no matter how unwise it might appear to a third party.”³ Accordingly, attorneys representing landlords should strive to negotiate lease terms providing (1) that the lease shall be terminated for the chronic nonpayment of rent, (2) that all rents due during the lease term shall be accelerated upon one or more defaults in the payment of rent, (3) that the availability of a cure period, the trigger to seeking a *Yellowstone* Injunction, either be omitted from the lease entirely or that the lease contain agreed terms to be included in a *Yellowstone* injunction, should a court be inclined to grant one, such as the amount of the bond to be posted during the *Yellowstone* period, limitations on discovery, and a requirement for expedited litigation, and (4) that all monies due under the lease, other than the specified rent, shall be deemed “additional rent,” thus also making a default in payment of such “additional rent” subject to a summary non-payment proceeding.

2 Too many cases recite that it is not the job of the court to redraft a lease when that is precisely what the court is, in effect, doing.

3 “A lease agreement, like any other contract, essentially involves a bargained-for exchange between the parties. Absent some violation of law or transgression or a strong public policy, the parties to a contract are basically free to make whatever agreement they wish no matter how unwise it might appear to a third party.” *Rowe v. Great Atl. & Pac. Tea Co.*, 46 N.Y.2d 62, 412 N.Y.S.2d 62 (1978); see also *GAB Mgmt. v. Blumberg*, 226 A.D.2d 499, 641 N.Y.S.2d 340 (2d Dep’t 1966); *Queen Art Publishers, Inc. v. Animazing Gallery*, 2002 WL 452207 (N.Y.C. Civil Ct., N.Y. Co. 2002); *Grand Liberte Co-op, Inc. v. Bilhaud*, 487 N.Y.S.2d 250, 487 N.Y.S.2d 250 (App. Term, 1st Dep’t 1984).

In properly drawn commercial leases, monetary defaults give rise *both* to summary nonpayment proceedings under Real Property Actions and Proceedings Law § 711(2) (RPAPL) *and* summary holdover proceedings under RPAPL § 711(1), at the landlord's election.⁴ We note in passing that since the Supreme Court *Yellowstone* action is already slower than the local court summary proceeding, many practitioners throughout the State opt to counterclaim in a tenant's Supreme Court action with an ejectment cause of action, so that once all *Yellowstone* issues in the case are adjudicated, the eviction can proceed apace in the same proceeding, if the landlord prevails.

[39.1] II. COMMON PROVISIONS OF THE DEFAULT CLAUSE

[39.2] A. Events of Default

The commercial lease should specify all of the foreseeable circumstances where the landlord would want to protect its property interests and regain possession and control of the leased premises in order to remedy or forestall any condition, caused by a material act or omission of the tenant, or by a third party to whom the tenant is indebted, that is prejudicial to the landlord's property interests. Therefore, the most essential part of the default clause is a provision listing all of the situations that will be deemed to be an event of default under the lease.

Every lease negotiation is *sui generis* and dependent upon facts and circumstances relevant only to the particular premises and the parties involved. Nevertheless, there are several categories or "events" of default, other than property-specific defaults, that are common to most commercial leases.

1. Failure to pay rent in a particular month or months;
2. Having a pattern of late rent payments;
3. Failure to comply with any other lease term;
4. Third party action against tenant under bankruptcy or insolvency laws;

⁴ See discussion *infra* about default clauses that *appear* to give a landlord a summary holdover proceeding (RPAPL art. 7), but actually only allow for the normally longer, slower ejectment action (RPAPL art. 6).

5. Tenant's failure to use premises for Permitted Uses;
6. Illegal use of the premises or nuisance at the premises;⁵
7. Tenant's abandonment of the premises prior to the lease expiration date;
8. Guarantor in breach of its obligations under its guaranty of tenant's obligations or the death or insolvency of the Guarantor and Tenant's failure to furnish a suitable substitute;
9. Tenant's failure to provide an estoppel certificate;
10. Tenant's failure to comply with assignment or subleasing provisions; and
11. Tenant's misrepresentation regarding USA Patriot Act certification.

Each of these events of default should be negotiated for inclusion in most commercial leases.

[39.3] B. Conditional Limitation and Condition Subsequent

A conditional limitation is a lease provision that, upon the nonpayment of rent⁶ or upon the occurrence of any other event of default specified in the lease, gives the landlord the contractual right, before the expiration date specified in the lease, to prematurely terminate the lease, on a specific date set forth in a written notice of termination. By exercising this right, the landlord effectively terminates the lease prior to the date on which it would otherwise expire, as if the new termination date were the expiration date otherwise specified in the lease.

It is not the particular conduct of the tenant constituting the event of default that acts to terminate the lease.

Rather, it is by the passage of time—the period of time specified in the termination notice—that the lease auto-

5 RPAPL § 715, the so called “Bawdy House Law,” gives the district attorney and a large variety of other persons (including the owner) the statutory right to bring a proceeding to cancel a tenancy, regardless of the legal rights of the parties to the tenancy, if the premises are notoriously used for any kind of illegal business.

6 In many leases, monetary defaults are specifically carved out of the conditional limitation clause. Such clauses disfavor landlords and favor tenants. Thus, whether the practitioner wants such a clause depends on who his client is.

matically comes to an end; without service of a notice specifying the date of expiration of the lease there can be no termination and the lease remains in effect.⁷

The following is one example of a conditional limitation provision:

If a Default occurs,⁸ this lease is subject to the conditional limitation that Landlord may, at any time during the continuance of the Default, give notice to Tenant that this lease shall terminate on the date specified in that notice, which date shall not be less than five (5) days after Landlord gives such notice to Tenant. If Landlord gives that notice, this lease and the Term shall expire and come to an end on the date set forth in that notice as if said date were the date originally fixed in this lease as the Expiration Date and Tenant shall quit and surrender the Premises to Landlord (but Tenant shall remain liable as provided in this lease).

The service of a notice of termination in accordance with the terms of a proper conditional limitation provision enables the landlord to maintain a summary holdover proceeding under RPAPL § 711(1) against a tenant who remains in possession beyond the expiration date specified in the notice of termination.⁹ The fact that the landlord, at its option, could bring a nonpayment proceeding in which tenant would have the right, under RPAPL § 751(1), to deposit the amount of the final judgment into court prior to the issuance of a warrant, does not preclude the landlord from ter-

7 *TSS-Seedman's, Inc. v. Elota Realty Company*, 72 N.Y.2d 1024, 1027, 534 N.Y.S.2d 925, 926 (1988) (conditional limitation provision in commercial lease, which required the landlord to give written notice to the tenant specifying the default and stating that the lease shall expire and terminate on a prescribed date “which must be at least five days after the giving of the notice [of termination],” permitted the tenant to cure the default within a separate five-day grace period in which to pay the rent, as otherwise provided in the lease, and the landlord’s service of a notice of termination, *after accepting the tenant’s rent payment within that separate five-day grace period*, was “ineffective” because the termination notice was sent after the tenant had cured the default in accordance with the lease terms). *See also Midco Nowash LLC v. #1 Travel, Inc.*, 29 Misc. 3d 254, 905 N.Y.S.2d 765 (Dist. Ct., Nassau Co. 2010).

8 In more conservatively drawn leases, conditional limitation clauses like this one rely on “Default” being a lease-defined situation that persists after the expiration of the cure period specified in the Notice to Cure. *See Yellowstone* discussion *infra* as to the advantages and disadvantages of this conservative drafting.

9 *See Perrotta v. Western Regional Off-Track Betting Corp.*, 98 A.D.2d 1, 469 N.Y.S.2d 504 (4th Dep’t 1983).

minating the lease in accordance with its terms and maintaining the hold-over proceeding instead.¹⁰

Nevertheless, because a summary holdover proceeding is entirely statutory in origin, “there must be strict compliance with the statute to give the court jurisdiction.”¹¹ It is therefore important that the notice of termination be given in connection with an act or omission, for which the landlord may invoke the *conditional limitation* provision of the lease and specify the date on which the lease shall *automatically expire*, and not be given for an act or omission constituting a breach of a *condition* of the lease that subjects the lease to termination only *at the option of the landlord*, for which an action of ejectment against a holdover tenant would be required.¹²

In other words, if the commercial lease provision is deemed a “condition subsequent,”¹³ instead of a conditional limitation, a judge may dismiss the summary proceeding in the Commercial Part of landlord-tenant court or civil court and decide that the case must be brought in State Supreme Court in an ejectment action.¹⁴ Generally, summary proceedings in the Commercial Part of landlord-tenant court proceed more quickly

10 See *Grand Liberte Coop v. Bilhaud*, 126 Misc. 2d 961, 487 N.Y.S.2d 250 (Sup. Ct., App. Term, 1st Dep’t 1984). However, in residential proceedings, termination clauses based upon monetary defaults have been held to be void as against public policy.

11 *Perrotta*, 98 A.D.2d 1.

12 *Id.*

13 The literature renders this all the more confusing by sometimes referring to conditions subsequent simply as “conditions.” A “condition subsequent” or “condition” (or even more rarely a “condition of the lease”) can be defined as a situation that gives the landlord the *option* to cancel the lease, but not until the landlord’s exercise of that option will the cancellation be actually effected. A condition subsequent may also be the unknown future occurrence of an event that will automatically cancel the lease, such as a clause which provides that, in the event of a Congressional declaration of war, the lease shall be automatically canceled. By contrast, in the event of the invocation of a “conditional limitation,” after a lease default, the expiration of the period of time specified in the notice of termination, automatically effects the cancellation of the lease. In such cases, the only question at issue may be whether the landlord’s notice of termination was given with or without first giving the tenant a notice of default specifying a time within which to cure the default. Some decisions have sought to cut through all the theory to hold that, where there is a notice to cure requirement, there is a conditional limitation, and, where there is no notice to cure requirement, there is a condition subsequent. See, e.g., *VNO 100 W. 33rd St. LLC v. Square One Manhattan, Inc.*, 22 Misc. 3d 560, 874 N.Y.S.2d 683 (N.Y.C. Civ. Ct., N.Y. Co. 2008).

14 Some local courts, like the New York City Civil Court, actually do have jurisdiction to hear ejectment actions, but typically only if the assessed value of the real property is within the monetary jurisdiction of the Court. See N.Y.C. Civil Court Act § 203(j). Since such monetary values are so low, such ejectment actions are exceedingly rare.

than do landlord-tenant cases brought in State Supreme Court. In commercial lease cases brought in landlord-tenant court, discovery is rarely permitted, and in cases where no motions are made in the Commercial Part in New York City on the return date of the petition, those matters are immediately sent out to any judge who is available to hear or try the case. Most commercial landlord-tenant cases will be concluded in a number of months in New York City and weeks in some other parts of the State.¹⁵ By contrast, the proceedings in commercial landlord tenant actions brought in State Supreme Court can extend for several years. This highlights the importance of why a proper notice of termination should be deemed given for violation of a conditional limitation of the lease and not merely for a condition subsequent thereof.

[39.4] C. Notice Provisions

A landlord's notice of default¹⁶ is distinct from a landlord's notice of termination. A notice of default specifies the particular lease provision that the tenant has violated and the period, if any, within which the tenant is obliged to cure the default before the lease becomes subject to termination under its conditional limitation provision.

The notice of default "must be sufficiently specific to demonstrate what remedial action is being required and what lease provision requires it."¹⁷ Unless the landlord demonstrates what remedial action is required by the lease, "the omission in the notice must be considered a fatal defect."¹⁸

However, even where the notice of default is not sufficiently specific on its face, the landlord may still be able to demonstrate, from the correspondence and communications between the parties prior to the notice, that the

15 In some regions of the State, the greatest source for delay in summary proceedings is the limited number of days the Court is sitting to hear such proceedings in any given week. Practitioners should acquaint themselves with the appropriate calendar practice of the court where they are bringing their proceeding. Also, in most parts of the State, State Supreme Court sits in the County Seat while the courts hearing summary proceedings are local to the location of the property in question. In those many parts of the state where there is a Village or a City contained within the boundaries of a Town, there can be two local courts, each of which has *statutory* jurisdiction to hear a summary proceeding, but only one of which actually entertains them, typically the Town Court.

16 It is also commonly known as a "Notice to Cure."

17 *White Angel Realty v. Asian Bros. Corp.*, 183 Misc. 2d 674, 676, 706 N.Y.S.2d 583, 585 (Dist. Ct., Nassau Co., 2000) citing *Chinatown Apts, Inc. v. Chu Cho Lam*, 51 N.Y.2d 786, 433 N.Y.S.2d 86 (1980).

18 *Chinatown Apts, Inc.*, 51 N.Y.2d 786.

tenant fully appreciated the nature of the breach stated in the notice of default. Therefore, in an appropriate case, “evidence extrinsic to the notice may be considered in assessing the notice’s sufficiency.”¹⁹ Nevertheless, attorneys should always strive to make the notice of default sufficiently specific on its face, to avoid ever having to persuade a court to admit evidence extrinsic to the notice to determine its sufficiency.

The lease usually specifies various permissible methods for landlord’s service of a notice of default upon the tenant—hand delivery, registered or certified mail, and/or recognized overnight courier. For each method of service, the lease should also specify how and when service is considered to have occurred.

The point of specifying methods by which a notice of default is to be given is, fundamentally, to ensure that the putative defaulter has actual notice and an opportunity to protest the claim of default or, if so provided, to avail itself of an opportunity to cure the default, if any.²⁰

Any ambiguity concerning the effective date on which the notice of default is deemed received by the tenant is resolved against the drafter of the lease.²¹

If the tenant wishes to preserve the right to cure a default under the lease by commencing a *Yellowstone* declaratory judgment action,²² the tenant must obtain a stay of the period within which the default may be cured by seeking an injunction in state supreme court. “The existence of a

19 *White Angel Realty*, 183 Misc. 2d 674.

20 *Gucci Am., Inc. v. Sample Sale Wholesalers, Ltd.*, 39 A.D.3d 271, 272-273, 835 N.Y.S.2d 26 (1st Dep’t 2007).

21 *See Solow Bldg. Co., LLC v. Frelau LLC*, 27 Misc. 3d 32, 899 N.Y.S.2d 794 (Sup. Ct., App. Term, 1st Dep’t 2010).

22 In form, a *Yellowstone* action is an action seeking a declaratory judgment declaring that the Tenant is *not* in default of the requirements of the lease. However, under the doctrine enunciated in the *Yellowstone* decision, if the action does not include an application for a Temporary Restraining Order and a motion for Preliminary Injunction against terminating the lease, the demand for the declaration will be rendered moot because the remedy will necessarily be too late to be effective. The standards for obtaining such a TRO and Preliminary Injunction in *Yellowstone* litigation are much more liberal than otherwise required in New York Civil Practice. Most courts require little more than a showing that there are a commercial lease and a notice to cure, the application made prior to the expiration of the notice to cure, and the formal requirement of a desire and ability to cure. Rarely are such applications denied, and if they are denied, but the denial is reversed on appeal, the appellate reversal is *nunc pro tunc* to the date of the application for the emergency relief.

period in which a violation may be cured does not depend on the contents of the notice of default, but upon the terms of the lease.”²³ Thus, although the landlord’s failure to state a cure period in the notice of default may render the notice defective, “it does not vitiate the cure period itself.”²⁴ However, the failure of a tenant to toll the curative period specified in the lease divests a court of its power to grant a temporary stay under *Yellowstone*.²⁵ The period between a notice of termination and the lease expiration date specified in accordance with the conditional limitation provision is not one within which the tenant can cure a default.²⁶ Conditions subsequent do not give rise to *Yellowstone* actions, but they also do not give rise to summary holdover proceedings.

[39.5] III. TOOLS OF THE EFFECTIVE DEFAULT CLAUSE

[39.6] A. Additional Rent

It is important that all monies the lease requires the tenant to pay during the term of the lease, other than the rent itself, be expressly designated as “additional rent.” Additional rent can include late charges, taxes, various building expenses, attorney’s fees, letters of credit, insurance, and any other items specific to the particular premises involved that the landlord requires the tenant to pay. If such items are designated as “additional rent” in the lease, the landlord may initiate a summary proceeding to recover possession of the premises for the tenant’s failure to make a required payment of additional rent, whether or not the tenant has paid the requisite monthly base rent.²⁷

23 *Empire State Bldg. Assocs. v. Trump Empire State Partners*, 245 A.D.2d 225, 228, 667 N.Y.S.2d 31, 34 (1st Dep’t 1997).

24 *Id.*; see also *TSS-Seedman’s, Inc. v. Elota Realty Company*, 72 N.Y.2d 1024, 534 N.Y.S.2d 925 (1988).

25 *See Health ‘N Sports, Inc. v. Providence Capitol Realty Group, Inc.*, 75 A.D.2d 884, 428 N.Y.S.2d 288 (2d Dep’t 1980).

26 *Id.*

27 *See Melick v. Ken’s Service Station, Inc.*, 44 Misc. 3d 143(A), 2014 WL 4251023 (Sup. Ct., App. Term, 2d Dep’t 2014).

If the lease requires the tenant to pay the particular charge but does not expressly designate the item as “additional rent,” it will not be deemed additional rent by the court.²⁸

Where the lease itself is “reasonably susceptible of more than one interpretation” as to how the additional rent is to be calculated, the court may properly consider evidence of the parties’ course of conduct, including the methodology used by the landlord in its annual billing for additional rent and the tenant’s payment of such additional rent since the beginning of the tenancy.²⁹ Nevertheless, attorneys should strive to eliminate all ambiguities concerning the calculations required to accurately determine the amounts that will become due as additional rent under the lease.

It should be noted that General Obligations Law § 7-103(1) (GOL) provides that a tenant’s security deposit, until repaid to the tenant at the termination of the lease *or applied to payments due under the lease*,

shall continue to be the money of the person making such deposit or advance and shall be held in trust by the person with whom such deposit or advance shall be made and shall not be mingled with the personal moneys or become an asset of the person receiving the same.

It has been held, therefore, that the tenant’s security deposit itself is not “rent,” and it cannot be recovered in a nonpayment proceeding.³⁰ Nor does the New York City Civil Court or any Local Court have jurisdiction to order a tenant to replenish a security deposit that has been applied to payments due under the tenant’s lease obligations.³¹ However, the failure to maintain the security deposit is a breach of a substantial obligation of the lease and is therefore a proper basis for a conditional limitation and ensuing holdover proceeding.³²

28 See, e.g., *Perrotta v. Western Regional Off-Track Betting Corporation*, 98 A.D.2d 1, 469 N.Y.S.2d 504 (4th Dep’t 1983); *Rector of Trinity Church v. Chung King House of Metal, Inc.*, 193 Misc. 2d 44, 747 N.Y.S.2d 292 (NYC Civil Court 2002).

29 *One Hundred Grand, Inc. v. Chaplin*, 70 A.D.3d 513, 895 N.Y.S.2d 68, 69 (1st Dep’t 2010), citing *Chimart Assoc. v. Paul*, 66 N.Y.3d 570, 573, 498 N.Y.S.2d 344 (1986).

30 See, e.g., *225 Holding Co., LLC v. Beal*, 12 Misc. 3d 136(A), 820 N.Y.S.2d 846 (Sup. Ct., App. Term, 2d Dep’t 2006).

31 *930 Fifth Ave. Corp. v. Shearman*, 17 Misc. 3d 1126(A), 851 N.Y.S.2d 71 (N.Y.C. Civ. Ct., N.Y. Co. 2007) (Lebovits, J.).

32 See *225 Holding Co., LLC*, 12 Misc. 3d 136(A).

[39.7] B. Rent Acceleration

As the most powerful weapon ever devised for a lease, aside from the guarantee provision, rent acceleration clauses provide a wonderful way to ensure that rent payments are not only made, but are made timely. Upon a default in the payment of rent, a properly drafted acceleration clause permits the landlord to seek recovery of the total balance of rent due under the lease without having to wait until the lease's expiration date. Without a properly drafted acceleration clause, the right of the landlord to sue for damages for the breach of the lease accrues, generally, upon the termination date of the lease.³³

[I]n rare cases, agreements providing for the acceleration of the entire debt upon the default of the obligor may be circumscribed or denied enforcement by utilization of equitable principles. In the vast majority of instances, however, these clauses have been enforced at law in accordance with their terms. * * * * Absent some element of fraud, exploitive overreaching or unconscionable conduct on the part of the landlord to exploit a technical breach, there is no warrant, either in law or equity, for a court to refuse enforcement of the agreement of the parties.³⁴

However, as discussed at length below, the Court of Appeals' recent decision in *172 Van Duzer Realty Corp. v. Globe Alumni Student Assistance Association*³⁵ casts some doubt on the full collectability of accelerated rent. In *Van Duzer*, the Court held that a hearing on the landlord's actual damages may be necessary to determine what portion of accelerated rent, undiscounted, will not constitute an otherwise forbidden penalty. Under "penalty" jurisprudence, a lease that provides for acceleration for breach of any of its terms, no matter how trivial or inconsequential, is likely to be considered an unconscionable penalty and will not be enforced by a court of equity.³⁶ For example, acceleration will not be permitted for a tenant's failure to comply with a covenant collateral to the

33 See *Muss v. Daytop Village, Inc.*, 43 A.D.2d 945, 352 N.Y.S.2d 28 (2d Dep't 1974).

34 *Fifty States Mgmt. Corp. v. Pioneer Auto Parks, Inc.*, 46 N.Y.2d 573, 577, 415 N.Y.S.2d 800 (1979).

35 24 N.Y.3d 528, 2 N.Y.S.3d 39 (2014). Author Bailey has his doubts about *Van Duzer* being good law and sees it as an anomaly. Since it is a relatively recent decision, there is no track record with which to evaluate this position. The doctrine announced in the case is discussed, *infra*.

36 *Fifty States Mgmt. Corp.*, 46 N.Y.2d 573.

primary obligation of the tenant. In such circumstances, acceleration will be held to constitute a forfeiture, as the damages reserved in the lease are likely to be disproportionate to any actual loss that could possibly accrue to the landlord from such breach.³⁷

However, a covenant to pay rent at a specified time “is an essential part of the bargain as it represents the consideration to be received for permitting the tenant to remain in possession of the property of the landlord.”³⁸ Therefore, acceleration is permitted as liquidated damages if the sum to be recovered is no greater than the amount the tenant would have paid had it fully performed and been entitled to possession upon payment.³⁹ Further, it has been held that a single default in the payment of rent is sufficient to effectuate an acceleration clause.⁴⁰ Moreover, where the lease terms can be construed to allow it, the tenant’s guarantor can also be held liable for the accelerated sum due under the lease.⁴¹

It should be noted that the Second Department has held that “accelerated rent” is not “rent due.”⁴² As the court explained, “accelerated rent” is “contractual damages not recoverable in a summary proceeding.” Accordingly, upon a default by the tenant, the landlord can use summary proceedings to regain possession of the premises with a judgment of eviction and a monetary judgment for past rent due. But, to recover the monies due upon the contractual claims for accelerated rent and other monetary obligations that survive the termination of the lease, the landlord must commence a plenary action.⁴³ The judgment entered for the landlord in the summary proceeding is neither *res judicata* nor an election of remedies and therefore does not bar the landlord from seeking contractual damages in the plenary action. As the Second Department further explained,

[r]es judicata is inapplicable where a party is unable to seek a certain remedy or form of relief in the first action

37 *Id.*

38 *Id.* at 578.

39 *Id.*, subject to *172 Van Duzer Realty Corp.*, 24 N.Y.3d 528.

40 *GAB Management, Inc. v. Blumberg*, 226 A.D.2d 499, 641 N.Y.S.2d 340 (2d Dep’t 1996).

41 *See Madison Ave. Leasehold, LLC v. Madison Bentley Assocs. LLC*, 8 N.Y.3d 59, 861 N.Y.S.2d 254 (2006).

42 *Ross Realty v. V & A Fabricators, Inc.*, 42 A.D.3d 246, 836 N.Y.S.2d 242 (2d Dep’t 2007).

43 *Id.*; *see also 930 Fifth Ave. Corp. v. Shearman*, 17 Misc. 3d 1126(A), 851 N.Y.S.2d 71 (N.Y.C. Civ. Ct., N.Y. Co. 2007); *Marketplace v. Smith*, 181 Misc. 2d 440, 694 N.Y.S.2d 893 (J. Ct., Monroe Co. 1999).

because of limitations on the subject matter jurisdiction of the court or restrictions on its authority to entertain multiple remedies or form of relief in a single action.⁴⁴

[39.8] C. Late Charges

Commercial lease clauses that impose late charges for failing to pay rent or other additional rent obligations in a timely manner, and which specify that the late charges shall also be deemed additional rent, are generally enforced by the courts.⁴⁵ However, late charges, as additional rent, may be sought only for rent that is past due. At the time of a default, where a lease does not contain a rent acceleration clause, the landlord may sue only for the amount of late charges past due at the time the action or proceeding is commenced.⁴⁶ In such cases, the landlord's entitlement for damages for the remaining installments of rent will ripen and may be sued for at the end of the lease term.⁴⁷

Whether or not the particular late charge specified in any commercial lease, or the formula used to calculate such late charge, as negotiated between sophisticated business people, may be found to be "unconscionable" will depend upon whether there is evidence suggesting that the late charge was unreasonable or against public policy.⁴⁸ The late fee must bear some reasonable relationship to the landlord's additional administrative expense by reason of the lateness. If the late fee is too high, the courts regard it as an unenforceable penalty.⁴⁹

[39.9] D. Chronic Nonpayment

A necessary part of an effective default clause is a provision enabling the landlord to cancel the lease for the frequent delinquency of rent payments, commonly referred to as a "chronic nonpayment" of rent due termination clause. It often happens that a landlord who is forced to

44 *Ross Realty*, 42 A.D.3d 246.

45 *See, e.g., Goldman v. MJI Music, Inc.*, 17 Misc. 3d 1127(A), 2007 WL 3378369 (N.Y.C. Civ. Ct., Kings Co. 2007).

46 *See, e.g., Barr v. Country Motor Car Group, Inc.*, 15 A.D.3d 985, 789 N.Y.S.2d 350 (4th Dep't 2005).

47 *Id.*

48 *See, e.g., K.I.D.E. Associates, Inc. v. Garage Estates Company*, 280 A.D.2d 251, 720 N.Y.S.2d 114 (1st Dep't 2001).

49 *Wilsdorf v. Fairfield Northport Harbor, LLC*, 34 Misc. 3d 146(A), 2012 WL 330928 (Sup. Ct., App. Term, 2d Dep't 2012).

commence a nonpayment proceeding in New York City Civil Court, or other local court with summary jurisdiction, is faced with a tenant who is either chronically late in paying the rent or does not pay the rent at all, thus causing the landlord to have to institute repeated legal proceedings to procure the timely payment of rent.⁵⁰

Including the time it takes to obtain a court date, to request shortened adjournment periods, and a resolution by settlement, trial, or default in the case of a non-appearance, the earliest a landlord can expect to obtain an eviction will be no less than three to five months after commencement of the nonpayment process.⁵¹ Even after an eviction is scheduled, RPAPL § 751(1) mandates that the tenant be given ten days to pay the amount of rent owed to stay the issuance of a warrant and avoid eviction.

For many landlords, the cycle of late payments or nonpayment is repeated continuously and, in many cases, perennially. To further exacerbate their frustration, in addition to the wasted energy, time, and money they expend in participating in the process, many cases result in empty tenancies with thousands of uncollectible dollars. Accordingly, although “[a] history of repeated nonpayment proceedings brought to collect chronically late rental payments supports an eviction proceeding on the ground that the tenant has violated a ‘substantial obligation’ of the tenancy,”⁵² attorneys should strive to draft into any default clause a provision by which the tenancy is terminated for the chronic nonpayment of rent.

A chronic nonpayment provision terminates the tenancy upon the happening of multiple defaults in the timely payment of rent. A typical clause will terminate the tenancy once a tenant fails to timely pay the rent at least three times within a twelve consecutive month period. Even where the lease contains a grace period (typically five days) within which the tenant is normally permitted to cure a default for nonpayment after issuance of a notice of default, the chronic nonpayment provision can prescribe that, after two consecutive defaults, the landlord, prior to serving the notice of termination, is not required to serve the tenant with a notice of default for a third consecutive default, but may, after the expiration of the five-day grace period, immediately serve the notice of termination. Therefore, the third consecutive default triggers the termination of the lease automati-

50 See, e.g., *National Shoes v. Annex Camera & Elecs., Inc.*, 114 Misc. 2d 751, 452 N.Y.S.2d 537 (N.Y.C. Civ. Ct., N.Y. Co. 1982).

51 Some less urban areas of the State report shorter periods, but not by a lot.

52 *Adam's Tower Ltd. Partnership v. Richter*, 186 Misc. 2d 620, 757 N.Y.S.2d 825 (Sup. Ct., App. Term, 1st Dep't 2000); see also *Sharp v. Norwood*, 89 N.Y.2d 1068, 659 N.Y.S.2d 834 (1997).

cally.⁵³ At this point the commercial tenant cannot ward off eviction by paying the rent in full. As a result of the chronic nonpayment clause, the landlord has the option of evicting the tenant, so long as the requirements of the chronic nonpayment provision have been followed and proven in court. This is one instance where the precedents are clear both that a summary holdover proceeding lies and that it does *not* require an antecedent notice to cure.⁵⁴

[39.10] E. Self-Help Evictions

Upon termination of the lease or upon the commercial tenant's defaulting on payment of rent or other lease terms, a landlord may reenter the leased premises peaceably without resort to court process, when the right to do so is expressly reserved in a commercial lease.⁵⁵ A commercial landlord's common law right to use "self-help" to reenter its property peaceably to evict a defaulting tenant or other person with no right to possession has been recognized from time immemorial.⁵⁶ Nevertheless, although the common law right of self-help reentry is not abrogated by the statutory remedy of summary proceedings,⁵⁷ it is a remedy that is rarely used and in many municipalities throughout the state abolished or restricted. The extent of self-help available also varies by Judicial Department.⁵⁸

53 See, e.g., *Midco Nowash LLC v. #1 Travel, Inc.*, 29 Misc. 3d 254, 905 N.Y.S.2d 765 (Dist. Ct., Nassau Co., 2010); see also *Estate of Birnbaum v. Yankee Whaler*, 75 A.D.2d 708, 427 N.Y.S.2d 1291 (4th Dep't 1980).

54 *Definitions Personal Fitness, Inc. v. 133 E. 58th St.*, 107 A.D.3d 617, 967 N.Y.S.2d 647 (1st Dep't 2013); *Adam's Tower*, 186 Misc. 2d 620, 717 N.Y.S.2d 825.

55 See *Bozewicz v. Nash Metalware Co., Inc.*, 284 A.D.2d 288, 725 N.Y.S.2d 671 (2d Dep't 2001); *110-45 Queens Blvd. Garage, Inc. v. Park Briar Owners, Inc.*, 265 A.D.2d 415, 696 N.Y.S.2d 490 (2d Dep't 1999); *Jovan Spaghetti House, Inc. v. Heritage Co. of Massena*, 189 A.D.2d 1041, 592 N.Y.S.2d 879 (3d Dep't 1993).

56 See *Bliss v. Johnson*, 73 N.Y. 529, 534 (1878) ("The true owner of land wrongfully held out of possession may watch his opportunity, and if he can regain possession peaceably may maintain it—and lawfully resist an attempt by the former occupant to retake possession, nor will he be liable to be proceeded against under the statute of forcible entry and detainer. There can be no wrongful detainer by the true owner when the entry was both lawful and peaceable."); *Fults v. Munro*, 202 N.Y. 34, 39 (1911) ("Statutes relating to forcible entry and to forcible detainer, which are separate and distinct wrongs, have existed for centuries."); see also *Mayer v. UVI Holdings, Inc.*, 280 A.D.2d 153, 723 N.Y.S.2d 151 (1st Dep't 2001).

57 See *Cohen v. Carpenter*, 128 A.D. 862, 113 N.Y.S. 168 (2d Dep't 1908); *Liberty Indus. Park Corp. v. Protective Packaging Corp.*, 71 Misc. 2d 116, 335 N.Y.S.2d 333 (Special Term, Kings Co., 1972), *aff'd*, 43 A.D.2d 1020, 351 N.Y.S.2d 944 (2d Dep't 1974).

58 Practitioners should be certain to know the local ordinances on the subject prior to expressing an opinion.

Attorneys who represent commercial landlords are often reluctant to advise their clients to use this neglected self-help remedy to regain possession of leased premises from defaulting commercial tenants.⁵⁹ This reluctance stems, in part, from the perception that courts are generally hostile to a commercial landlord's use of self-help, because self-help renders a forfeiture of the premises before a tenant can litigate its right to remain in possession.⁶⁰ In addition, because of the lack of use of self-help many attorneys are unfamiliar with this body of law and are hesitant to employ such an aggressive measure. Courts also refuse to approve use of self-help where there is ambiguity in the lease terms or factual questions concerning the expiration of the lease.⁶¹ Moreover, under RPAPL § 853, a tenant wrongfully ejected from real property by force or other unlawful means may sue to recover treble damages from the landlord and be restored to possession if ejected before the end of the lease term.⁶²

As a result of the combination of general court hostility and attorney reluctance to recommend the use of proper self-help measures, commercial tenants have been allowed to violate their leases or extend them based on technical or frivolous defenses, sometimes for months or years at a time, in blatant disregard of the lease terms.⁶³ In addition to the loss of rental income that often accompanies such disputes, landlords faced with this situation lose valuable time to repair, renovate, and re-let their premises to responsible tenants. These circumstances also adversely affect any effort by the landlord to sell the leased premises to potential buyers.

Landlords have every incentive to insist on including a proper and effective self-help provision in their commercial leases. With appropriate drafting and proper execution of the self-help measures provided in their leases, commercial landlords should be able to exercise their right to peaceable reentry whenever such action is warranted. With the availability

59 Self-help is limited to the commercial context only. New York City Administrative Code § 26-521 prohibits the use of self-help in the residential context.

60 Courts created the so-called "Yellowstone" injunction to allow the parties to dispute their differences while the tenant remains in possession and to prevent forfeiture. *See, e.g., Stuart v. D&D Assocs.*, 160 A.D.2d 547, 554 N.Y.S.2d 197 (1st Dep't 1990).

61 *See Sol De Ibiza, LLC v. Panjo Realty, Inc.*, 26 Misc. 3d 331, 890 N.Y.S.2d 806 (N.Y.C. Civ. Ct., N.Y. Co. 2009), *reversed and remanded on undeveloped record*, 29 Misc. 3d 72, 911 N.Y.S.2d 567 (App. Term, N.Y. Co. 2010).

62 *See Suffolk Sports Center, Inc. v. Belli Constr. Corp.*, 212 A.D.2d 241, 628 N.Y.S.2d 952 (2d Dep't 1995).

63 *See, e.g., Million Gold Realty Co. v. S.E. & K. Corp.*, 4 A.D.3d 196, 772 N.Y.S.2d 271 (1st Dep't 2004).

of self-help written into the lease, tenants are likely to be more careful to avoid any action that will place themselves in default and thereby become subject to immediate peaceable eviction. Thus, commercial landlords may both (a) provide an incentive for their tenants to comply with the lease terms, and (b) be able, when compelled to use self-help, to timely re-let the premises without first having to await the outcome of costly and lengthy litigation before doing so.

Nevertheless, landlords who use self-help will not necessarily be able to avoid all litigation. There is always a possibility that the landlord will be required to litigate (a) whether the tenant was in default at the time of the landlord's reentry, and/or (b) whether the self-help used was peaceable and otherwise lawful.⁶⁴ Therefore, landlords should (a) carefully document a tenant's default before reentering the leased premises and (b) ensure that reentry is accomplished peaceably. Where it is not crystal clear that the lease term has expired or that the tenant is in default, the landlord should not use self-help, but should resort only to summary proceedings or other legal process. However, recognizing that the outcome of any litigation is always uncertain, a landlord may view the possibility of a future, adverse treble damages judgment as a risk worth taking in order to obtain the real, current ability to re-let the premises to a responsible tenant who will pay rent during the litigation that ensues between the landlord and the evicted tenant. Also, it is wise to remember that three times zero is still zero. If there are no genuine damages, trebling them is not going to hurt the landlord.

In deciding whether or not to run that risk, the landlord should consider the kind of damages that the evicted tenant will have a right to claim, i.e., whether any injury caused by the reentry will be limited to property damage only or whether the evicted tenant will be able to claim and prove damages measured by the loss of the value of the leasehold.⁶⁵ Where the lease has expired or been terminated by reason of the default, the tenant is not entitled to possession.⁶⁶ In that situation, the tenant's damage is likely to be limited to such property damage as may occur during the course of the reentry only—the sum of which a landlord may be more than willing to bear—but a judgment that the landlord may also be able to avoid by taking care to see that the tenant's property is carefully removed from the

64 See *Maracina v. Shirrmeister*, 105 A.D.2d 672, 673, 482 N.Y.S.2d 14, 16 (1st Dep't 1984) ("RPAPL 853 no longer requires that the use of physical force be demonstrated.")

65 See *Mayes v. UVI Holdings, Inc.*, 280 A.D.2d 153, 723 N.Y.S.2d 151 (1st Dep't 2001).

66 See *110-45 Queens Blvd. Garage, Inc. v. Park Briar Owners, Inc.*, 265 A.D.2d 415, 696 N.Y.S.2d 490 (2d Dep't 1999).

premises by persons other than the landlord itself, such as a bonded moving company, and placed in a reputable storage facility.

Whether a landlord's reentry is deemed peaceable or not will depend on whether it is made in a "forcible" manner. For a reentry to be forcible, the force used:

must be unusual and tend to bring about a breach of the peace, such as an entry with a strong hand, or a multitude of people, or in a riotous manner or with personal violence, or with the threat and menace to life or limb, or under circumstances which would naturally inspire fear and lead one to apprehend danger or personal injury if he stood up in defense of his possession.⁶⁷

In the absence of force that tends to breach the peace, hiring trucks and workers and even a garbage company to evict a tenant does not constitute forcible entry,⁶⁸ even if, in the case of a municipal landlord, the eviction is performed with the assistance of armed police.⁶⁹ However, to ensure that its use of self-help is indeed "peaceable" and that there is no confrontation during the eviction, the landlord should arrange for the reentry to occur during late night/early morning hours when the tenant's business is closed and when the landlord's agents are certain that no one is present on the leased premises before entering. When conducting the eviction, if there is any conflict with the tenant or its representatives, the attempted eviction should be abandoned and accomplished at a later date or under court order.

Upon reentry, when the peaceable self-help eviction is successful, the landlord may then change the locks or padlock the doors. To thwart any potential damage claims, the entire reentry operation should be videotaped, and all items of tenant property removed from the property should be photographed and inventoried. The tenant's property should then be placed in storage, for a reasonable period of time,⁷⁰ in accordance with a lease provision that contemplates such action in the event of an eviction.

67 *Fults v. Munro*, 202 N.Y. 34, 39 (1911).

68 *See Liberty Indus. Park Corp. v. Protective Packaging Corp.*, 71 Misc. 2d 116, 335 N.Y.S.2d 333 (Special Term, Kings Co., 1972), *aff'd*, 43 A.D.2d 1020, 351 N.Y.S.2d 944 (2d Dep't 1974).

69 *See Paulino v. Wright*, 210 A.D.2d 171, 620 N.Y.S.2d 363 (1st Dep't 1994).

70 Universal custom supported by no case law whatsoever, deems "reasonable time" to be thirty days.

Ultimately, whether or not the landlord is permitted to use self-help to regain possession of the leased premises will depend on whether the landlord's right to do so is reserved in the lease. The lease should expressly provide (a) that, if the tenant defaults in the payment of rent or commits any other violation of the lease constituting a default, the lease shall terminate automatically, (b) that the landlord may thereafter recover possession in accordance with its common law rights, (c) that the landlord may do so without any duty, requirement, or necessity to provide due process or to seek prior court approval, through summary dispossess proceedings or any other action or proceeding at law, before evicting the tenant and removing tenant's property and/or any person from the premises, and (d) that the term "re-entry" is not used in its technical or narrow sense but in the sense that the landlord may effect *physical* entry of the premises.⁷¹ Such a provision does not preclude the landlord from initiating summary proceedings if it chooses to do so. However, the landlord should exercise its options carefully. If the landlord does not use self-help initially, but commences a summary proceeding in the first instance, the right to use self-help thereafter may be considered waived.⁷²

The lease terms should also obligate the tenant to pay the landlord all monies owed by the tenant up to the time of the landlord's recovery of possession, whether the landlord recovers possession through self-help or summary proceedings. In addition, the lease should reserve the landlord's right to sue after reentry for any damages incurred as a result of the tenant's actions, such as an unlawful holdover that causes the landlord to lose an opportunity for re-letting the premises. The lease should provide that the landlord need not assert such claims against the tenant in summary proceedings only, but may do so in a separate plenary action.

While there are decided risks involved in using self-help measures, the careful landlord and the careful landlord's attorney should generally be able to avoid the pitfalls that exist and make self-help work to the landlord's benefit in the long run.

71 This clause is essential because much case law continues to define "re-entry" simply as the right to bring a summary proceeding.

72 See *Sol de Ibiza, LLC v. Panjo Realty, Inc.*, 26 Misc. 3d 331, 890 N.Y.S.2d 806 (N.Y.C. Civ. Ct., N.Y. Co. 2009), *reversed and remanded on undeveloped record*, 29 Misc. 3d 72, 911 N.Y.S.2d 567 (App. Term, N.Y. Co., 2010).

[39.11] IV. COMMON ISSUES WITH DEFAULT CLAUSES

[39.12] A. Attorney Fees

Commercial leases generally provide that the landlord may recover the attorney's fees the landlord incurs if the landlord prevails in a litigation with the tenant. However, unlike the situation in residential lease disputes, where a residential tenant who prevails over a residential landlord in an action or a summary proceeding, is enabled, by statute,⁷³ to recover the tenant's attorney fees from the landlord, the commercial tenant has no such reciprocal right to recover the tenant's attorney fees if it prevails over its commercial landlord.⁷⁴ While most attorney fees clauses allow the landlord to recover its attorney fees in the event the landlord sues the tenant under the lease, better drafted clauses also allow the landlord to recover its attorney fees for a successful defense of a suit brought by the tenant.

A reciprocal requirement for attorney fees will not be implied for the benefit of a tenant where a commercial lease does not contain a provision authorizing the tenant to recover its attorney's fees from a defeated landlord.⁷⁵ However, although a lease issued under the Loft Law⁷⁶ may be commercial in form, when, for example, it provides for limited occupancy of the premises as an artist's studio, it has nevertheless been held that "where the intent of the parties, or the effect of the lease or of applicable law, was to create or accede to a residential use, the attorney's fee recovery clause becomes a reciprocal, mutual obligation."⁷⁷

[39.13] B. Liquidated Damages Provisions: Avoiding the Penalty

Besides a guarantee, liquidated damages provisions provide the greatest incentive for commercial tenants to comply with the lease. Below, we attempt to guide the practitioner in drafting an enforceable clause that will

73 N.Y. Real Property Law § 234 (RPL).

74 See, e.g., *Reade v. Stonybrook Realty, LLC*, 63A.D.3d 433, 882 N.Y.S.2d 8 (1st Dep't 2009).

75 See, e.g., *NSB Abatement Servs., Inc. v. Detailing Café, Inc.*, 7 Misc. 3d 1025(A), 2005 WL 1189038 (Mt. Vernon City Ct., 2005).

76 N.Y. Multiple Dwelling Law, Article 7C, § 286(11).

77 *Feierstein v. Moser*, 124 Misc. 2d 369, 371, 477 N.Y.S.2d 545, 548 (Special Term, N.Y. Co., 1984).

withstand the scrutiny of a judge. Liquidated damages provisions in commercial leases are enforceable if not deemed to be a penalty that renders a forfeiture. As the New York Court of Appeals has explained:

As a general matter parties are free to agree to a liquidated damages clause “provided that the clause is neither unconscionable nor contrary to public policy.” Liquidated damages that constitute a penalty, however, violate public policy, and are unenforceable. A provision which requires damages “grossly disproportionate to the amount of actual damages provides for a penalty and is unenforceable.”⁷⁸

A contractual provision fixing damages in the event of a breach will be sustained “if the amount liquidated bears a reasonable proportion to the probable loss and the amount of actual loss is incapable or difficult of precise estimation.”⁷⁹ Liquidated damages provisions have their basis in the principle of just compensation for loss, and “a clause which provides for an amount plainly disproportionate to real damages is not intended to provide fair compensation, but to secure performance by the compulsion of the very disproportion.”⁸⁰ The burden is on the party seeking to avoid liquidated damages to show that the stated liquidated damages are in fact a penalty.⁸¹

“Whether a provision in an agreement is ‘an enforceable liquidation of damages or an unenforceable penalty is a question of law, giving due consideration to the nature of the contract and the circumstances.’”⁸² Where there is doubt as to whether a liquidated damages provision constitutes an unenforceable penalty or a proper liquidated damages clause, it will be resolved in favor of a construction that holds the provision to be a penalty.⁸³ It is immaterial whether the parties have called the provision one

78 *172 Van Duzer Realty Corp. v. Globe Alumni Student Assistance Association, Inc.*, 24 N.Y.3d 528, 2 N.Y.S.3d 39 (2014) (internal citations omitted); see also *Truck Rent-A-Center, Inc. v. Putitan Farms 2d, Inc.*, 41 N.Y.2d 420, 393 N.Y.S.2d 365 (1977).

79 *Truck Rent-A-Center, Inc.*, 41 N.Y.2d at 425; *City of Rye v. Public Service Mut. Ins. Co.*, 34 N.Y.2d 470, 473, 358 N.Y.S.2d 391 (1974).

80 *Truck Rent-A-Center, Inc.*, 41 N.Y.2d at 424.

81 *172 Van Duzer Realty Corp.*, 24 N.Y.3d 528.

82 *Id.*

83 *Pyramid Ctrs. & Co. v. Kinney Shoe Corp.*, 244 A.D.2d 625, 663 N.Y.S.2d 711 (3d Dep’t 1997).

for “liquidated damages.”⁸⁴ The provision is to be interpreted as of the date it was created, not as of the date of its breach.⁸⁵ Thus, courts “must look to the anticipated loss discernible at the time of contracting and not the actual loss incurred by the breach to determine whether the liquidated damages are reasonable or whether the damages are capable of calculation.”⁸⁶ Where one party establishes that the stated liquidated damages is a penalty, the other party’s proper recovery is the amount of that party’s actual provable damages.⁸⁷

In cases where an acceleration clause provides for recovery of all future rent due as liquidated damages, the New York Court of Appeals has distinguished between (a) cases where the tenant remains in possession after being compelled to pay the total accelerated rent (where the total amount of accelerated rent is no greater than the amount that would otherwise have been paid, if timely paid by the tenant over the term of the lease),⁸⁸ and (b) cases where the tenant has vacated the premises and the landlord remains in possession.⁸⁹

In the latter case, the Court held that, “on its face,” the tenant’s argument, that permitting the landlord “to hold possession *and* immediately collect all rent due,” gives the landlord a windfall, was “compelling” because:

arguably the ability to obtain all future rent due in one lump sum, undiscounted to present-day value, and also enjoy uninterrupted possession of the property provides the landowner with more than the compensation attendant to the losses flowing from the breach – even though such compensation is the recognized purpose of a liquidated damages provision.

Accordingly, the Court determined that the defaulting tenant “should have had the opportunity to present evidence that the undiscounted accelerated rent amount is disproportionate to [the landlord’s] actual losses,

84 See *Truck Rent-A-Center, Inc.*, 41 N.Y.2d 420.

85 *Vernitron Corp. v. CF 48 Assocs.*, 104 A.D.2d 409, 478 N.Y.S.2d 933 (2d Dep’t 1984).

86 *Id.*

87 *172 Van Duzer Realty Corp.*, 24 N.Y.3d 528.

88 *See Fifty States Mgmt. Corp. v. Pioneer Auto Parks, Inc.*, 46 N.Y.2d 573, 577, 415 N.Y.S.2d 800 (1979).

89 *172 Van Duzer Realty Corp.*, 24 N.Y.3d 528.

notwithstanding that the landowner had possession, and no obligation to mitigate.”⁹⁰ The Court did *not* hold that the landlord would not be entitled to recover *any* accelerated contractual damages. The Court acknowledged it had previously held, in *Holy Properties Limited, L.P. v. Kenneth Cole Productions, Inc.*,⁹¹ “that once a tenant abandons the property prior to expiration of the lease, a ‘landlord [is] within its rights under New York law to do nothing and collect the full rent due under the lease,’”⁹² where “the parties have freely agreed to bind [the tenant] to pay rent after termination of the landlord-tenant relationship.”⁹³ Nevertheless, after *172 Van Duzer Realty Corp.*, determining the measure of those damages in such cases (whether “discounted” or not) will be subject to case by case development.

[39.14] 1. Representative Cases Where the Liquidated Damages Provision Was Not Enforced

Pyramid Ctrs. & Co. v. Kinney Shoe Corp.

244 A.D.2d 625, 663 N.Y.S.2d 711 (3d Dep’t 1997)

- Default provision in the lease provided that if tenant vacated the premises, tenant still remained liable to pay rent for the remainder of the lease period. Additionally, if tenant ceased operation prior to termination date, landlord could require tenant to “pay as liquidated damages and not as a penalty. . . double the fixed minimum rent for the remainder or unexpired portion of the term.”
- The Court determined that the provision was disproportionate to any subsequent loss suffered by the landlord and thus it was intended to coerce tenant’s performance rather than compensate landlord for tenant’s breach, and, therefore, its purpose was not to provide just compensation.⁹⁴
- In the interest of justice, the Court afforded the landlord the opportunity to present evidence of actual damages as a result of tenant’s decision to close its store before the expiration of the lease.

90 *Id.*

91 87 N.Y.2d 130 (1995).

92 *172 Van Duzer Realty Corp.*, 24 N.Y.3d 528.

93 *Id.*

94 Of course, such coercion is precisely what many landlords hope to achieve, but there is simply no way to draft a “coercive” provision in accordance with the law.

Vernitron Corp. v. CF 48 Associates**104 A.D.2d 409, 478 N.Y.S.2d 933 (2d Dep't 1984)**

- Lease had a clause which called for liquidated damages in a sum equivalent to one year's rent for a default under the lease. The lease defined the term "default" to include any breach of the covenants of the lease.
- The lease contained numerous covenants of varying degrees of importance.
- Because the court looked at the anticipated losses discernible at the time of contracting and not the actual loss incurred by the breach to determine whether the liquidated damages were reasonable, the provision was determined to be an unenforceable penalty.
- Loss attributable to certain defaults such as late payment of rent is clearly readily ascertainable and is inappropriate for application of liquidated damages.
- Loss which might occur as a result of certain minor defaults under the lease (i.e., for a two-day delay in payment of rent) would be disproportionate to the amount of liquidated damages. That is to say that where there is an obvious contrast in the seriousness of the breaches, there should be a concomitant contrast in the consequences thereof.

Irving Tire Co. v. Stage II Apparel Corp.**230 A.D.2d 772, 646 N.Y.S.2d 528 (2d Dep't 1996)**

- Prior to termination of the lease, tenant became dissatisfied and entered into negotiations with landlord for early termination.
- Tenant agreed to pay landlord \$50,000 for early termination agreement, which included a provision authorizing the landlord, in the event of a default, to enter judgment against the tenant in the sum of \$140,000.
- After paying landlord \$37,500, tenant stopped making payments because landlord had leased the store to a new tenant.
- Landlord commenced action to recover \$102,500 in damages under the liquidated damages clause of the early termination agreement.

- Provision was deemed unenforceable because the actual damages arising from tenant's breach of the early termination agreement was readily ascertainable and the \$140,000 fixed sum was disproportionate to the landlord's loss.

[39.15] 2. Representative Cases Where the Liquidated Provision Was Enforced

***New 24 W. 40th St. LLC v. XE Capital Management, LLC* 104 A.D.3d 513, 961 N.Y.S.2d 139 (1st Dep't 2013)**

- Provision in lease stated that if the tenant breached its duties under the lease, the landlord was entitled to recover as liquidated damages "an amount equal to the rent reserved hereunder for the unexpired portion of the term demised."
- Court determined the provision did not constitute a penalty because the provision did not allow recoupment of damages disproportionate to any loss which could possibly accrue to the landlord.

***Bates Adver. USA, Inc. v. 498 Seventh, LLC* 291 A.D.2d 179, 739 N.Y.S.2d 71 (1st Dep't 2002)**

- Both parties were highly sophisticated business entities, represented by accomplished and experienced real estate attorneys.
- The lease provided that if certain renovation work to be done by the landlord was not completed by the time the tenant had taken full occupancy of the initial demised premises and was conducting its ordinary business therein, then the tenant would be entitled to either a one-half day or one full day delay in the occurrence of the rent Commencement Date for each day from January 2, 1999 until the landlord substantially completed the work.
- Testimony established that this was a situation where it would be difficult, if not impossible, to calculate plaintiff's damages resulting from a breach, since there would be no way of knowing whether tenant's loss of an advertising client had been caused by construction conditions in the building.
- The parties made every reasonable effort to provide appropriate compensation in the event the landlord breached its obligations by breaking down the contemplated nine improvements into two categories;

those which if not completed would entitle the plaintiff to a half-day rent abatement for each day and those which if not completed would entitle the plaintiff to a full day rent abatement for each day left uncompleted.

- “By imposing this one-to-one proportionality between the days the breach continued and the value of the compensation, the parties successfully avoided the possibility that the tenant would obtain a benefit in gross disproportion to the injury it suffered.”
- Although the trial court ruled the provision an unenforceable penalty because the half-day abatement was applied whether one item or all nine items were lacking, the First Department determined this reasoning takes the concept of proportionality to the extreme:
 - “To require that a liquidated damages amount be set for each individual work item with the type of specificity this ruling requires, would be contrary to the concept of liquidated damages.”

Feyer v. Reiss

154 A.D. 272, 138 N.Y.S. 964 (2d Dep’t 1912)

- Case involved a three-year lease of eight tenement houses that housed sixty different tenants.
- The contract provided that: “It being expressly understood and agreed that if the lessees surrender the said premises or are dispossessed therefrom prior to the expiration of this lease in 1914, then and in that event the said eight hundred (\$800) dollars, together with any subsequent installments which shall be paid by the lessees as hereinbefore provided, shall belong to the lessor as liquidated and stipulated damages, and the parties hereto agree to stipulate such deposit as liquidated damages because they cannot ascertain the exact amount of damage which the lessor would sustain in the event of any breach or violation hereunder.”
- Court determined liquidated damages clause was valid because:
- Lease was clear and definite as to the character of the deposit.
- Formal expression that deposit was liquidated damages.

- Affirmative provision that the parties had agreed that deposit was liquidated damages because they could not ascertain the exact amount of damages that the landlord would sustain in the event of a breach.
- There was no excessive disproportion between the deposit and the possible damages.

Tenber Associates. v. Bloomberg L.P.

51 A.D.3d 573, 859 N.Y.S.2d 61 (1st Dep’t 2008)

- Landlord commenced a commercial holdover proceeding based upon tenant’s continued possession of office space following the expiration of the parties’ lease agreement.
- Liquidated damages clause, which provided for **two times** the existing rent in the event of a holdover, was not an unenforceable penalty.
- Tenant failed to establish that the actual amount of damages could have been anticipated in 1995, when the lease was executed.
- Tenant also failed to establish that the amount fixed was “plainly or grossly disproportionate to the probable loss.”

Parsons & Whittemore, Inc. v. 405 Lexington L.L.P.

299 A.D.2d 156, 753 N.Y.S.2d 36 (1st Dep’t 2002)

- Lease provided that if the tenant did not vacate the property within two days after the expiration of the lease, the landlord was entitled to a sum equal to **two times** the average rent and additional rent which was payable per month under the lease during the last six months of the lease.
- Court determined that the liquidated damages clause was not an unenforceable penalty since the damages could not have been anticipated in 1983, when the lease was executed and the amount fixed is not plainly or grossly disproportionate to the probable loss.

Federal Realty Ltd. Partnership v. Choices Women’s Med. Ctr., Inc.

289 A.D.2d 439, 735 N.Y.S.2d 159 (2d Dep’t 2001)

- Provision in lease stated that in the event of a failure to timely surrender the premises, the tenant “shall pay to the Owner for each month and for each portion of any month during which Tenant holds over a sum equal to **three times** the aggregate of that portion of the fixed

rent and additional rent which was payable under this lease during the last month of the term hereof.”

- Provision also stated that “the damage to the Owner resulting from any failure by Tenant to timely surrender possession of the demised premises will be substantial and will be impossible to accurately measure.”
- Court determined this was a valid liquidated damages provision because the parties’ lease contained provisions which clearly and unambiguously permitted the landlord to recover a reasonable amount of damages for any injuries which resulted from the failure to timely surrender the premises:
- Furthermore, the record was devoid of evidence that the amount of liquidated damages to which the parties agreed was grossly disproportionate to the landlord’s actual loss.

Thirty-Third Equities Co. v. Americo Group., Inc.
294 A.D.2d 222, 743 N.Y.S.2d 10 (1st Dep’t 2002)

- Provision in lease allowed landlord to collect **two and one-half times** the rent for each month that tenant was on the premises after the expiration of the lease.
- Court determined this was a valid liquidated damages clause since there was no evidence that the projection of a 250% increase in rent was unreasonable.
- Premises were in fact rented to a new tenant in an amount approximating a 250% increase.

Montgomery Trading Co. v. Cho
22 Misc. 3d 135(A), 2009 WL 400083 (Sup. Ct., App. Term, 1st Dep’t 2009)

- Provision in lease allowed landlord to collect **1.5 times** the existing rent in the event of a holdover.
- Court determined this was a valid provision since tenants failed to establish that damages could be anticipated in 1998 when the lease was executed or that the amount fixed was plainly or grossly disproportionate to the probable loss.

319 Fifth Ave. Realty v. 319 Smile Corp.**21 Misc. 3d 139(A), 875 N.Y.S.2d 824 (Sup. Ct., App. Term, 1st Dep't 2008)**

- Liquidated damages clause providing for use and occupancy at **two times** the rent in the event of a holdover was not an unenforceable penalty because damages could not be anticipated in 1997 when the lease was executed and the amount fixed was not plainly or grossly disproportionate to the loss.

[39.16] C. Monetary and Non-Monetary Defaults

Monetary events of default, such as failure to pay the rent or any of the items designated as additional rent in the lease, clearly entitle the landlord to serve a notice of default and/or a notice of termination under a conditional limitation clause. However, landlords may also serve notices of default and/or notices of termination for any designated non-monetary event of default specified in the lease.⁹⁵

In a properly drawn commercial lease, the landlord's right to terminate a lease and seek to evict a defaulting tenant, for a non-monetary event of default, rests on equal ground with the right to terminate for a monetary event of default. As previously noted, (a) so long as the non-monetary event of default is expressly defined in the lease, and (b) so long as the notice of default has specified the particular lease provision that the tenant has violated and the period, if any, during which the tenant is obliged to cure the default, the landlord may then serve a notice of termination after the expiration of the cure period.

Non-monetary events of default can also provide the basis upon which a court may deny a tenant's application for a *Yellowstone* injunction. As noted *infra*, one of the prime factors that a commercial tenant must demonstrate, in order to be eligible for obtaining a *Yellowstone* injunction, is to show that the tenant "is prepared and maintains the ability to cure the alleged default by any means short of vacating the premises." However, in those unusual cases where the tenant is clearly not prepared or willing to cure the default, the courts will not grant a *Yellowstone* injunction.

In *330 Hudson Owner, LLC v. Rector, Church Wardens and Vestrymen of Trinity Church in the City of New York*,⁹⁶ the Court found that the

95 See "Events of Default," *supra*.

96 23 Misc. 3d 1131(A), 2009 WL 1470449 (Sup. Ct., N.Y. Co. 2009).

tenant had stopped construction on a mixed-use building it had contracted to build, as provided in its lease, and that the tenant had “no present intention to resume construction.” The Court said that “the evidence indicates that [tenant] is attempting to use its shutdown in construction as leverage to force Trinity to renegotiate its lease.” Accordingly, the Court held that a *Yellowstone* injunction was not warranted.

A similar situation occurred in *Gristede’s Operating Corp./Namdor Inc. v. Centre Financial LLC*,⁹⁷ where the Court found that the supermarket tenant’s primary interest was “in closing its store, selling its assets and assigning the lease” with no indication of “any interest, inter alia, in remaining at the premises and curing the alleged violation of the Continuous Operation provision” of the lease. Given the facts, there was no basis for granting a *Yellowstone* injunction after the expiration of the notice to cure and the service of the notice of termination.

[39.17] D. Notices to Cure and Avoiding the *Yellowstone* Injunction

The so-called “*Yellowstone*” injunction, or other similar relief, when obtained by a commercial tenant in a Supreme Court plenary action, prohibits a property owner from terminating a tenancy for a non-monetary event of default and freezes any eviction efforts that may have already commenced in a local court summary proceeding. The *Yellowstone* injunction also tolls any corrective period stated in the lease until the parties have fully litigated whether a non-monetary violation of the lease has occurred.⁹⁸ “The purpose of the *Yellowstone* injunction is to maintain the status quo so that the tenant served with a notice to cure an alleged non-monetary lease violation may challenge the propriety of the landlord’s notice while protecting a valuable leasehold interest.”⁹⁹

In order to obtain a *Yellowstone* injunction, the courts require the tenant to show (a) the existence of a commercial lease, (b) receipt from the landlord of a notice of default thereunder, a notice to cure such default, or a threat of termination of the lease, (c) application for the issuance of an injunction made prior to the termination of the cure period specified in the

97 16 Misc. 3d 1132(A), 2007 WL 2457588 (Sup. Ct., Nassau Co. 2007).

98 See *First Nat’l Stores, Inc. v. Yellowstone Shopping Ctr., Inc.*, 21 N.Y.2d 630, 290 N.Y.S.2d 721 (1968).

99 *Garland v. Titan West Assocs.*, 147 A.D.2d 304, 307, 543 N.Y.S.2d 56, 58 (1st Dep’t 1989).

lease, and (d) the tenant's ability and desire to cure the alleged non-monetary default by any means short of vacating the premises.¹⁰⁰

The availability of the *Yellowstone* injunction provides an invaluable defensive tool to a commercial tenant. At the same time, it is one of the most paralyzing tenant weapons that the judiciary has ever created; first, because it permits tenants to cure any lease violations after the litigation is completed; second, the case is brought and tried in Supreme Court where it may take years before completion and permit an excessive period of time to cure any violation; and third, the tolling of the "cure" period gives tenants the opportunity to commit knowingly blatant transgressions of the lease during the pendency of the action.¹⁰¹

However, a cure period is not required in a commercial lease. In a case in which the commercial lease had no cure period, the tenant argued that the clause was unconscionable because the absence of a cure period precluded the tenant from seeking a *Yellowstone* injunction to stay the lease's forfeiture. The court held that a cure period was not required and noted that "while it might have precluded defensive tactics such as seeking a *Yellowstone* injunction prior to the expiration of the lease, it was part of the fully negotiated contract between represented parties. It would not be contrary to public policy to enforce the provisions of the lease under such circumstances."¹⁰²

In *New Eagle, Inc. v. H.R. Neumann Associates, Inc.*,¹⁰³ a case in which a commercial lease lacked a cure period, the Court determined that the tenant could not satisfy the elements necessary to invoke the protection of a *Yellowstone* injunction. As the Court explained:

Although the plaintiff has established that it held a commercial lease and that the thirty-day eviction notice served as a threat of termination of the lease, said notice is not susceptible to a cure. Even if its application for a

100 See, e.g., *Garland*, 147 A.D.2d 304; *Continental Towers Garage Corp. v. Contowers Assocs. Ltd. Partnership*, 141 A.D.2d 390, 529 N.Y.S.2d 322 (1st Dep't 1988); see also *Health 'N Sports, Inc. v. Providence Capitol Realty Group, Inc.*, *Health 'N Sports, Inc. v. Providence Capitol Realty Group, Inc.*, 75 A.D.2d 884, 428 N.Y.S.2d 288 (2d Dep't 1980).

101 Although, theoretically, if they are brazen enough, the Defendant-Landlord can move the court for relief.

102 *Queen Art Publishers, Inc., v. Animazing Gallery Inc.*, 2002 WL 452207, 2002 N.Y. Slip Op. 40033(U).

103 4 Misc. 3d 1005(A), 2004 WL 1609174 (Sup. Ct., Kings Co. 2004).

temporary restraining order was made prior to the termination of the lease, the plaintiff does not have the ability to effect a cure in this case: it would appear that it has not. The purpose of a *Yellowstone* injunction is to toll the running of the cure period in the landlord's notice to cure so that, after determination of the merits, the tenant may cure the defect and avoid a forfeiture of the leasehold. In the case at hand, there is simply no "cure" period for this Court to toll or stay.

If the cure period is eliminated from a commercial lease, tenant transgressions will decrease as the tenant's contemplation of the reality of the possibility of a swift termination and eviction, in the event of a default, is ever present. Moreover, the basis for injunctive action in the Supreme Court is also eliminated, and, when injunctive relief is denied, the question of whether or not the lease has been violated will be tried in a Civil Court proceeding, without the time impediments of discovery and the lengthy time-line of a Supreme Court matter.

Nevertheless, the omission of a cure period may be resisted in lease negotiations, and, even where the omission of a cure period is successfully negotiated, it is still possible that some judges will seek ways to insert an equitable cure period into the lease agreement. Therefore, as an alternative to entirely omitting a cure period from the lease, we recommend devising a scenario whereby time limits and other handcuffs are placed on the *Yellowstone* action within the terms of commercial lease: First, the tenant should be required to place a substantial bond, in a specified amount upon the granting of the *Yellowstone* application; Second, the scope of discovery in any resulting litigation should be limited with specific procedures pre-agreed upon to foster an expedited hearing or trial; and Third, the parties should agree that all resulting proceedings should be placed on an expedited court schedule (presuming that the court will enforce such commercial lease provisions).

[39.18] V. LICENSES

The legal relationship established between the property owner-landlord and a tenant, by a lease, is entirely distinct from the legal relationship established, by a license, between the property-owner-licensor and a licensee. Under a bona fide license agreement, the tenant-licensor 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.¹⁰⁴ The landlord thus avoids having to endure months or years of lengthy and frustrating litigation to regain possession of valuable real estate.

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,”¹⁰⁵ (2) the retention by the licensor of absolute control over the premises,¹⁰⁶ and (3) the licensor’s supplying to the licensee all of the essential services required for the licensee’s permitted use of the premises.¹⁰⁷

Courts have found “licenses” to be leases 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.¹⁰⁸ However, the less control given the licensee, the more likely the agreement is to be held 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.”¹⁰⁹ Nevertheless, it has been held that the licensor’s retention of control over prices charged by the licensee, times of operation with 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

104 See *P & A Bros., Inc. v. City of N.Y. Dep’t of Parks & Rec.*, 184 A.D.2d 267, 585 N.Y.S.2d 335 (1st Dep’t 1992). Provided the license really is a license, there are *no* municipal restrictions on self help in a commercial license.

105 See *Ark Bryant Park Corp. v. Bryant Park Restoration Corp.*, 285 A.D.2d 143, 730 N.Y.S.2d 48 (1st Dep’t 2001) upholding the license even though the at will revocation had a built in delay period.

106 See *Karp v. Federated Dep’t Stores*, 301 A.D.2d 574, 754 N.Y.S.2d 27 (2d Dep’t 2003).

107 See *Nextel of N.Y. v. Time Mgmt. Corp.*, 297 A.D.2d 282, 746 N.Y.S.2d 169 (2d Dep’t 2002).

108 See *Miller v. City of New York*, 15 N.Y.2d 34, 255 N.Y.S.2d 78 (1964).

109 *Lordi v. County of Nassau*, 20 A.D.2d 658, 659, 246 N.Y.S.2d 502, 505 (2d Dep’t 1964).

would reasonably be demanded by a careful owner as against a lessee for [any] business.”¹¹⁰

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. Communications to the client of the risks, as well as the benefits, of utilizing a license agreement 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 licensees are willing to sign such agreements may depend upon the type of premises that the owner is making available for licensed use; 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 of office space and to users of certain types of storage. That there is a market for such agreements is clearly apparent. 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, the time is fast approaching when landlords may need to test the market by striving to transform the commercial rental landscape into a true license regime.

¹¹⁰ *Miller*, 15 N.Y.2d 34; but see *Union Sq. Park Community Coalition, Inc. v. N.Y.C. Dep’t of Parks and Rec.*, 22 N.Y.3d 648, 985 N.Y.S.2d 422 (2014).

[39.19] VI. DRAFTING FOR THE COMMERCIAL TENANT

[39.20] A. Introduction

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.¹¹¹ Equity gained greater currency and judicial decisions softened commercial lease provisions that potentially endangered or evicted tenants.¹¹² In recent years, 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 commercial tenants’ rights has evolved into a consistent enforcement and implementation of commercial leases.¹¹³ In many cases, no matter how draconian the lease provision, New York courts have been enforcing the contents of commercial leases.¹¹⁴

In this judicial environment, many tenants have suffered severe financial consequences or lost their leases as a result of poorly drafted leases. Although temporary tenant victories providing endless delays resulting from technical mistakes and jurisdictional defect defenses are still used regularly, tenant attorneys have reason to be prudent and avoid overreliance upon such tactics. It is possible that, in a given case, their holdover commercial tenant client might be found liable, for damages suffered by the third-party incoming tenant, by reason of their client’s failure to vacate after its lease term expired.¹¹⁵

It is imperative, therefore, that commercial tenants negotiate better leases in order to protect their interests. The topics covered below contain suggestions on how commercial tenants should attempt to do so.

111 See David Frey, *The Yellowstone Injunction, or How to Vex Your Landlord Without Really Trying*, 58 Brooklyn L. Rev. 155, 161-162; see also Curtis J. Berger, *Hard Leases Make Bad Law*, 74 Columbia L. Rev. 791 (1974) (under subsection entitled “Doctrines Openly Hostile to the Landlord and the Lease”).

112 See Notices to Cure and Avoiding the *Yellowstone Injunction*, *supra*.

113 See *Excel Graphics Technologies, Inc. v. CFG/AGSCB 75 Ninth Avenue*, 1 A.D.3d 65, 767 N.Y.S.2d 99 (1st Dep’t 2003).

114 See, e.g., *Four Cees Jewelry Inc. v. 1537 Realty LLC*, 11 Misc. 3d 1056(A), 2005 WL 3803491 (Sup. Ct., N.Y. Co. 2005).

115 See *Kronish Lieb Weiner & Hellman, LLP v. Tahari, Ltd.*, 11 Misc. 3d 1057(A), 2006 WL 469310 (Sup. Ct., N.Y. Co. 2006).

[39.21] B. Mitigation of Damages

Since the Court of Appeals decided the seminal case of *Holy Properties v. Kenneth Cole Productions*,¹¹⁶ 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 lease term, 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.¹¹⁷ This has produced exceedingly harsh results.¹¹⁸

Therefore, from a tenant's interest, every commercial 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 whom 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, in order to reduce any remaining rent liability.

Negotiating a mitigation of damages clause may provide a commercial tenant with a life preserver in an ocean of financial devastation.

[39.22] C. Prevailing Party Clause

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

Although state law mandates that such an attorney's fees clause in a residential lease is deemed to be reciprocal, the statutory mandate in residential cases does not apply to commercial leases. Despite many failing arguments to the contrary, attorney's fees provisions providing payment to the landlord in connection with a legal proceeding will not provide the

116 87 N.Y.2d 130, 637 N.Y.S.2d 964 (1995).

117 See, e.g., *Syndicate Bldg. Corp. v. Lorber*, 128 A.D.2d 381, 512 N.Y.S.2d 674 (1st Dep't 1987).

118 Even *Holy Properties* acknowledged the results to be harsh, but held that it was better to have a reliable old rule than to break new precedential ground.

same rights to a commercial tenant unless specifically stated in the tenant's commercial lease.¹¹⁹

Accordingly, a prevailing party clause should be negotiated into the commercial lease agreement. The provision should require the losing party to any action to 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 landlords and tenants. As neither party will be able to commence a legal action without the threat of being required to fund the victorious party's legal bill, parity should prevail and thereby preclude attempts to exploit any inequitable leveraging position.

[39.23] D. 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. 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 its present space, or (b) permits the tenant to simply expand its tenancy 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 the 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 fair market rent, and (c) any increases in taxes and/or operating expenses. In addition, a provision requiring the landlord to sue reasonable efforts to recover possession

119 See, e.g., *Huron Associates, LLC v. 210 East 86th Street Corp.*, 18 A.D.3d 231, 794 N.Y.S.2d 360 (1st Dep't 2005).

from a holdover tenant in the chosen expansion space should be included. Commercial tenants should also attempt to negotiate a right of first refusal to protect their long term interests in the premises.

[39.24] E. The Option to Renew

The option to renew has been used in practice for hundreds of years.¹²⁰ 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 of 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 has impeded lease negotiations.

[39.25] F. Ownership and Use

The Internet 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 appropriate governmental website. Second, determine whether the commercial tenant's anticipated use of the premises is permitted by law by also visiting the relevant government website. For example, in New York City, the legal use for the premises and the certificate of occupancy can be viewed

¹²⁰ See *Crosby v. Moses*, 92 N.Y. 634 (1883).

by search the Department of Buildings website. In New York City, any premises constructed after 1938, or where significant renovations occurred in the interim, require a certificate of occupancy.

The certificate of occupancy will report the legal uses of 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 include in the description of its business in the lease the catch-all phrase "any lawful use." However, obtaining a favorable use clause will not guarantee that the business will also be able to function as such. If there is any doubt about whether the premises can be lawfully used for the tenant's particular business, 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 to the relevant governmental authority. 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 negotiated. If the lease is cancelled due to non-approval of the tenant's proposed use, 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 approval and permits necessary to complete construction.

[39.26] G. Signage and Alterations

A disproportionate amount of commercial lease litigation derives from disputes over signs and alterations.¹²¹ In an attempt to decrease the

amount of litigation involving such items, attorney should learn a tenant's business needs and carefully adapt the lease to them. In addition, 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, include a representation by the landlord that it will remove any existing violations against the premises, so that any permit applications needed to perform the work will not be rejected. For all other alterations requiring the landlord's permission, ensure that such authorization will not be unreasonably¹²² withheld.

[39.27] H. Repairs and Self-Help

Commercial tenants should attempt to make the landlord liable for all structural repairs to the demised space and to the building, as well as non-structural repairs occasioned by the landlord's negligence.¹²³

Commercial tenants should also strive to include a self-help provision. Such a provision allows the a tenant to complete any repairs that the landlord neglects to complete within an allotted time period after notification from the tenant. This clause should allow the tenant to seek reimbursement by obtaining a rent credit for the cost of repair or by obtaining reimbursement directly from the landlord. Besides eliminating the perennial tenant's dilemma of whether it can withhold rent until necessary repairs are done, the clause will also provide a mechanism that should assist in keeping the premises free of conditions requiring necessary repairs.¹²⁴ 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. Any lease provision specifying that each provision is independent of every other provision should be modified to include the tenant self-help provision.

121 See, e.g., *Marshall v. Ahamed*, 5 Misc. 3d 136(A), 2004 WL 2851209 (Sup. Ct., App. Term, 2d Dep't 2004).

122 "Unreasonably" is a term of art. It means a cause for which a specific reason can be articulated. See *Conrad v. Third Sutton Realty Co.*, 81 A.D.2d 50, 439 N.Y.S.2d 376 (1st Dep't 1981).

123 See GOL § 5-322.1.

124 See *Green 440 Ninth LLC v. Duane Reade*, 10 Misc. 3d 75, 809 N.Y.S.2d 756 (Sup. Ct., App. Term., 1st Dep't 2005).

APPENDIX

SAMPLE DEFAULT CLAUSES

Conditions of Limitation

1.01 This lease and the term and estate hereby granted are subject to the limitation that whenever Tenant, or any guarantor of Tenant's obligations under this lease, shall make an assignment for the benefit of creditors, or shall file a voluntary petition under any bankruptcy or insolvency law, or an involuntary petition alleging an act of bankruptcy or insolvency shall be filed against Tenant or such guarantor under any bankruptcy or insolvency law, or whenever a petition shall be filed by or against Tenant or such guarantor under the reorganization provisions of the United States Bankruptcy Code or under the provisions of any law of like import, or whenever a petition shall be filed by Tenant, or such guarantor, under the arrangement provisions of the United States Bankruptcy Code or under the provisions of any law of like import, or whenever a permanent receiver of Tenant, or such guarantor, or of or for the property of Tenant, or such guarantor, shall be appointed, then Landlord (a) if such event occurs without the acquiescence of Tenant, or such guarantor, as the case may be, at any time after the event continues for XXXX (XX) days, or (b) in any other case at any time after the occurrence of any such event, may give Tenant a notice of intention to end the term of this lease at the expiration of five (5) days from the date of service of such notice of intention, and upon the expiration of said five-day period this lease and the term and estate hereby granted, whether or not the term shall theretofore have commenced, shall terminate with the same effect as if that day were the expiration date of this lease, but Tenant shall remain liable for damages as provided in Article XXXX hereof.

1.02 This lease and the term and estate hereby granted are subject to the further limitations that:

- (a) if Tenant shall default in the payment of any Fixed Rent or Additional Charges, and such default shall continue for five (5) days after written notice thereof has been given to Tenant, or
- (b) if Tenant shall, whether by action or inaction, be in default of any of its obligations under this lease (other than a default in the payment of Fixed Rent or Additional Charges) and such default shall continue and not be rem-

edied as soon as practicable and in any event within XXXX (XX) days after Landlord shall have given to Tenant a notice specifying the same, or, in the case of a default which cannot with due diligence be cured within a period of XXXX (XX) days and the continuance of which for the period required for cure will not (i) subject Landlord or any Superior Lessor or any Superior Mortgagee to prosecution for a crime or any other fine or charge, (ii) subject the Premises or any part thereof or the Building or Land, or any part thereof, to being condemned or vacated, (iii) subject the Building or Land, or any part thereof, to any lien or encumbrance which is not removed or bonded within the time period required under this Lease, or (iv) result in the termination of any Superior Lease or foreclosure of any Superior Mortgage, if Tenant shall not within said XXXX (XX) day period advise Landlord of Tenant's intention to take all steps reasonably necessary to remedy such default, (y) duly commence within said XXXX (XX) day period, and thereafter diligently prosecute to completion all steps reasonably necessary to remedy the default and (z) complete such remedy, or

(c) if any event shall occur or any contingency shall arise whereby this lease or the estate hereby granted or the unexpired balance of the term hereof would, by operation of law or otherwise, devolve upon or pass to any person, firm or corporation other than Tenant, except as expressly permitted by Article XXXX (xx) hereof, or

(d) if Tenant shall abandon the Premises, or

(e) if there shall be any default by Tenant under any other lease with Landlord (or any person which, directly or indirectly, controls, is controlled by, or is under common control with, Landlord) covering space in the Building which shall not be remedied within the applicable grace period, if any, provided therefor under such other lease, or if Tenant holds over in the premises demised under such other lease,

Then, in any of said cases in clauses (a) through (e) of this Section, Landlord may give to Tenant a notice of

intention to end the term of this lease at the expiration of five (5) days from the date of the service of such notice of intention, and upon the expiration of said five days this lease and the term and estate hereby granted, whether or not the term shall theretofore have commenced, shall terminate with the same effect as if that day was the day herein definitely fixed for the end and expiration of this lease, but Tenant shall remain liable for damages as provided in Article XXXX hereof.

Chronic Nonpayment

1.03 Notwithstanding anything in this Lease to the contrary, and without limiting Landlord's other rights and remedies provided for in this Lease or at law or equity, if Tenant fails to pay by the due date any Base Rent, Additional Rent, or any other charges owing under this Lease more than [INSERT, e.g., two (2) times within any consecutive twelve (12) month period, then Landlord, at its sole election and in its sole discretion, may do one or more of the following:

- (a) If Landlord shall elect, Landlord shall have the right to terminate this Lease, in the manner provided in Section 1.02 hereof, and evict Tenant from the Premises;
- (b) Require that, beginning with the first monthly installment of Base Rent next due, the Base Rent shall no longer be paid in monthly installments, but shall be payable in advance, on a quarterly basis, on the first day of the first month of each following three-month period, with the first three-month period beginning when payment of the Base Rent is next due, in the total amount of all Base Rent due for each such three-month period;
- (c) Require Tenant to direct its bank or other financial institution or securities broker(s) to automatically and electronically transfer, in accordance with Section XXXX [INSERT AUTOMATIC TRANSFER LEASE CLAUSE] of this Lease, all Base Rent, Additional Rent, and/or other charges due under this Lease, to a bank account, or other financial or securities/brokerage account, chosen and identified by Landlord for such purpose. Landlord shall provide Tenant with written notice of the bank or other financial or securities/brokerage

account information necessary to effectuate such transfers; and/or

(d) Increase the Security Deposit by an amount that Landlord determines, in its sole and absolute discretion, to be necessary to protect Landlord's interests, provided that such amount does not exceed [INSERT, e.g., an amount equal to three (3) months of the then-applicable monthly Base Rent. Such increase of the Security Deposit shall be paid by Tenant immediately upon demand by Landlord.

Bankruptcy

1.04 (a) If Tenant shall have assigned its interest in this lease, and this lease shall thereafter be disaffirmed or rejected in any proceeding under the United States Bankruptcy Code or under the provisions of any federal, state or foreign law of like import, or in the event of termination of this lease by reason of any such proceeding, the assignor or any of its predecessors in interest under this lease, upon request of Landlord given within XXXX (XX) days after such disaffirmance or rejection, Tenant shall (a) pay to Landlord all Fixed Rent and Additional Charges then due and payable to Landlord under this lease to and including the date of such disaffirmance or rejection and (b) enter into a new lease as lessee with Landlord of the Premises for a term commencing on the effective date of such disaffirmance or rejection and ending on the Expiration Date, unless sooner terminated as in such lease provided, at the same Fixed Rent and Additional Charges and upon the then executory terms, covenants and conditions as are contained in this lease, except that (i) the rights of the lessee under the new lease, shall be subject to any possessory rights of the assignee in question under this lease and any rights of persons claiming through or under such assignee, (ii) such new lease shall require all defaults existing under this lease to be cured by the lessee with reasonable diligence, and (iii) such new lease shall require the lessee to pay all Additional Charges which, had this lease not been disaffirmed or rejected, would have become due after the effective date of such disaffirmance or rejection with respect to any prior period. If the lessee shall fail or refuse to enter into the new lease within ten (10) days after Landlord's request to do so, then in addition to all other rights and remedies by reason of such default, under this lease, at law or in equity, Landlord shall have the same rights and remedies against the lessee as if the lessee had entered into such new lease and such new lease had thereafter been terminated at the beginning of its term by reason of the default of the lessee thereunder.

(b) If pursuant to the Bankruptcy Code Tenant is permitted to assign this lease in disregard of the restrictions contained in Article XXXX hereof (or if this lease shall be assumed by a trustee), the trustee or assignee shall cure any default under this lease and shall provide adequate assurance of future performance by the trustee or assignee including (a) the source of payment of rent and performance of other obligations under this lease (for which adequate assurance shall mean the deposit of cash security with Landlord in an amount equal to the sum of one year's Fixed Rent then reserved hereunder plus an amount equal to all Additional Charges payable under Article XXXX for the calendar year preceding the year in which such assignment is intended to become effective, which deposit shall be held by Landlord, without interest, for the balance of the term as security for the full and faithful performance of all of the obligations under this lease on the part of Tenant yet to be performed) and that any such assignee of this lease shall have a net worth exclusive of good will, computed in accordance with generally accepted accounting principles, equal to at least ten (10) times the aggregate of the annual Fixed Rent reserved hereunder plus all Additional Charges for the preceding calendar year as aforesaid, and (b) that the use of the Premises shall in no way diminish the reputation of the Building as a first-class office building or impose any additional burden upon the Building or increase the services to be provided by Landlord. If all defaults are not cured and such adequate assurance is not provided within sixty (60) days after there has been an order for relief under the Bankruptcy Code, then this lease shall be deemed rejected, Tenant or any other person in possession shall vacate the Premises, and Landlord shall be entitled to retain any rent or security deposit previously received from Tenant and shall have no further liability to Tenant or any person claiming through Tenant or any trustee. If Tenant receives or is to receive any valuable consideration for such an assignment of this lease, such consideration, after deducting therefrom (a) the brokerage commissions, if any, and other expenses reasonably incurred by Tenant for such assignment and (b) any portion of such consideration reasonably designed by the assignee as paid for the purchase of Tenant's Property in the Premises, shall be and become the sole exclusive property of Landlord and shall be paid over to Landlord directly by such assignee. If Tenant's trustee, Tenant or Tenant as debtor-in-possession assumes this lease and proposes to assign the same (pursuant to Title 11 U.S.C. Section 365, as the same may be amended) to any person, including, without limitation, any individual, partnership or corporate entity, who shall have made a bona fide offer to accept an assignment of this lease on terms acceptable to the trustee, Tenant or Tenant as debtor-in-possession, then notice of such proposed assignment, setting forth (x) the name and

address of such person, (y) all of the terms and conditions of such offer, and (z) the adequate assurance to be provided Landlord to assure such person's future performance under this lease, including, without limitation, the assurances referred to in Title 11 U.S.C. Section 365(b)(3) (as the same may be amended), shall be given to Landlord by the trustee, Tenant or Tenant as debtor-in-possession no later than twenty (20) days after receipt by the trustee, Tenant or Tenant as debtor-in-possession of such offer, but in any event no later than ten (10) days prior to the date that the trustee, Tenant or Tenant as debtor-in-possession shall make application to a court of competent jurisdiction for authority and approval to enter into such assignment and assumption, and Landlord shall thereupon have the prior right and option, to be exercised by notice to the trustee, Tenant or Tenant as debtor-in-possession, given at any time prior to the effective date of such proposed assignment, to accept an assignment of this lease upon the same terms and conditions and for the same consideration, if any, as the bona fide offer made by such person, less any brokerage commissions which may be payable out of the consideration to be paid by such person for the assignment of this lease.

Reentry by Landlord

1.05 If Tenant shall default in the payment of any Fixed Rent or Additional Charges, and such default shall continue for ten (10) days after written notice thereof has been given to Tenant, or if this lease shall terminate as provided in Article XXXX hereof, Landlord or Landlord's agents and employees may immediately or at any time thereafter reenter the Premises, or any part thereof, either by summary dispossession proceedings or by any suitable action or proceeding at law, or by force or otherwise, including self-help, without being liable to indictment, prosecution or damages therefor, and may repossess the same, and may remove any person therefrom, to the end that Landlord may have, hold and enjoy the Premises. The word "reenter," as used herein, is not restricted to the narrow sense of its technical or legal meaning, but instead in the sense that the Landlord may effect physical entry of the Premises in accordance with its common law rights.

1.06 In the event of a breach or threatened breach by Tenant of any of its obligations under this lease, Landlord shall also have the right of injunction. The special remedies to which Landlord may resort hereunder are cumulative and are not intended to be exclusive of any other remedies to which Landlord may lawfully be entitled at any time and Landlord may invoke any remedy allowed at law or in equity as if specific remedies were not provided for herein.

1.07 If this lease shall terminate under the provisions of Article XXXX hereof, or if Landlord shall reenter the Premises under the provisions of this Article XXXX, or in the event of the termination of this lease, or of reentry, by or under any summary dispossession or other proceeding or action or any provision of law by reason of default hereunder on the part of Tenant, Landlord shall be entitled to retain all monies, if any, paid by Tenant to Landlord, whether as advance rent, security or otherwise, but such monies shall be credited by Landlord against any Fixed Rent or Additional Charges due from Tenant at the time of such termination or reentry or, at Landlord's option, against any damages payable by Tenant under Article XXXX hereof or pursuant to law.

Damages

2.01 If this lease is terminated under the provisions of Article XXXX hereof, or if Landlord shall reenter the Premises under the provisions of Article XXXX hereof, or in the event of the termination of this lease, or of reentry, by self-help or under any summary dispossession or other proceeding or action or any provision of law by reason of default hereunder on the part of Tenant, Tenant shall pay to Landlord as damages, at the election of Landlord, either:

- (a) a sum which at the time of such termination of this lease or at the time of any such reentry by Landlord, as the case may be, represents the then value of the excess, if any (assuming a discount at a rate per annum equal to the interest rate then applicable to 7-year Federal Treasury Bonds), of (i) the aggregate amount of the Fixed Rent and the Additional Charges under Article XXXX hereof which would have been payable by Tenant (conclusively presuming the average monthly Additional Charges under Article XXXX hereof to be the same as were payable for the last twelve (12) calendar months, or if less than twelve (12) calendar months have then elapsed since the Commencement Date, all of the calendar months immediately preceding such termination or reentry) for the period commencing with such earlier termination of this lease or the date of any such reentry, as the case may be, and ending with the date contemplated as the expiration date hereof if this lease had not so terminated or if Landlord had not so reentered the Premises, or (ii) the aggregate fair market rental value of the Premises for the same period, or

(b) sums equal to the Fixed Rent and the Additional Charges under Article XXXX hereof which would have been payable by Tenant had this lease not so terminated, or had Landlord not so reentered the Premises, payable upon the due dates therefor specified herein following such termination or such reentry and until the date contemplated as the expiration date hereof if this lease had not so terminated or if Landlord had not so reentered the Premises, *provided, however*, that if Landlord shall relet the Premises during said period, Landlord shall credit Tenant with the net rents received by Landlord from such reletting, such net rents to be determined by first deducting from the gross rents as and when received by Landlord from such reletting the expenses incurred or paid by Landlord in terminating this lease or in reentering the Premises and in securing possession thereof, as well as the expenses of reletting, including, without limitation, altering and preparing the Premises for new tenants, brokers' commissions, reasonable legal fees, and all other expenses properly chargeable against the Premises and the rental therefrom, it being understood that any such reletting may be for a period shorter or longer than the remaining term of this lease; but in no event shall Tenant be entitled to receive any excess of such net rents over the sums payable by Tenant to Landlord hereunder, nor shall Tenant be entitled in any suit for the collection of damages pursuant to this subdivision to a credit in respect of any net rents from a reletting, except to the extent that such net rents are actually received by Landlord. If the Premises or any part thereof should be relet in combination with other space, then proper apportionment on a square foot basis shall be made of the rent received from such reletting and of the expenses of reletting. If the Premises or any part thereof be relet by Landlord for the unexpired portion of the term of this lease, or any part thereof, before presentation of proof of such damages to any court, commission or tribunal, the amount of rent reserved upon such reletting shall, *prima facie*, be the fair and reasonable rental value for the Premises, or part thereof, so relet during the term of the reletting. Landlord shall not be liable in any way whatsoever for its failure or refusal to relet the Premises or any part thereof, or if the

Premises or any part thereof are relet, for its failure to collect the rent under such reletting, and no such refusal or failure to relet or failure to collect rent shall release or affect Tenant's liability for damages or otherwise under this lease.

2.02 Suit or suits for the recovery of such damages, or any installments thereof, may be brought by Landlord from time to time at its election, and nothing contained herein shall be deemed to require Landlord to postpone suit until the date when the term of this lease would have expired if it had not been so terminated under the provisions of Article XXXX hereof, or had Landlord not reentered the Premises. Nothing herein contained shall be construed to limit or preclude recovery by Landlord against Tenant of any sums or damages to which, in addition to the damages particularly provided above, Landlord may lawfully be entitled by reason of any default hereunder on the part of Tenant. Nothing herein contained shall be construed to limit or prejudice the right of Landlord to prove for and obtain as damages by reason of the termination of this lease or reentry on the Premises for the default of Tenant under this lease an amount equal to the maximum allowed by any statute or rule of law in effect at the time when, and governing the proceedings in which, such damages are to be proved whether or not such amount be greater than any of the sums referred to in Section XXXX hereof.

2.03 In addition, if this lease is terminated under the provisions of Article XXXX hereof, or if Landlord shall, reenter the Premises under the provisions of Article XXXX hereof, Tenant agrees that:

(a) the Premises then shall be in the condition in which Tenant has agreed to surrender the same to Landlord at the expiration of the term hereof;

(b) Tenant shall have performed prior to any such termination any covenant of Tenant contained in this lease for the making of any Alterations or for restoring or rebuilding the Premises or the Building, or any part thereof; and

(c) for the breach of any covenant of Tenant set forth above in this Section XXXX, Landlord shall be entitled immediately, without notice or other action by Landlord, to recover, and Tenant shall pay, as and for liquidated damages therefor, the cost of performing such covenant (as estimated by an independent contractor selected by Landlord).

2.04 In addition to any other remedies Landlord may have under this lease, and without reducing or adversely affecting any of Landlord's rights and remedies under Article XXXX, if any Fixed Rent, Additional Charges or damages payable hereunder by Tenant to Landlord are not paid within seven (7) days after the due date thereof, the same shall bear interest at the rate of one and one-half percent (1½%) per month or the maximum rate permitted by law, whichever is less, from the due date thereof until paid, and the amount of such interest shall be an Additional Charge hereunder. For the purposes of this Section XXXX, a rent bill sent by first class mail, to the address to which notices are to be given under this lease, shall be deemed a proper demand for the payment of the amounts set forth therein (but nothing contained herein shall be deemed to require Landlord to send any rent bill or otherwise make any demand for the payment of rent except in those cases, if any, explicitly provided for in this Lease).

Affirmative Waivers

3.01 Tenant, on behalf of itself and any and all persons claiming through or under Tenant, does hereby waive and surrender all right and privilege which it, they or any of them might have under or by reason of any present or future law, to redeem the Premises or to have a continuance of this lease after being dispossessed or ejected therefrom by process of law or under the terms of this lease or after the termination of this lease as provided in this lease.

3.02 If Tenant is in arrears in payment of Fixed Rent or Additional Charges, Tenant waives Tenant's right, if any, to designate the items to which any payments made by Tenant are to be credited, and Tenant agrees that Landlord may apply any payments made by Tenant to such items as Landlord sees fit, irrespective of and notwithstanding any designation or request by Tenant as to the items which any such payments shall be credited.

3.03 Landlord and Tenant hereby waive trial by jury in any action, proceeding or counterclaim brought by either against the other on any matter whatsoever arising out of or in any way connected with this lease, the relationship of Landlord and Tenant, Tenant's use or occupancy of the Premises, including, without limitation, any claim of injury or damage, and any emergency and other statutory remedy with respect thereto.

3.04 Tenant shall not interpose any counterclaim of any kind in any action or proceeding commenced by Landlord to recover possession of the Premises (other than compulsory counterclaims).

No Waivers

4.01 The failure of either party to insist in any one or more instances upon the strict performance of any one or more of the obligations of this lease, or to exercise any election herein contained, shall not be construed as a waiver or relinquishment for the future of the performance of such one or more obligations of this lease or of the right to exercise such election, and such right to insist upon strict performance shall continue and remain in full force and effect with respect to any subsequent breach, act or omission. The receipt by Landlord of Fixed Rent or partial payments thereof or Additional Charges or partial payments thereof with knowledge of breach by Tenant of any obligation of this lease shall not be deemed a waiver of such breach.

4.02 If there be any agreement between Landlord and Tenant providing for the cancellation of this lease upon certain provisions or contingencies and/or an agreement for the renewal hereof at the expiration of the term, the right to such renewal or the execution of a renewal agreement between Landlord and Tenant prior to the expiration of the term shall not be considered an extension thereof or a vested right in Tenant to such further term so as to prevent Landlord from canceling this lease and any such extension thereof during the remainder of the original term; such privilege, if and when so exercised by Landlord, shall cancel and terminate this lease and any such renewal or extension; any right herein contained on the part of Landlord to cancel this lease shall continue during any extension or renewal hereof; any option on the part of Tenant herein contained for an extension or renewal hereof shall not be deemed to give Tenant any option for a further extension beyond the negotiated renewal or extended term continued therein.

Curing Tenant's Defaults

5.01 If Tenant shall default in the performance of any of Tenant's obligations under this lease, Landlord, any Superior Lessor or any Superior Mortgagee without thereby waiving such default, may (but shall not be obligated to) perform the same for the account and at the expense of Tenant, without notice in a case of emergency, and in any other case only if such default continues after the expiration of the applicable grace period, if any. If Landlord effects such cure by bonding any lien which

Tenant is required to bond, Tenant shall obtain and substitute a bond for Landlord's bond at its sole cost and expense and reimburse Landlord for the cost of Landlord's bond.

5.02 Bills for any expenses incurred by Landlord or any Superior Lessor or any Superior Mortgagee in connection with any such performance by it for the account of Tenant, and bills for all costs, expenses and disbursements of every kind and nature whatsoever, including reasonable counsel fees, involved in collecting or endeavoring to collect the Fixed Rent or Additional Charges or any part thereof or enforcing or endeavoring to enforce any rights against Tenant or Tenant's obligations hereunder, under or in connection with this lease or pursuant to law, including any such cost, expense and disbursement involved in instituting and prosecuting summary proceedings or in recovering possession of the Premises after default by Tenant or upon the expiration or sooner termination of this lease, and interest on all sums advanced by Landlord or such Superior Lessor or Superior Mortgagee under this Section 27.02 and/or Section 27.01 (at the Interest Rate or the maximum rate permitted by law, whichever is less) may be sent by Landlord or such Superior Lessor or Superior Mortgagee to Tenant monthly, or immediately, at its option, and such amounts shall be due and payable as Additional Charges in accordance with the terms of such bills. Notwithstanding anything to the contrary contained in this Section, Tenant shall have no obligation to pay Landlord's costs, expenses, or disbursements in any proceeding in which there shall have been rendered a final judgment against Landlord, and the time for appealing such final judgment shall have expired.

Yellowstone Injunction

6.01 Landlord and Tenant, after due consideration and negotiation at arms length, and being fully advised by their respective counsel, hereby agree that the cure period for any event of default under this Lease shall not be the subject of any application or motion by the Tenant to a Court of law for a so-called "*Yellowstone*" injunction to enjoin Landlord from maintaining a summary proceeding against Tenant, and Tenant hereby expressly and knowingly waives and relinquishes all rights it might otherwise have to seek a "*Yellowstone*" injunction or other comparable equitable relief, if and when Landlord should have occasion to issue a Notice of Default and/or a Notice to Cure under the terms of this Lease after any Event of Default, as defined in this Lease.

6.02 In the event that a Court of law should (a) declare any part of this "*Yellowstone Injunction*" provision null and void, (b) issue a "*Yellow-*

stone” injunction or other comparable equitable relief in contravention of Section “6.01” above, or (c) issue any other order inconsistent with Section “6.01” above, which results in a plenary proceeding to adjudicate whether an Event of Default has occurred under this Lease, then Landlord and Tenant hereby further agree:

- (a) That Tenant shall make current all of its Rent and/or Additional Rent obligations then due under this Lease;
- (b) That Tenant shall secure a bond in the amount of no less than One (1) Million (\$1,000,000.00);
- (c) That both parties shall cooperate in seeking to have said plenary action placed on an expedited court schedule for the purpose of obtaining an early pre-trial hearing of the case;
- (d) That discovery in any such plenary action shall be limited to (i) production of copies of the Lease, any correspondence between the parties, and any other written, photographic, video and/or electronic evidence, and any expert reports and exhibits, relating to the claimed Event of Default, and (ii) no more than three depositions of party and/or non-party witnesses representing the Landlord’s interests and no more than three depositions of party and/or non-party witnesses representing the Tenant’s interests; and
- (e) That Tenant, within the time specified in this Lease for the payment of its monthly rent, shall pay all Rent and/or Additional Rent due each month, during the pendency of such plenary action.

CHAPTER FORTY

OVERVIEW OF LEASE ENFORCEMENT

**Michelle A. Maratto Itkowitz, Esq.
Jay B. Itkowitz, Esq.**

[40.0] I. INTRODUCTION TO LEASE ENFORCEMENT

Many transactional document drafters, who are not litigators, spend a lot of time working on commercial lease clauses without a clear conception of how such clauses can be enforced. They assume their work will be self-effectuating. It is not.

This chapter does two things: (1) it explains the actual nuts and bolts of how to practice commercial landlord and tenant litigation; and (2) it offers strategies that may be employed in this area to achieve expeditious and cost-effective results. Accordingly, the chapter serves two functions. First, it is a resource for the landlord and tenant litigator. Second, it provides much needed context for the drafter.

The draftsman should assume that every clause will at some time be violated. After all, we live in a very litigious environment in which, at some time or another, a party to a deal is going to test the limits of what has been written, either because of market forces, a business going bad, or just because they like to test.

Advice dispensed by this chapter often appears to be directed at landlord's counsel. This is so because the protagonist of much of the action examined is, indeed, the landlord. Tenant's counsel, both the litigator and the drafter, will, however, find an equal amount of value in every section. If a course of action is recommended for those seeking to enforce the lease on behalf of the landlord, then it can be inferred that the opposite protocol will work well for the tenant.

[40.1] A. Occupancy Relationships

We begin by defining what a landlord and tenant relationship is (and what it is not), and noting that "landlord and tenant law" often deals with evicting people and companies who are neither landlords nor tenants.

- **Tenant:** There is a written or oral contract between a landlord and a tenant that includes: (a) fixed term, (b) fixed rental amounts, (c) a clearly delineated premises, (d) a grant of exclusive use of the subject premises, and (e) a grant of exclusive control over the business conducted in the subject premises.¹

¹ *Williams v. City of New York*, 248 N.Y. 616 (1928); *Davis v. Dinkins*, 206 A.D.2d 365, 613 N.Y.S.2d 933 (2d Dep't 1994). *American Jewish Theatre v. Roundabout Theatre*, 203 A.D.2d 155, 610 N.Y.S.2d 256 (1st Dep't 1994).

- **Tenant at Sufferance:** One holding over, with no privity to the landlord. But the wrongful holding is by the laches of the landlord because it is the folly of the owner to suffer him to continue in possession after the determination of the preceding estate. No liability for rent, not really a “tenant.” Nor can the owner maintain an action of trespass against such a person.²
- **Tenant at Will:** A tenancy at will is “One who enters upon lands by permission of the owner, without any term being prescribed or rent reserved.”³ The obligation to pay rent is not an absolute element of “tenancy at will.”⁴ Exclusive use and possession is sufficient to create a “tenant at will.”⁵ The dispositive test is whether “he who is in possession has, by some act or agreement, recognized the other as his lessor or landlord and taken upon himself the character of a tenant under him, so that he is not at liberty afterwards to dispute his title.”⁶ An example of a tenancy-at-will is when employee remained in possession after employment relationship ended.⁷
- **Contract Vendee:** Generally, a tenant’s exercise of an option to purchase contained in a lease merges the landlord-tenant relationship into a vendor/vendee relationship thereby serving to terminate the landlord-tenant relationship unless the parties intend otherwise. The same is true when a seller under a contract of sale of real property allows the purchaser into the space before the closing.⁸ Thus, if the closing falls apart, the former-contact-vendee-occupant-left-in-the-space is not a tenant. Again, there was no meeting of the minds creating a tenancy, setting a rent and a term, etc. The best you can hope for in this situation is to be

2 *Livingston v. Tanner*, 14 N.Y. 64 (1856).

3 *Larned v. Hudson*, 60 N.Y. 102 (1875).

4 *Fisher v. Queens Park Realty Corp.*, 41 A.D.2d 547, 339 N.Y.S.2d 642 (2d Dep’t 1973).

5 *See Burns v. Bryant*, 31 N.Y. 453 (1865) (“The defendant was in possession, holding for no particular time, paying no rent, making no compensation for the use of the land . . . He was clearly a tenant at will”).

6 *Benjamin v. Benjamin*, 5 N.Y. 383 (1851), *superseded by statute*, RPAPL §§ 711-713, as recognized in *Drost v. Hookey*, 25 Misc. 3d 210, 881 N.Y.S.2d 839 (Dist. Ct., Suffolk Co. 2009).

7 *See, e.g., Harris v. Frink*, 49 N.Y. 24 (1872); *Stiles v. Donovan*, 100 Misc. 2d 1048, 420 N.Y.S.2d 433 (Civ. Ct., N.Y. Co. 1979).

8 *Kaygreen Realty Co., LLC v. IG Second Generation Partners, L.P.*, 78 A.D. 3d 1010, 912 N.Y.S.2d 246 (2d Dep’t 2010). *But see Lind v. Lind*, 203 A.D.2d 696, 610 N.Y.S.2d 347 (3d Dep’t 1994), holding that parties to a contract of sale do not have a landlord-tenant relationship, but there are exceptions to this rule, such as when the contract expressly avoids a merger by an express declaration in the contract that the relationship will remain that of landlord and tenant.

able to get the occupant out using Real Property Actions and Proceedings Law § 713 (RPAPL) “Grounds where no landlord-tenant relationship exists.”⁹

- **Former Mortgagor in Possession after Foreclosure:** After a property is conveyed at a foreclosure sale, the former mortgagor is not the new owner’s “tenant.” Again, as above, there was no meeting of the minds creating a tenancy, setting a rent and a term, etc. Once more, you need RPAPL § 713 “Grounds where no landlord-tenant relationship exists.”¹⁰
- **Licensee in Commercial Context:** Connotes use or occupancy of the grantor’s premises, not exclusive possession of designated space. Typically, license agreements are utilized for concession stands operated within other establishments;¹¹ agreements to place and maintain vending machines in certain areas;¹² agreements to sell particular merchandise on the floor space of department stores;¹³ signage on roof tops;¹⁴ and coin-operated laundries.¹⁵

[40.2] B. Summary Proceedings

In most instances when a landlord finds it necessary to sue a tenant to recover rent or possession of a premises, the proper vehicle is a summary proceeding for the recovery of real property. A summary proceeding for

-
- 9 RPAPL § 713: A special proceeding may be maintained under this article after a ten-day notice to quit has been served upon the respondent in the manner prescribed in section 735, upon the following grounds: . . . 9. A vendee under a contract of sale, the performance of which is to be completed within ninety days after its execution, being in possession of all or a part thereof, and having defaulted in the performance of the terms of the contract of sale, remains in possession without permission of the vendor.
- 10 RPAPL § 713: . . . 5. Subject to the rights and obligations set forth in section thirteen hundred five of this chapter, the property has been sold in foreclosure and either the deed delivered pursuant to such sale, or a copy of such deed, certified as provided in the civil practice law and rules, has been exhibited to him.
- 11 *Senrow Concession, Inc. v. Shelton Properties, Inc.*, 10 N.Y.2d 320, 222 N.Y.S.2d 329 (1961); *Lordi v. County of Nassau*, 20 A.D.2d 658, 246 N.Y.S.2d 502 (2d Dep’t 1964), *aff’d*, 14 N.Y.2d 699, 250 N.Y.S.2d 54 (1964).
- 12 *People v. Horowitz*, 309 N.Y. 426 (1956).
- 13 *Layton v. A.I. Namm & Sons*, 275 A.D. 246, 89 N.Y.S.2d 72 (1st Dep’t 1949), *aff’d, sub. nom.* 302 N.Y. 720 (1951).
- 14 *Reynolds v. Van Beuren*, 155 N.Y. 120 (1898); *but see San Filippo v. American Bill Posting Co.*, 188 N.Y. 514 (1907).
- 15 *Linro Equip. Corp. v. Westage Tower Assocs.*, 233 A.D. 2d 824, 650 N.Y.S.2d 399 (3d Dep’t 1996).

the recovery of real property (“summary proceeding”) is an expedited lawsuit, for the recovery of rent and possession of a premises, created by the New York State Legislature in 1820 and governed by Article 4 of the Civil Practice Law and Rules (CPLR) and Article 7 of the RPAPL. Summary proceedings are expeditious because the parties’ procedural rights and remedies are severely limited. Among other things, for example, the tenant’s time to answer the lawsuit is accelerated and, absent leave of court, there is no discovery.¹⁶

Due to the accelerated nature of a summary proceeding and the limits on pre-trial discovery, a landlord prosecuting such a proceeding is held to a higher standard with respect to complying with the technical requirements of the RPAPL. In general, even though courts have adopted more liberal standards in recent years, technical defects that might have no effect on a plenary action will mandate dismissal of a summary proceeding.¹⁷

For the most part, we are not concerned in these materials with a plenary lawsuit (i.e., a regular lawsuit filed in a non-landlord and tenant part of the Civil Court of the City of New York or in the Supreme Court of the State of New York). Sometimes, however, it is possible, desirable, or even necessary, for a landlord to sue to recover rent or possession of a premises in a plenary action. We will consider these less frequent occasions later in these materials.

16 See, e.g., CPLR 408; RPAPL § 701; *McQueen v. Grinker*, 158 A.D.2d 355 (1st Dep’t 1990); *Kavanaugh v. Kane*, 15 H.C.R. 94B (Civ. Ct., N.Y. Co. 1986) (no discovery in a simple non-payment proceeding); *NYU v. Farkas*, 121 Misc. 2d 643, 468 N.Y.S.2d 808 (Civ. Ct., N.Y. 1983) (defines “ample need” test for discovery to be allowed in a summary proceeding).

17 *Clarke v. Wallace Oil Co.*, 284 A.D.2d 492, 727 N.Y.S.2d 139 (2d Dep’t 2001). (“[F]ailure strictly to comply with the statutes governing summary proceedings deprives the court of jurisdiction and mandates dismissal. '[A] summary proceeding is a special proceeding governed entirely by statute and it is well established that there must be strict compliance with the statutory requirements to give the court jurisdiction.'”) citing *MSG Pomp Corp. v. Jane Doe*, 185 A.D.2d 798, 799-800, 586 N.Y.S.2d 965, quoting *Berkeley Assocs. Co. v. Di Nolfi*, 122 A.D.2d 703, 705); but see *17th Holding LLC v. Rivera*, 195 Misc. 2d 531, 758 N.Y.S.2d 758 (2d Dep’t 2002) (distinguishing *Clarke* by limiting the case to its own facts and stating that “First Department has now adopted the more liberal rule of construction (*433 Assocs. v. Murdock*, 276 A.D.2d 360, 715 N.Y.S. 2d 6 (1st Dep’t)) and has stated that a rule of strict construction was applied in *MSG Pomp Corp. v. Doe* . . . only as a matter of equity.”); *Elul Realty Corp v. Java New York Ltd.*, 12 Misc. 3d 336, 816 N.Y.S.2d 885 (Civ. Ct., Kings Co. 2006) (distinguishing *Clarke* on its facts, while holding the petition in the summary proceeding defective on different grounds pertaining to the vague/incomplete description of the premises in the petition).

[40.3] C. Nonpayment Vs. Holdover

There are two types of summary proceedings: nonpayment proceedings and holdover proceedings. A nonpayment is a lawsuit for the recovery of rent due and, in the absence of full and timely recovery of rent due, possession of the premises.¹⁸ A holdover is a lawsuit for recovery of possession of the premises, regardless of the payment of rent, although past due rent or a fee for using and occupying the subject premises may also be recovered in a holdover.¹⁹

The distinction between a nonpayment and a holdover, and the circumstances under which each may be initiated, are confusing to many people. The chart below compares the characteristics of a nonpayment and a holdover.

	Nonpayment	Holdover
Grounds for Lawsuit	Rent not paid.	Someone in possession who is not entitled to be.
Predicate Notice	Rent demand.	Various: 30-day Notice of Termination; Notice to Cure and Notice to Terminate; in some cases no notice required.
Relief Sought	Money judgment for past due rent and a judgment of possession.	Judgment of possession and possibly a money judgment for use and occupancy.
Is Payment of Rent a Defense?	Yes, if tenant pays prior to issuance of warrant of eviction (even after a money judgment is issued)—case over.	No.
Speed	Usually moves faster than a holdover.	Usually moves more slowly than a nonpayment.

18 RPAPL § 711(2).

19 RPAPL § 711(1).

	Nonpayment	Holdover
Complexity	Usually easier to prosecute than a holdover.	Usually more difficult to prosecute than a nonpayment.
First Court Date	Not scheduled until Respondent answers.	Scheduled when Petitioner purchases index number.
Default	If Respondent defaults, Petitioner may apply for a judgment of possession and a warrant of eviction via the Marshal's office.	If Respondent defaults, there must be an inquest before a judgment of possession is issued.

The only instance in which one can bring a nonpayment is when a tenant fails to pay the rent. In contrast, there are a greater variety of situations in which a landlord may institute a holdover. Interestingly, however, holdovers are actually commenced much less frequently than nonpayments.

[40.4] 1. What About a Holdover for the Non-Payment of Rent?

A question often asked at this point is: “*Why can you not bring a holdover for the non-payment of rent? How can failing to pay the rent on time not be a violation of a provision of the lease that would cause the lease to end early?*”

In the *commercial* context,²⁰ sometimes leases will allow the landlord to bring a holdover when the only provision of the lease being violated is the covenant to pay rent. However, whether a lease contains this provision is usually the result of market forces at the time of the lease negotiation.

20 In the residential context, there is a statute prohibiting as a matter of public policy any automatic forfeiture of residential tenancies for the non-payment of rent. *Semans Family Ltd. Partnership v. Kennedy*, 177 Misc. 2d 345, 675 N.Y.S.2d 489 (Civ. Ct., N.Y. Co. 1998) (conditional limitation in residential lease, which provided that, in the event of nonpayment of rent, lease would automatically expire on termination date fixed in notice of default, did not allow tenant to pay rent due in order to avoid forfeiture, violated public policy prohibiting automatic forfeitures of residential tenancies for nonpayment of rent).

[40.5] 2. Which Case Should I Bring—a Nonpayment or a Holdover?

If the landlord has the option of bringing either a nonpayment or a holdover, the following are some major advantages and disadvantages of each. A nonpayment usually moves faster than a holdover. However, if the tenant pays the rent, or is able to demonstrate why it does not owe the rent, the tenant wins the proceeding.²¹ A holdover is usually a bit more challenging to prosecute than a nonpayment and takes longer. Payment of rent, or disproving that rent is owed, is not a defense to a holdover, however, and if the proceeding is properly prosecuted, it may terminate the tenancy. Deciding which summary proceeding to institute really depends on the landlord's goals and the lawyer's or managing agent's strategy. Maybe a landlord really wants a tenant out because the market is such that the landlord can re-let the space for more money. Suppose the lease has expired and now the tenant is a month-to-month tenant, so a 30-day notice of termination is required as a predicate to initiating a holdover proceeding.²²

The litigator should ask the following questions:

- How much rent does the tenant owe?
- Can I prove it? and
- If I can prove it, can the tenant pay it?

If the tenant is in bad financial condition and will be unable to defend against a simple nonpayment, why bother bringing a holdover with its long predicate notice period? In that case, it might be best to do a nonpayment with its relatively short predicate notice period.

**[40.6] II. VITAL PRELIMINARY
CONSIDERATIONS IN LEASE
ENFORCEMENT LITIGATION**

Landlord and tenant cases are often won (or lost) before the case is even filed. A myriad of factual issues need to be examined, understood legally, and dealt with in order to bring a winnable case on behalf of a landlord. This is so because, as we will explore in detail below, a landlord

21 See 89 N.Y. Jur. 2d Real Property Possessory Actions § 97.

22 See *infra*, § 39.33, "Termination of Month-to-Month Tenancies."

and tenant case depends on the service of a proper predicate notice, which is not amendable. Therefore, mistakes made at the predicate notice stage, even before a pleading is drafted, can destroy a landlord and tenant case. If a mistake is not discovered until trial, it can be devastatingly wasteful of a landlord-client's time and money.

[40.7] A. Create a Lease Abstract

In order to do this work well, the authors strongly recommend that litigation counsel always prepare a "Lease Abstract," a short reference document that records and consolidates all the salient information about the particular case. This information is collected online, by speaking with the client, and by reading the lease and other information.

The Lease Abstract serves at least two purposes. One purpose of the Lease Abstract is that its preparation forces the practitioner to engage fully with the case, preventing careless errors with the many details that need to be considered and the many choices that need to be made when drafting a predicate notice or a pleading. The Lease Abstract is a kind of checklist. Another purpose of the Lease Abstract is to make life easy going forward. If the phone rings and the client wants to discuss the matter, the lawyer does not need to fumble to answer simple questions, such as, How much is the monthly rent? Is there a guaranty? How much security are we holding? Is there an attorney fee provision?

A Lease Abstract Should Include the Following:

- General information about the building and the case:
 - The building's zip code (If service copies are mailed to the wrong zip code the case can be dismissed for bad service).²³
 - Any a/k/a for the address
 - The block and lot numbers
 - The deed from the NYC Dept. of Finance ACRIS

²³ The general rule is that an incorrect address on a mailing must lead to dismissal, for the court will not have acquired personal jurisdiction. *See Soils Eng'g Svcs., Inc. v. Donald*, 258 A.D.2d 425, 685 N.Y.S.2d 723 (1st Dep't 1999.) (noting that court lacked personal jurisdiction over defendant because "Plaintiff ... failed to establish that the summons was mailed to the correct address"). The court will lack personal jurisdiction even when a plaintiff includes the wrong zip code in a summons and complaint in a plenary action. *Avakian v. De Los Santos*, 183 A.D.2d 687, 583 N.Y.S.2d 275 (2d Dep't 1992).

- The certificate of occupancy from the NYC Dept. of Buildings (DOB)
- Any relevant DOB or NYC Dept. of Environmental Protection violations
- The Multiple Dwelling Registration from the NYC Dept. of Housing Preservation and Development
- Check the NYS Dept. of State Division of Corporations website to see if the landlord and the tenant are authorized to do business in New York State
- Google the tenant and the address (one never knows what one will find)
- Look at the building on Google maps
- Ask the managing agent if he or she is aware of occupants in addition to the tenant
- Get the last six checks tenant paid with and note the name and address of payee
- For each document in the lease chain note:
 - Document date
 - Document name (i.e. “Standard Form of Loft Lease”)
 - Party of the First Part
 - Party of the Second Part
 - Exact Description of Premises
 - Term
- Note the status of the following (with citations to the controlling part of the lease chain):
 - Timing for a rent demand
 - Whether there is a conditional limitation for the nonpayment of rent

- Number of days required for a notice to cure for a rent default
- Number of days required for a notice to terminate for a rent default
- Number of days required for a notice to cure for a non-rent default
- Number of days required for a notice to terminate for a non-rent default
- Method of notice
- When a notice is deemed effective
- What the premises can be used for
- How much security is being held; how much left
- Whether there is a guaranty
- Whether the lease provides for attorney fees
- The monthly rent

Much of the balance of this chapter addresses how this information is utilized in litigation.

[40.8] B. Petitioner's Interest

At trial the petitioner (i.e., landlord) must prove its interest in the premises.²⁴

The lawyer must get his or her hands on and carefully examine the documents that prove landlord's interest in the premises *before* drafting any documents for the lawsuit.

A copy of the deed to the building in which the premises is located can be obtained online in New York City at the Department of Finance, ACRIS section of the site.

Or you can obtain a certified deed from the County Clerk's office of the county in which the property is located. Moreover, you will need a certified copy of the deed for trial. An original deed is admissible, but often

²⁴ RPAPL § 741(1).

the original deed is unavailable and it is not sensible to risk losing it by bringing it to court. Since a certified copy of the deed usually takes about a week to obtain, you should order a certified copy well in advance.

It should also be noted, however, that there are consistent holdings that “proof of ownership” is *not* a prerequisite to maintaining a proceeding pursuant to RPAPL § 721 which authorizes summary proceedings by “landlord or lessor,” and that introduction of the lease agreement is sufficient proof of petitioner’s right to maintain a summary proceeding.²⁵ Although it is probably less trouble to bring proof of ownership to trial, if for some reason such proof is not available *and* petitioner is the lessor named in the lease, this is an important line of cases to keep in mind.

Finally, sometimes a landlord-client will be a Limited Liability Company, but the deed will be in the name of a previous partnership. Not to worry—this is one of the few situations where it is not hazardous to a *prima facie* case for the deed to be in a different name than the petitioner. Limited Liability Company Law § 1007 (Effect of conversion) states:

- (a) A partnership or limited partnership that has been converted pursuant to this chapter is for all purposes the same entity that existed before the conversion.
- (b) When a conversion takes effect:
 - (i) all property, real and personal, tangible and intangible, of the converting partnership or limited partnership remains vested in the converted limited liability company;
 - (ii) all debts, obligations, liabilities and penalties of the converting partnership or limited partnership continue as debts, obligations, liabilities and penalties of the converted limited liability company;
 - (iii) any action, suit or proceeding, civil or criminal, then pending by or against the converting partnership

25 *Fifth Ave & 60th St. Corp. v. Kinney E. 60th St. Parking Corp.*, N.Y.L.J., July 28, 1994 (App. Tm. 1st Dep’t), citing *K.R.F. Management Co. v. Bartle*, N.Y.L.J., October 19, 1987, p. 9, c. 2 (App. Tm. 1st Dep’t) (and cases cited). Introduction of the lease agreement, like here, is sufficient proof of a petitioner’s right to maintain a summary proceeding. *Id.*; see also *201-222 Realty LLC v. Headley*, 2003 WL 21355416 (App. Term 2d & 11th Jud. Dists. May 15, 2003) (“[L]andlord was not required to establish proof of ownership, only that it was tenants’ lessor (RPAPL 721), and this was adequately proven by the introduction of the lease”).

or limited partnership may be continued as if the conversion had not occurred; and

(iv) to the extent provided in the agreement of conversion and in this chapter, the partners of a partnership or the general partners and limited partners of a limited partnership shall continue as members in the converted limited liability company.

[40.9] C. Lease

[40.10] 1. Get the Whole Lease

If there is a lease with the tenant, landlord's lawyer needs all of it when preparing the proceeding. A landlord's lawyer should not let his client get away with sending him only the cover page, the default paragraph and the signature page, no matter how long a fax or pdf it is. If the landlord's lawyer misses something because he did not properly review the lease, then the landlord will, rightfully, say, "*Well, I could have sent you the whole lease; why didn't you ask for it?*"

[40.11] 2. How to Get Around Problems with Petitioner's Interest in the Lease

What if a landlord who bought a building but no one bothered to assign the building's leases to the new owner?

Real Property Law § 223 (RPL) states that:

The grantee of leased real property . . . has the same remedies, by entry, action or otherwise, for the nonperformance of any agreement contained in the assigned lease for the recovery of rent, for the doing of any waste, or for other cause of forfeiture as his grantor or lessor had, or would have had, if the reversion had remained in him.

Therefore, when the petitioner becomes the owner of the fee, the petitioner takes the same subject to the existing lease, and there can be no question of the petitioner's right to institute summary proceedings to regain possession of the premises.²⁶

²⁶ *507 Madison Ave. Realty Co. v. Martin*, 200 A.D. 146, 192 N.Y.S. 762 (1st Dep't 1922), *aff'd*, 233 N.Y. 683 (1922).

Therefore, when a landlord conveys the fee, and makes no reservation as to any unexpired leases (even though he does not formally assign these leases), he nevertheless transfers these leases to the grantee together with all of the grantor's rights in and under them. The conveyance *does not* terminate the lease. From the time of the conveyance of the fee to the grantee, the grantee becomes bound by, and entitled to the benefits of, all the covenants in the lease which run with the land. A privity of estate has been created between the grantee and the tenant by virtue of the conveyance, and the covenants that run with the land fix and define the tenure by which the parties hold the leased property. If it is a covenant running with the land, it will inure to the benefit of the original landlord's grantee, notwithstanding that the original agreement did not provide that it would be binding on or inure to the benefit of the assigns of the original parties.²⁷

[40.12] D. Arrears Report

In a nonpayment proceeding, as will be demonstrated later in this chapter, a landlord's attorney must be exact about the rent demanded. Therefore, it is important to look at the arrears report that the managing agent will use in court to refresh his or her recollection regarding the arrears and how additional rent, if any, was computed. If notices were sent to the tenant regarding the computation of additional rent, these should be examined before drafting the papers, and brought to court for trial as well.

If the tenant receives rent and/or additional rent bills or has received any correspondence or earlier notices from the landlord regarding what landlord claims is owed, tenant's attorney should compare those bills to the rent demand to see if they match.

[40.13] E. Corporate Status in New York

When a New York State corporation has been dissolved for neglecting to pay requisite franchise taxes, absent subsequent reinstatement (achievable by payment of unpaid franchise taxes, penalties, interest and charges pursuant to Tax Law § 203-a(7)) the corporation is essentially legally dead and has no *de facto* existence. Accordingly the corporation is no longer permitted to sue or be sued.²⁸ This is a great trick for a tenant to use to

27 Rasch, *New York Landlord & Tenant, Including Summary Proceedings* § 5:17.

28 *De George v. Yusko*, 169 A.D.2d 865, 564 N.Y.S.2d 597 (3d Dep't 1991); *Lorisa Capital Corp. v. Gallo*, 119 A.D.2d 99, 506 N.Y.S.2d 62 (2d Dep't 1986); *Brady v. State Tax Comm'n*, 176 Misc 1053 (Sup. Ct., Kings Co. 1941), *aff'd*, 263 A.D. 955, 33 N.Y.S.2d 384 (2d Dep't 1942), *aff'd*, 289 N.Y. 585, 43 N.E.2d 719 (1942).

derail a landlord and tenant case. True, a landlord can simply pay the back taxes and then re-initiate the case, but that costs time and money (sometimes a lot) that the landlord was not planning on shelling out as a predicate to suing the tenant.²⁹

[40.14] F. Other Litigation

Sometimes it is just nice to know how much litigation your opponent is, or has been, tied up in. This information is not really relevant to the landlord's prima facie case, but the color commentary it provides might cause a judge to view the tenant in a less sympathetic light. Similarly, if you are representing the tenant, under certain circumstances, learning what other cases the landlord has brought can be vital. The bottom line is that knowledge is power. It also does not hurt to look up your opponents on the internet to try to figure out who they are.

[40.15] G. Correspondence

Obtain all correspondence between landlord and/or managing agent and the tenant.

[40.16] H. Chronology on Microsoft Excel

It is good to make a chronology of important events in an excel chart, where you can easily add a new event and then sort the events by date. Do not wait until the eve of trial to begin assembling the facts into a chronology. This exercise helps you to see patterns and to determine if you are missing any vital information.

[40.17] I. Evidence of Additional Occupants

It is important for a landlord's attorney to figure out who is in the space sought to be recovered, so that all proper parties can be served.

Questions Landlord's Attorney Should Ask Client:

- Does the landlord know who occupies the space?
- Has the lease been assigned?

²⁹ To determine the status of a New York corporation, the New York State Department of State, Division of Corporations, Corporation and Business Entity Database can be accessed for free at https://www.dos.ny.gov/corps/bus_entity_search.html.

- Did the landlord give permission to anyone else to be in the space, either written or oral?
- Has the landlord encountered anyone other than the tenant with respect to the premises?
- Have subtenants, authorized or unauthorized, moved into the premises?
- Are there names other than that of tenant on the door?
- What is the name of the store?

[40.18] J. Search the Tenant and the Building Online, and Look At Google Maps

The tenant and the building should be searched online, and the building's image checked on Google maps. One never knows what one will find.

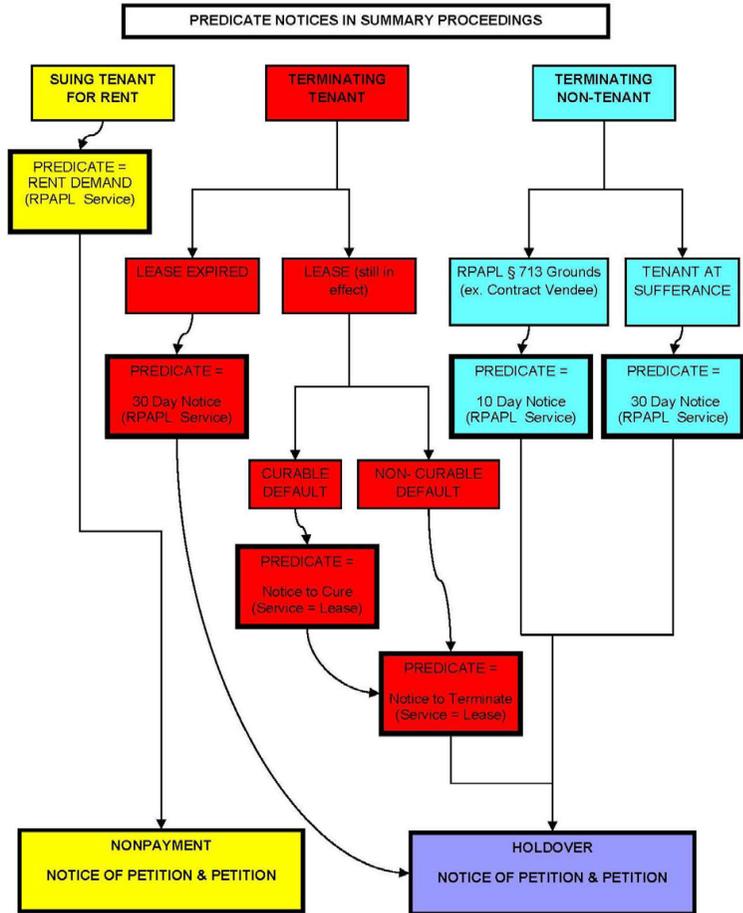
[40.19] K. Take a Field Trip—Go Visit the Premises

This last suggestion is not one to do for every case. In larger commercial litigations, however, we have found visiting the site of the dispute to be extremely helpful. For example, when considering what use and occupancy should be set at for a tenant in commercial strip mall, it is useful to walk around the mall. Are the stores upscale or downscale? Do the stores depend on one another to enhance one another's value? Yes, a broker will render an expert opinion in most use and occupancy disputes. Sometimes, however, there is no substitute for the understanding of a case that comes from seeing the subject of the litigation with one's own

[40.20] III. PREDICATE NOTICES IN GENERAL

Almost every summary proceeding requires service of a predicate notice before the lawsuit can be commenced. This can be a very confusing aspect of this area of law. On the next page is a chart designed to help one understand which predicate notices underlie which proceedings and how each are served.

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[40.21] A. Predicate Notices Not Amendable

A predicate notice is not amendable.³⁰ Therefore, if a predicate notice is not clear and precise it is jurisdictionally defective, and the proceeding upon which it is based is subject to dismissal.³¹ Consequently, if mistakes are made at the predicate notice stage, the case must be started all over again. A tenant's attorney should look for defects—the opportunity for them abound! Although the courts overlook some of the most technical defects in predicate notices, motion practice occasioned by defects can cause delays while the court sorts out the issue.

[40.22] B. Who May Sign A Predicate Notice

Although conflicting authority exists, in order to be safe, a predicate notice should be signed by the landlord.³² Leases usually require that the landlord issue any notice under the lease. Therefore, the attorney *should not* sign a predicate notice.³³

In order to remain in compliance with the Fair Debt Collection Practices Act (FDCPA), the landlord, not the managing agent or the lawyers, should sign, because they may be considered a debt collector under the FDCPA. Essentially, anyone can collect a debt owed to themselves without being subject to the FDCPA. However, once a managing agent or a lawyer sends out five demands under their own signature in a one year period, they are deemed a debt collector and subject to the special requirements set forth in the FDCPA.

This advice is not always practical. Often, the landlord will want its managing agent to sign the predicate notice on behalf of the landlord because the managing agent is the one privy to the details of the situation. When the tenant can be shown to know that the managing agent is authorized to act on behalf of the landlord, either by formal notice or prior interaction between the tenant and managing agent, an objection as to the sufficiency of the managing agent's authority will not be a defense to the

30 *Chinatown Apts., Inc. v. Chu Cho Lam*, 51 N.Y.2d 786, 433 N.Y.S.2d 86 (1980).

31 *See 185 E 85th St. v. Gravanis*, N.Y.L.J., Jan. 21, 1981, p.6, col. 2 (1st Dep't).

32 *Warehouse v. Mann*, N.Y.L.J., Dec. 12, 1990, p. 22, col. 4, (Civ. Ct., N.Y. Co.).

33 *See Siegel v. Kentucky Fried Chicken of Long Is.*, 108 A.D.2d 218, 488 N.Y.S.2d 744 (2d Dep't 1985), *aff'd*, 67 N.Y.2d 792, 501 N.Y.S.2d 317 (1986).

proceeding.³⁴ Nevertheless, the best practice is to have the landlord sign all predicate notices.

[40.23] IV. PREDICATE NOTICE WHEN SUING FOR RENT—RENT DEMANDS

[40.24] A. Rent Demands

A rent demand on at least three days' notice is a required predicate of a summary nonpayment proceeding.³⁵

[40.25] B. Lease Can Lengthen Time Requirement in Rent Demand

The three-day requirement may be lengthened by the lease.³⁶ In addition, the lease may require more stringent service requirements than those promulgated in the RPAPL.

[40.26] C. Oral Rent Demand

Pursuant to statute, a rent demand may be oral, unless the lease says otherwise (which it almost always does).³⁷ But even if the lease allows an oral rent demand, a demand in writing should be made because it is too difficult to prove the requisite elements of an oral demand at trial. The landlord will have to testify to exactly what he said to demonstrate that the demand was unequivocal,³⁸ and that the tenant was apprised of the particular time period for which rent is claimed to be in default and the approximate good faith amount alleged to be due.³⁹

34 *Liberty Diner, Inc. v. 2635 Food Corp.*, 264 A.D.2d 439, 694 N.Y.S.2d 438 (2d Dep't 1999).

35 See RPAPL § 711(2).

36 *Hendrickson v. Lexington Oil*, 41 A.D.2d 672, 340 N.Y.S.2d 963 (2d Dep't 1973).

37 See RPAPL § 711(2); *Trustees of C.I. Mtge. Group v. NYILR Ltd.*, N.Y.L.J., Dec. 8, 1978, p. 6, col. 3 (1st Dep't) ("the demand requirements of RPAPL § 711(2) should not be encumbered by judicially promulgated technicalities").

38 *Zinsser v. Herrman*, 23 Misc. 645, 52 N.Y.S. 107 (App Term 1898); *Schwartz v. Weiss-Newell*, 87 Misc. 2d 558, 386 N.Y.S.2d 191 (Civ. Ct., N.Y. Co. 1976).

39 *Brusco v. Miller*, 167 Misc. 2d 54, 639 N.Y.S.2d 246 (App. Term, 1st Dep't 1995).

[40.27] D. Good Faith Approximation of Arrears in Rent Demand

Under *Brusco v. Miller*,⁴⁰ a rent demand must set forth a good faith approximation of the rent believed to be due and owing. This contrasts with the often highly exaggerated damages asserted in a typical civil action. Furthermore, although much precedent supports a landlord's ability to rely upon a good faith approximation of the rent due, there are lower courts that have held that the arrears must be specifically itemized.⁴¹

[40.28] E. Payment or Surrender Options in Rent Demand

A rent demand must state that the tenant has the alternative of paying the arrears or surrendering the premises.⁴²

[40.29] F. Legal and Late Fees in Rent Demand

A rent demand may include legal fees, late fees and other "additional rent" if the lease allows such.⁴³

[40.30] G. Service of Rent Demand

Pursuant to RPAPL § 711(2), written rent demands must be served upon a tenant in the same manner set forth in RPAPL § 735 for service of process of summary proceedings for the recovery of real property. The requirements of RPAPL § 735 service are discussed in greater detail later in these materials. It is important to note that the lease itself may contain more stringent service requirements.

⁴⁰ *Id.*

⁴¹ *See, e.g., Heywood Towers v. Valdes*, N.Y.L.J., April 30, 1997, p. 27, col. 1 (Civ. Ct., N.Y. Co.); *622 W 141st St., LLC v. Garcia*, N.Y.L.J., April 30, 1997, p. 27, col. 2 (Civ.Ct., N.Y. Co.); *Life Realty Partners v. Samuel H. Moss, Inc.*, N.Y.L.J., Oct. 16, 1991, p. 22, col. 4 (Civ. Ct., N.Y. Co.).

⁴² *See Towne Centre v. Gristede's*, N.Y.L.J., Oct. 10, 1997, p. 28, col. 3 (App.Term 9th & 10th Jud. Dists.).

⁴³ *Meyers Parking Sys. v. 475 Park Ave. S. Co.*, 186 A.D.2d 92, 588 N.Y.S.2d 32 (1st Dep't 1992). However, when serving a rent demand on a rent stabilized or rent controlled tenant, attorneys' fees should not be included. *See, e.g., Silber v. Schwartzman*, 150 Misc. 2d 1, 575 N.Y.S.2d 226 (App. Term, 1st Dep't 1991) ("in a proceeding such as this brought under RPAPL § 711(2) for nonpayment of rent by the landlord of residential, rent stabilized premises, attorneys' fees may not be considered 'rent' or be awarded as 'additional rent' in order to enable the landlord to obtain a possessory judgment, and a lease clause to that effect is unenforceable"); *Crystal World Realty Corp. v. Sze*, 2001 WL 1635430 (App. Term, 1st Dep't, Dec. 13, 2001).

[40.31] V. PREDICATE NOTICES IN HOLDOVERS**[40.32] A. When No Predicate Notice Required**

A landlord does not need to give a predicate notice prior to initiating a holdover proceeding, if and only if, no rent has been accepted beyond the date of expiration of the lease.

[40.33] B. Termination of Month-to-Month Tenancy

A month-to-month tenancy is automatically created when a tenant whose term is longer than one month holds over after the expiration of the term and the landlord accepts rent after the expiration of the term.⁴⁴ Note that this situation exists: (1) where a tenant never had a lease; or (2) where the lease expired and the landlord accepted rent after the expiration of the lease term. A landlord may terminate a month-to-month tenancy by service on the tenant of a written 30-day notice of termination.⁴⁵

In New York City, the 30 days must span the beginning of the month to the end of the month. For example, if on June 14th the landlord wants to terminate the tenancy of a month-to-month tenant whose rent is usually due, and who usually pays, on the 1st of the month, the landlord has to serve the tenant with a 30-day notice prior to July 1, terminating the tenancy effective July 31, and the earliest the holdover can begin is on or after August 1.⁴⁶

Please also note that if the rent is paid on the 15th of the month, then the term runs from the 15th of one month to the 14th of the next, and the 30-day notice of termination in such case would, at a minimum, also need to span the 15th to the 14th.

Watch out for the February Problem—February does not have 30 days, so 30 days from the 1st of February is usually March 3rd, not March 1st. In order to terminate a month-to-month tenancy on February 28, the notice must be served by January 29.

44 RPL § 232-c; *Zobe, L.L.C. v. United N. Bancshares, Ltd.*, 251 A.D.2d 237, 673 N.Y.S.2d 314 (1st Dep't 1998); *Joyous Holdings, Inc. v. Volkswagen of Oneonta, Inc.*, 128 A.D.2d 1002, 513 N.Y.S.2d 841 (3d Dep't 1987).

45 RPL § 232-a.

46 *Id.*; see also *Clarke v. Shepard*, 188 Misc. 588, 68 N.Y.S.2d 707 (App. Term, 1st Dep't 1947).

The 30-day notice of termination should be clear, definite and unequivocal, *and* it should set forth the date on which the tenancy will end. The 30-day notice should also advise the tenant that unless the premises are vacated the landlord will commence summary proceedings. However, the notice need not set forth any reason for the termination of tenancy.⁴⁷

A 30-day notice of termination must be served in the same manner as a notice of petition and petition for a summary proceeding. In other words, it must be served in accordance with RPAPL § 735, which governs service of process in summary proceedings.⁴⁸

[40.34] VI. CONDITIONAL LIMITATIONS

One of the landlord's most powerful remedies, a default subject to a conditional limitation pursuant to the lease, permits the landlord to terminate the lease by following certain procedures.

[40.35] A. Types of Defaults Subject to Conditional Limitations in a Lease

[40.36] 1. Non-Rent Defaults Subject to Conditional Limitations

The following are events of default subject to a conditional limitation under the Real Estate Board of New York, Inc.'s Standard Form of Store Lease ("the REBNY Lease"):

If the Tenant defaults in fulfilling any of the covenants of this lease other than the covenants for the payment of rent or additional rent; or if the demised premises becomes vacant or deserted; or if any execution or attachment shall be issued against Tenant or any of Tenant's property whereupon the demised premises shall be taken or occupied by someone other than Tenant; or if the lease be rejected under Section 365 of Title II of the U.S. Code (Bankruptcy Code); or if Tenant shall have failed, after five (5) days written notice, to redeposit with Owner any portion of the security deposit hereunder which Owner

47 RPL § 232-a; *see also Park Summit Realty Corp. v. Frank*, 107 Misc.2d 318, 434 N.Y.S.2d 73 (App. Term, 1st Dep't 1980) *aff'd*, 84 A.D.2d 700, 448 N.Y.S.2d 414 (1st Dep't 1981) *aff'd*, 56 N.Y.2d 1025, 453 N.Y.S.2d 643 (1982); *Hughes v. Lenox Hill Hospital*, 226 A.D.2d 4, 651 N.Y.S.2d 418 (1st Dep't 1996).

48 RPL § 232-a; *see also Texaco v. Weinberg*, 13 A.D.2d 1002, 216 N.Y.S.2d 588 (2d Dep't 1961).

has applied to the payment of any rent and additional rent due and payable hereunder; or if Tenant shall be in default with respect to any other lease between Owner and Tenant; or if Tenant shall fail to move into or take possession of the premises within thirty (30) days after the commencement of the term of this lease. . . .

Other defaults which may be included in the lease as subject to a conditional limitation are: (a) assigning, mortgaging or encumbering the lease or subletting without the landlord's permission; (b) the filing of a mechanic's lien against the premises which is not discharged within a period of time after notification of the tenant by the landlord; (c) the failure to maintain insurance; and (d) the failure of any other lease obligation that the parties have deemed to be a substantial obligation of the lease.

Here is a sample email from my office to a landlord-client reviewing a lease and looking for possible areas where the commercial tenant might be in default:

We took a good hard look at the lease for TENANT. The lease does not expire until 2015.

Material Lease Breaches

- *the tenant mortgages, pledges, hypothecates or otherwise encumbers the lease, by operation of law or otherwise, without the prior consent of the landlord, consent may be withheld for any reason or no reason. (§ 74 of Rider)*
- *tenant assigns the lease, or any interest in the lease, transfer ownership of the lease (§ 78 of the Rider, § 11 of the Lease)*
- *tenant sublets the premises (§ 78 of the Rider, § 11 Lease)*
- *tenant closed for a period of ten or more days not for landlord authorized renovations (§ 17 Lease)*
- *tenant doesn't maintain the proper insurance We should check this incurable default! (§ 45 lease)*

Other Possible Breaches (Less Material)

- *tenant fails to make repairs but not most structural repairs (§ 60 rider)*

- *tenant makes alterations without proper permits or LL written consent; (§ 3 Lease)*
- *sidewalks, hallways, entrances, vestibules, etc are obstructed or used for unauthorized purpose; (§ 37 lease)*
- *hand trucks without rubber tires and safeguards make deliveries to tenant; (§ 37 lease)*
- *sweepings, or other substances or rags left in water and wash closets (they must be doing this, right? (§ 37 lease)*
- *smoking or cigars in elevators of building? (§ 37 lease)*
- *no signs can be hung that are visible from outside of premises without the prior written consent of LL; (§ 37 lease)*
- *tenant marks, paints, or bores into any part of the premises or building without the LL's consent; (§ 37 lease)*
- *tenant uses other than the freight elevators for freight elevator stuff like merchandise; (§ 37 lease)*
- *Tenant uses additional locks or bolts or changes original locks and bolts; (§ 37 lease)*
- *landlord can prohibit tenants advertising if you don't like it by the way; (§ 37 lease)*
- *if central air, tenant has to keep all windows closed at all times; (§ 37 lease)*
- *tenant keeps flammable liquid or causes odors or moves machinery or safe in and out of the building without the LL's permission; (§ 37 lease)*

[End of email]

[40.37] 2. Nonpayment of Rent as a Conditional Limitation

Although the REBNY Lease specifically excludes such, a lease can provide a mechanism whereby the landlord may terminate the lease, after default in the payment of rent, in the commercial context. Properly drafted, a conditional limitation clause for the nonpayment of rent in a commercial lease will be enforced by the courts and is, perhaps, the land-

lord's most powerful remedy, nonpayment being the most common default. This is particularly true where the market has quickly improved and the lease-rent has fallen "below market." A properly structured conditional limitation for the non-payment of rent should utilize the language cited approvingly by the court in *Grand Liberte Co-op Inc. v. Billhaud*,⁴⁹ expressly making the conditional limitation applicable to rent defaults and stating that "it [is] the intention of the parties hereto to create hereby a conditional limitation."⁵⁰

[40.38] B. Notice to Cure

Typically, as in ¶17 of the REBNY Lease, the landlord must first notify the tenant of the default and set forth a time period in which the tenant must cure the default; or, if it is impossible to cure within the time period, it must set forth a time period in which the tenant must begin curing the default. The time period in the current REBNY Lease is 15 days. This notice is commonly referred to as a "notice to cure" or "notice of default."

A notice to cure must "specifically apprise the tenant of the claimed default and of the forfeiture and termination of the lease if the default is not cured."⁵¹ It is a best practice to make notices to cure extremely detailed. That way the tenant and the tenant's representatives know that the landlord really did its homework and is prepared for a fight.

[40.39] C. "Yellowstone" and Tolling Time to Cure Defaults

Giving a notice to cure may force the commercial tenant to initiate a proceeding in Supreme Court commonly referred to as a "*Yellowstone*," so called after the case of *First National Stores v. Yellowstone Shopping Center*.⁵² The essence of a *Yellowstone* proceeding is a declaratory judgment complaint accompanied by a stay application (which is routinely granted, at least in the form of a temporary restraining order, pending a hearing on a preliminary injunction), which seeks a trial on the issue of

49 126 Misc. 2d 961, 487 N.Y.S.2d 250 (App. Term, 1st Dep't 1984).

50 *Id.* Note, however, that *this strategy will not work in a residential context*. A conditional limitation regarding the nonpayment of rent in a residential lease has been held to violate public policy as it would provoke a forfeiture, and the law disfavors automatic forfeitures of residential tenancies. *Semans Family Ltd. Partnership v. Kennedy*, 177 Misc. 2d 345, 675 N.Y.S.2d 489 (Civ. Ct., N.Y. Co. 1998).

51 *Filmtrucks, Inc. v. Express Indus. & Term. Corp.*, 127 A.D.2d 509, 510, 511 N.Y.S.2d 862 (1st Dep't 1987).

52 21 N.Y.2d 630, 290 N.Y.S.2d 721 (1968).

whether the tenant is indeed in violation of the lease. This procedure is designed to toll the time the tenant would ordinarily have to cure a lease violation while the court resolves the issue of whether the tenant is indeed in violation and/or has cured the violation. If the court finds the tenant in violation, then by virtue of the stay of the notice to cure, the tenant still has the opportunity to cure the violation before the cure period ends. This process in itself can buy the tenant significant time as the resolution of the proceeding can take months, if not years.

The purpose of a *Yellowstone* injunction is to maintain the status quo by means of a temporary stay while the tenant challenges the landlord's notice to cure.⁵³ Thus, the *Yellowstone* injunction tolls the cure period set forth in the landlord's notice of default until there is a judicial determination of the parties' rights.⁵⁴

To demonstrate one's entitlement to a *Yellowstone* injunction, a tenant must demonstrate that he or she: (1) holds a valuable commercial lease; (2) has received a notice to cure; (3) has requested injunctive relief prior to the termination of the lease; and (4) is prepared and maintains the ability to cure the alleged default by any means short of vacating the premises.⁵⁵ "These standards reflect and reinforce the limited purpose of a *Yellowstone* injunction: to stop the running of the applicable cure period."⁵⁶

A *Yellowstone* injunction can provide a modicum of protection to landlords as well as tenants, because they are often conditioned upon the tenant's ongoing payment of rent and/or the posting of a bond to protect the landlord from a wrongfully issued injunction.

53 See, e.g., *Jemaltown of 125th Street, Inc. v. Leon Betesh/Park Seen Realty Assocs.*, 115 A.D.2d 381, 496 N.Y.S.2d 16 (1st Dep't 1985); *Fratto v. Red Barn Farmers Market Corp.*, 144 A.D.2d 635, 535 N.Y.S.2d 53 (2d Dep't 1988).

54 See *Finley v. Park Ten Assocs.*, 83 A.D.2d 537, 441 N.Y.S.2d 475 (1st Dep't 1981); *South Ferry Bldg. Co. v. Schroder Bank & Trust Co.*, 91 A.D.2d 963, 458 N.Y.S.2d 584 (1st Dep't 1983).

55 *Garland v. Titan W. Assocs.*, 147 A.D.2d 304, 543 N.Y.S.2d 56 (1st Dep't 1989).

56 *Graubard Mollen Horowitz Pomeranz & Shapiro v. 600 Third Avenue Assocs.*, 93 N.Y.2d 508, 693 N.Y.S.2d 91 (1999).

The First Department has held that commercial tenants have a right to a virtually automatic issuance of a *Yellowstone* injunction⁵⁷ and has held that in order to obtain a *Yellowstone*, rather than requiring the tenant to prove on his application that he can cure the alleged default, a tenant must merely state his desire and ability to cure the default by any means short of vacating the premises.⁵⁸ Furthermore, a tenant is entitled to a *Yellowstone* injunction when the tenant argues that he is not in violation of the lease, and that if he is, he concedes to cure any such violations.⁵⁹

If the tenant is successful in having the *Yellowstone* injunction implemented, then the landlord must answer the Supreme Court action and counterclaim for termination of the tenancy. This is an example of a landlord and tenant dispute being litigated in a forum other than civil court.

An invariable condition of a *Yellowstone* injunction is that the tenant is ordered to pay rent during the pendency of the action.

[40.40] D. Termination Notice

If no *Yellowstone* proceeding is commenced and the default is not cured or being cured by the date specified in the notice to cure or if the default is not curable (see below), then the landlord may notify the tenant that the lease will be terminated in a certain number of days. In such case, the REBNY Lease allows the lease to be terminated in five days. This notice is commonly referred to as a “notice to terminate.” After the expiration of the termination notice, the landlord may commence a summary holdover proceeding against the tenant to recover possession of the premises.

57 See *Herzfeld & Stern v. Ironwood Realty Corp.*, 102 A.D.2d 737, 738, 477 N.Y.S.2d 7 (1st Dep’t 1984) (“where . . . a tenant denies any default and demonstrates that the landlord has given notice of default, and that a period of time remains within which to cure the tenant is entitled to a grant of preliminary relief. Since the tenant risks forfeiture of its leasehold, and ‘the law does not favor [such] forfeiture’ the tenant need not, as a prerequisite to the granting of a *Yellowstone* injunction, demonstrate a likelihood of success on the merits. Nor is a tenant required to prove its ability to cure prior to obtaining a *Yellowstone* injunction. The proper inquiry is whether a basis exists for believing that the tenant desires to cure and has the ability to do so through any means short of vacating the premises.”).

58 *Id.*

59 See *Empire State Building Assocs. v. Trump Empire State Partners*, 245 A.D.2d 225, 667 N.Y.S.2d 31 (1st Dep’t 1997) (where a tenant can show that it is able and willing to bring itself into compliance with the lease absent vacating the premises, forfeiture is inappropriate); *Garland*, 147 A.D.2d at 308.

[40.41] E. Things to Keep in Mind When Terminating a Tenancy Pursuant to a Conditional Limitation**[40.42] 1. Service of Notices to Cure and Notices of Termination Given Pursuant to a Lease**

Notices to cure and notices to terminate pursuant to the terms of a lease are served on the tenant in accordance with the lease. No statute specifies other methods of service for notices given strictly pursuant to a lease.⁶⁰ If the lease is silent on a method of service, the method used must be “reasonable.”

[40.43] 2. Effect of Acceptance of Rent Post-Termination

If rent is accepted after service of a notice of termination but prior to the proceeding’s first court date, then the termination notice will be vitiated.⁶¹

Therefore, upon serving a notice of termination on a tenant, the lawyer for landlord must send IN WRITING to the client, SPECIFIC instructions about not accepting the rent until further notice because it places the proceeding in danger. It is not good enough to merely tell them orally.

Here is what often happens otherwise: The managing agent forgets OR the rent goes to a lock box and the managing agent forgets to return it, and then when the proceeding is thereby rendered defective the Managing Agent says, “_____ (YOUR NAME HERE) NEVER told me!”

Tenant’s attorneys should encourage tenant to send the rent in a timely and usual fashion, so perhaps landlord will make this mistake.

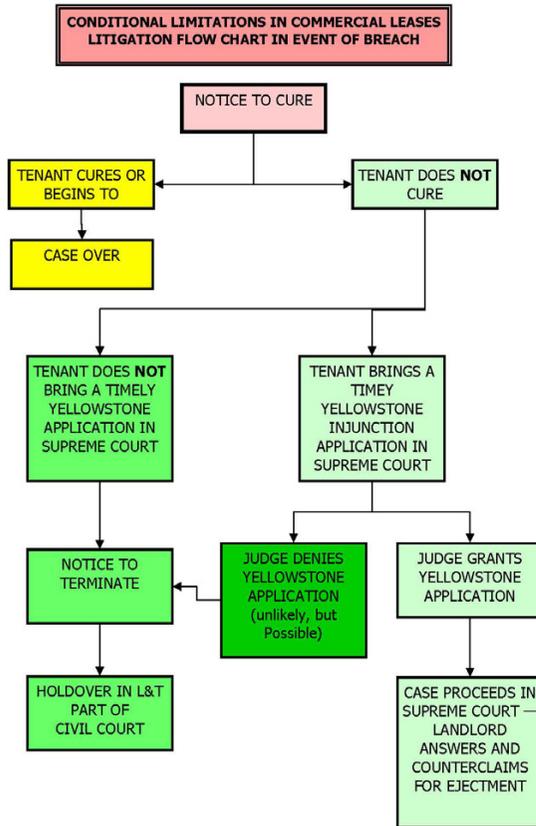
[40.44] F. Flow Chart of Litigation Regarding Conditional Limitations in Commercial Leases—*Yellowstone*

On the next page is a flow chart that visually represents the litigation described in this section regarding conditional limitations in commercial leases.

60 See *Rose Assoc. v. Bernstein*, 138 Misc. 2d 1044, 526 N.Y.S.2d 383 (Civ. Ct., N.Y. Co. 1988).

61 *Oppenheim v. Spike*, 107 Misc. 2d 55, 437 N.Y.S.2d 826 (App. Term, 1st Dep’t 1980).

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[40.45] G. Non-Curable Defaults

There are lease defaults of such a nature that curing the default is not possible. In such case, a necessary element for *Yellowstone* relief—that the tenant is prepared and maintains the ability to cure the alleged default by any means short of vacating the premises—is not present.

Therefore, in this section, we consider ways to terminate a commercial lease and avoid *Yellowstone* litigation by foregoing a cure period and going straight to lease termination on a non-curable default.

[40.46] 1. Insurance Defaults

Insurance defaults are not curable. Insurance is highly material and the tenant must have insurance in place during the times and in the amounts requisite in the lease, or else a lease can be terminated. The landlord deserves the benefit of their insurance bargain.⁶²

It has been held that even if the tenant wants to cure an insurance default, to do so is simply impossible. Tenant cannot cure by procuring, during the cure period, insurance coverage *prospectively*, as such policy will not protect landlord against the unknown universe of any claims arising during the period of no insurance coverage.⁶³

The landlord has no obligation to get the insurance for tenant and charge it back as additional rent. Furthermore, the sub-tenant's insurance does not satisfy the tenant's obligation.⁶⁴ Moreover, certificates of insurance, which were issued as a matter of information only, are insufficient to establish that it maintained the requisite insurance or was capable of curing its default.⁶⁵

62 *Kel Kim Corp. v. Central Mkts.*, 70 N.Y.2d 900, 524 N.Y.S.2d 384 (1987); *C & N Camera & Electronics, Inc. v. Farmore Realty, Inc.*, 178 A.D.2d 310, 577 N.Y.S.2d 613 (1st Dep't 1991). But see *Khatari v. Shami*, 35 Misc. 3d 1211(A), 950 N.Y.S.2d 723 (Sup. Ct., Kings Co. 2012) (waiver of the insurance default based on an earlier case between the parties).

63 *Kyung Sik Kim v. Idylwood, N.Y., LLC*, 66 A.D.3d 528, 529, 886 N.Y.S.2d 337 (1st Dep't 2009).

64 *166 Enterprises Corp. v. I G Second Generation Partners, L.P.*, 81 A.D.3d 154, 917 N.Y.S.2d 143 (1st Dep't 2011).

65 *JT Queens Carwash, Inc. v. 88-16 N. Blvd., LLC*, 101 A.D.3d 1089, 1090, 956 N.Y.S.2d 536 (2d Dep't 2012).

[40.47] 2. Other Incurable Defaults

Courts have found other incurable lease defaults and therefore denied *Yellowstone* relief. Some examples are provided here:

- Tenant failed to maintain records required by the lease for the contractually mandated time period, with respect to a percentage payment requirement. This clause in the lease was an integral part of a lease agreement and plaintiff's breach of that provision was material. Tenant failed to establish that it was prepared and able to cure the defaults alleged in defendant's notice to cure by any means short of vacating the premises.⁶⁶
- Unauthorized assignment. Tenant represented that its principal owned 90 percent of tenant's stock. Tenant assigned, without prior written consent, "twenty-five (25%) percent of the issued and outstanding capital stock of tenant without principal continuing to retain and exercise operational control of tenant." Landlord asserted that principal, who had been in control of tenant, was central to the parties' lease.⁶⁷

[40.48] 3. Defaults the Tenant Refuses To Cure

To procure a *Yellowstone* injunction, a commercial tenant must demonstrate, *inter alia*, that it has *the desire* and ability to cure the alleged default by any means short of vacating the premises.⁶⁸

[40.49] VII. NOTICE OF PETITION AND PETITION**[40.50] A. Elements of a Petition**

There are many samples that can be followed to be sure you include all the necessary elements in a petition (i.e., Blumberg and McKinney's

66 *Grenadeir Parking Corp. v. Landmark Assoc.*, 294 A.D.2d 313, 313–14, 743 N.Y.S.2d 95 (1st Dep't 2002).

67 *Zona, Inc. v. Soho Centrale*, 270 A.D.2d 12, 704 N.Y.S.2d 38 (1st Dep't 2000).

68 *Linmont Realty, Inc. v. Vitocarl, Inc.*, 147 A.D.2d 618 (2d Dep't 1989) ("To procure a *Yellowstone* injunction, a commercial tenant must demonstrate, *inter alia*, that it has the desire and ability to cure the alleged default by any means short of vacating the premises. The plaintiff herein has made no offer to cure any of the charged defaults, alleging instead that many of the alleged defaults listed in the Notice of Termination of Lease were not its responsibility, that various conditions did not exist as claimed by the defendants, and that the remainder of the defaults had been waived by the defendants acceptance of rent with knowledge of their existence." [(internal quotation marks and citation omitted)]).

forms). Therefore, we will not spend a lot of time on the obvious elements of a petition, other than to provide the checklist below of items to be included.

Items To Be Included In A Petition:

- Statement of Petitioner’s Interest
- Statement of Respondent’s Interest
- Description of Premises
- Facts upon which proceeding is based/Statements as to service of predicate notices
- Multiple Dwelling Registration
- Rent Regulatory Status
- Relief Sought

[40.51] B. Who to Name As a Respondent in the Petition

A very important and often overlooked aspect of drafting a petition is who to name as a respondent.

[40.52] 1. Subtenants

Subtenants—both authorized and unauthorized—should typically be named. In order to obtain complete relief (i.e., possession), any person or entity that claims an interest in the premises must be named. You can sail through an entire summary proceeding against tenant X (“X”) and be successful every step of the way, but on eviction day the marshal can show up to evict tenant X and finds subtenant Y (“Y”) in possession of the space. If the judgment and the warrant were not for Y, then Y does not get evicted. Moreover, Y can turn around and let X back in! Note, however, that a subtenant is not a legally necessary party.⁶⁹ The litigation can go

⁶⁹ See, e.g., *New York Railways v. Savoy*, 239 A.D. 504, 508, 268 N.Y.S. 181 (1st Dep’t 1933) (“The failure to make the subtenant a party to the first dispossession proceeding could not affect the character of its estate after the overlease fell for non-payment of rent.”); *First Federal Savings & Loan Assoc. of Rochester v. Moore*, 157 Misc. 2d 877, 878, 599 N.Y.S.2d 410 (Yonkers City Ct. 1993) (“It is also axiomatic that subtenants are not necessary parties to a summary proceeding and are joined in the proceeding at the discretion of the landlord in order to assure that any warrant which may be issued by the court is effective against the subtenant as well as against the prime tenant.”).

forward without a subtenant, but in order to gain complete relief for your landlord-client, you must get a warrant against the subtenant.

[40.53] 2. Unidentified People or Business Entities Occupying the Premises

If there is, or you suspect there might be, an unidentified person or business using the premises, other than a member of the tenant's family, then you should: (a) name them using a fictitious name; and (b) try to figure out who they are and attempt to use their real name or amend the petition later. Examples of this are "John/Jane Does #1–#3 (if you suspect three unauthorized occupants because the super has seen three unidentified people coming and going recently) or "XYZ Corp."⁷⁰ After commencing litigation, once the unidentified occupants have been identified, you can move, either at trial or before the trial, to substitute the actual persons' and/or entities' names for the fictitious names.

[40.54] 3. Do Not Name Guarantors to the Lease

Do not name guarantors to the lease. Guarantors need to be sued separately in a plenary action.

It is a strategic best practice, however, to mail a copy of the predicate notices and notice of petition and petition to the guarantors by mail. The sooner a guarantor is aware of a default, the more likely they are to step in and remedy the situation.

[40.55] VIII. SERVICE OF PROCESS

As discussed in § 40.94, Strategy and Gamesmanship, *infra*, service of process is often the only real defense that a tenant may present, and is frequently raised as a defense in commercial landlord and tenant proceedings. This section examines how to get service of process correct, if you represent a landlord, and how to question service if you represent a tenant.

70 See CPLR 1024 ("A party who is ignorant, in whole or in part, of the name or identity of a person who may properly be made a party, may proceed against such person as an unknown party by designating so much of his name and identity as is known. If the name or remainder of the name becomes known all subsequent proceedings shall be taken under the true name and all prior proceedings shall be deemed amended accordingly.").

[40.56] A. Process Service—In General

A court cannot make a decision that applies to a person or company unless it has personal jurisdiction over that person or company. Personal jurisdiction is a courts' power to bring a person or company into its adjudicative process. One of the things that a person who wants to sue a person or company must do to cause the court to have personal jurisdiction over a person or company is serve the person or company with process.

“Process” is a legal document that directs an appearance or response to a legal action or proceeding. Process includes such documents as a notice of petition and petition, a summons and complaint, a rent demand, a 30-day notice of termination, or a subpoena.

A process server is one who “serves” process. With certain exceptions, a person must be licensed by the New York City Department of Consumer Affairs to serve process. One exception is that one who serves process less than five times in one year is exempt from needing a license.

RPAPL § 735 is the section that covers the service of rent demands, notices of petition and petitions. Lease provisions cannot alter or modify the § 735 service requirements. Service of process for non-landlord and tenant matters is governed by CPLR Article 3. Note that RPAPL § 735 service is somewhat different than regular CPLR service.

RPAPL § 735 states:

§ 735. Manner of service; filing; when service complete

1. Service of the notice of petition and petition shall be made by personally delivering them to the respondent; or by delivering to and leaving personally with a person of suitable age and discretion who resides or is employed at the property sought to be recovered, a copy of the notice of petition and petition, if upon reasonable application admittance can be obtained and such person found who will receive it; or if admittance cannot be obtained and such person found, by affixing a copy of the notice and petition upon a conspicuous part of the property sought to be recovered or placing a copy under the entrance door of such premises; and in addition, within one day after such delivering to such suitable person or such affixing or placement, by mailing to the respondent both by registered or certified mail and by regular first class mail,

- (a) if a natural person, as follows: at the property sought to be recovered, and if such property is not the place of residence of such person and if the petitioner shall have written information of the residence address of such person, at the last residence address as to which the petitioner has such information, or if the petitioner shall have no such information, but shall have written information of the place of business or employment of such person, to the last business or employment address as to which the petitioner has such information; and
 - (b) if a corporation, joint-stock or other unincorporated association, as follows: at the property sought to be recovered, and if the principal office or principal place of business of such corporation, joint stock or other unincorporated association is not located on the property sought to be recovered, and if the petitioner shall have written information of the principal office or principal place of business within the state, at the last place as to which petitioner has such information, or if the petitioner shall have no such information but shall have written information of any office or place of business within the state, to any such place as to which the petitioner has such information. Allegations as to such information as may affect the mailing address shall be set forth either in the petition, or in a separate affidavit and filed as part of the proof of service.
2. The notice of petition, or order to show cause, and petition together with proof of service thereof shall be filed with the court or clerk thereof within three days after;
 - (a) personal delivery to respondent, when service has been made by that means, and such service shall be complete immediately upon such personal delivery; or
 - (b) mailing to respondent, when service is made by the alternatives above provided, and such service shall be complete upon the filing of proof of service.

[40.57] B. Five Elements of Process Serving

There are **FIVE** elements to serving process:

1. Delivery of the papers
2. GPS-ing the service
3. Mailing the papers

4. Filing proof of service with the court
5. Completing and maintaining the process server log book

[40.58] 1. Delivery of the Papers

[40.59] a. Delivery Options Set Forth in RPAPL § 735

- **Personal Service on an Individual.** Personal delivery to respondent who is an individual.
- **Personal Service on a Corporation.** Personal service on a corporation must be made on an officer, director, managing or general agent, cashier or other person authorized to accept service on behalf of the corporation, in compliance with CPLR 311(a)(1). **RPAPL does not permit service on a corporation via the secretary of state.**
- **Substituted Service (“Suitable Age and Discretion”).** If respondent is not able to be personally served, a copy of the papers may be left with a person of suitable age and discretion who resides or is employed at the premises sought to be recovered. Substituted service must be made at the premises sought to be recovered.
- **Conspicuous Place Service (“Nail and Mail”).** Only after reasonable application to serve respondent(s) by personal or substituted service fail, a copy of the notice and petition may be “affixed” to the door or a conspicuous place on the premises. There is a plethora of law on this topic. The following is a good rule to follow: Unless the landlord has specific information about when the tenant is likely to be found in the premises (in which case, that is the time to attempt service), in commercial evictions, reasonable application means the process server makes at least two attempts to find the tenant at the premises, during two different times of day (or night) which encompass tenant’s regular business hours. For example, go to an office during regular business hours; go to a nightclub during the evening.

[40.60] b. An Important Note on Delivery Options

There are three types of delivery: (1) personal, (2) suitable age and discretion, and (3) conspicuous place. **Numbers 1 & 2 are EQUALS.** Number 3 is inferior in that you may NOT use #3 unless you have tried for either #1 or #2. But here’s the thing that people get a little confused about:

you do NOT have to attempt #1 before resorting to #2. They are equal. Suitable age and discretion service is as good as personal service.

Therefore, the author's policy is to SKIP personal service and go straight for suitable age and discretion. Why? Because personal is harder to get than suitable age and discretion. If it's a corporation, then personal service on a corporation requires reference to another statute. And that statute requires you to find an officer or director or person authorized to accept service. It is burdensome to have a traverse over whether someone was an officer or was authorized.

Under suitable age and discretion all a process server needs to find is a person of suitable age and discretion. It has nothing to do with "officer, director, authorized, etc." And it is just as good in the first instance as personal service.

BUT contrast this advice with the following. If a service is made on a tenant in a manner other than by personal service and the tenant never appears in the proceeding, then the landlord may get a possessory judgment against the tenant *but not a money judgment*.⁷¹ This is worth keeping in mind because occasionally a landlord is quite certain that a tenant will default. But note that at least a few judges have recently questioned this rule,⁷² and some judges will give you a money judgment on default.

[40.61] 2. GPS

[40.62] a. GPS Rule

As of November 11, 2011, all process servers licensed in New York City must carry a device (such as a telephone or digital assistant) that utilizes a global positioning system (GPS) technology or Assisted-Global Positioning System (A-GPS) technology and that utilizes the software necessary to establish electronically a record of the time, date, and location of a service or an attempted service. *See* Subchapter W of Chapter 2 of Title 6 of the Rules of the City of New York § 2-233b ("§ 2-233b").

71 *In re McDonald*, 225 A.D. 403, 233 N.Y.S. 368 (4th Dep't 1929); *Ressa Family, LLC v. Dorfman*, 193 Misc. 2d 315, 749 N.Y.S.2d 387 (Dist. Ct., Nassau Co. 2002); *Arnold v. Lyons*, 2003 WL 2004246 (Dist. Ct., Nassau Co. Mar. 31, 2003).

72 *Dolan v. Linnen*, 195 Misc. 2d 298, 753 N.Y.S.2d 682 (N.Y.C. Civ. Ct., Richmond Co. 2003); *Guevera v. Cueva*, 5 Misc. 3d 1024(A), 799 N.Y.S.2d 160 (Dist. Ct. 2004); *Laskey v. Tillotson*, 16 Misc. 3d 1124(A), 847 N.Y.S.2d 902 (Lockport City Ct. 2007); *Avgush v. Berrahu*, 17 Misc. 3d 85, 847 N.Y.S.2d 343 (App. Term, 9th & 10th Jud. Dists. 2007); *Avgush v. Pascale*, 25 Misc. 3d 139(A), 906 N.Y.S.2d 770 (9th and 10th Dist. 2009); *Expressway Village v. Denman*, 26 Misc. 3d 954, 893 N.Y.S.2d 736 (Cnty. Ct., Niagara Co. 2009).

Section 2-233b states, in pertinent part, as follows:

(a) General Requirements. A process server licensed pursuant to this subchapter must comply with the requirement of section 20-410 of the Code to carry at all times during the commission of his or her licensed activities, and operate at the time process is served or attempted, a device to establish electronically and record the time, date, and location of service or attempted service as follows:

(1) Equipment.

(i) The process server must obtain a mobile device, such as a telephone or personal digital assistant, that utilizes the software necessary to make an electronic record of the location where, and the time and date when, the record is made as determined by Global Positioning System (GPS) technology or Assisted-Global Positioning System (A-GPS) technology, and labels the record with the network date and time maintained by the mobile device, the DCA license number of the process server, . . . the name of the plaintiff or petitioner, the name of the defendant or respondent, the docket number (if any), the name of the person to whom process is delivered and a unique file identifier of the process being served.

(ii) The mobile device must be equipped with the software necessary to make an electronic record of the location where and time and date when the record is made, as determined by triangulated cell tower signals, in the event that at the time of the effected or attempted service of process a GPS signal is not available.

(iii) The mobile device software must automatically add that location, time and date information to the electronic record as soon as a GPS or cellular signal reaches the device if neither a GPS nor a cellular signal is present at the time the process server causes the electronic record to be made.

(2) Operation of Equipment.

(i) On every occasion that a process server attempts or effects service of process, the process server must ensure that the mobile device makes an electronic record of the GPS location, time and date of the attempted or effected service immediately after attempting or effecting service. In the event that no GPS signal is available at the time of attempted or effected service of process, the location, time and date will be determined by triangulated cell tower signals.

[40.63] b. Picture Still Worth 1000 Words

Do not get too excited over GPS. There ARE opportunities to dispute if visits happened, even in the age of GPS. Your GPS readings could say that you are at, for example, 1 Maple Street. That is great. But:

- Did the process server go *INSIDE* 1 Maple Street? Or just sit out front in his or her car drinking coffee?
- If the process server entered the building, did he or she go to the premises door, or simply hang out in the lobby reading the paper?
- If process server went to the premises door, did he or she knock loudly and remain there for a period of time—or did he or she just tape the papers to the door with no knock?

The authors defeated a landlord on a traverse (kind of, landlord discontinued the case when we raised these objections) because the server went to the door, but did not knock. Rather, the server just taped the papers to the door. How do we know? Because our tenant-client was inside and heard some scratching at her door. She opened it to find the process server (who admitted to her he did not knock) taping the papers. Now in that case, the GPS would read that the server was there. But that doesn't mean the server did what he was supposed to do to effectuate good service on the delivery of the papers.

[40.64] 3. Mailing Requirement

Within one day of delivery, a copy of the papers must be mailed to respondent. The attorney should tell the process server where and how to mail the papers. I do not like to leave my process servers any discretion about the mail and thus send them a “mailing list” pulled from my Lease Abstract (see above). Here is an example on the following page.

MAIL TYPE	NUMBER	LINE	ADDRESS	METHOD	SOURCE
premises	1	1	VC Telecom Inc.	regular mail, certificate of	premises
		2	501 Hudson Street		
		3	Store 3		
		4	New York, New York 10014		
		5			
additional	2	1	VC Telecom Inc.	regular mail, certificate of mailing	check paying with
		2	228 Bleecker Street		
		3	New York, New York 10014		
		4			
		5			
TYPE	NUMBER	LINE	ADDRESS	METHOD	SOURCE
premises	3	1	VC Telecom Inc.		premises
		2	501 Hudson Street	certified mail	
		3	Store 3		
		4	New York, New York 10014		
		5			
additional	4	1	VC Telecom Inc.		check paying with
		2	228 Bleecker Street	certified mail	
		3	New York, New York 10014		
		4			
		5			
TYPE	NUMBER	LINE	ADDRESS	METHOD	SOURCE
premises	5	1	VC Telecom Inc.		premises
		2	501 Hudson Street		
		3	Store 3	certified mail, return receipt	
		4	New York, New York 10014		
		5			
additional	6	1	VC Telecom Inc.		check paying with
		2	228 Bleecker Street		
		3	New York, New York 10014	requested	
		4			
		5			

[40.65] 4. Filing the Petition and Filing Proof of Service for Petition**[40.66] a. Commencing the Proceeding and Filing the Petition**

Once the notice of petition and petition are prepared, but before they are served on the respondents, they are brought to court, where the index number is purchased and the clerk stamps the original notice of petition indicating it was issued by the court, and then returns it to you. Bring the original notice of petition back to the office.

The index number is then written on all copies of the notice of petition and petition, and the notice of petition and petition are served as one document. Now, you may serve the notice of petition and petition.

[40.67] b. Filing Proof of Service of Petition

Once service is complete, affidavits of service are affixed to the original notice of petition and filed with the court. The notice of petition with proof of service must be filed within three days of completing service. Service is officially complete upon filing proof of service. It is good practice to obtain a copy of the stamped notice of petition.

[40.68] 5. Log Book**[40.69] a. Log Book In General**

The process server must maintain a “log book.” This is a very specific kind of log book. This log book will be a vital record in any court proceeding in which the process server is called to testify.

Pursuant to General Business Law § 89-cc(1):

Each process server shall maintain a legible record of all service made by him as prescribed in this section. **Such records shall be kept in chronological order in a bound, paginated volume.** Corrections in records shall be made only by drawing a straight line through the inaccurate entry and clearly printing the accurate information directly above the inaccurate entry. All other methods of correction, including but not limited to erasing, opaquing, obliterating or redacting, are prohibited (emphasis added).

[40.70] b. What Must Go Into Log Book

The record to be maintained shall include the following information, where applicable:

- The title of the action or a reasonable abbreviation thereof;
- The name of the person served, if known;
- The date and approximate time service was effected;
- The address where service was effected;
- The nature of the papers served;
- The court in which the action has been commenced;
- The index number of the action, if known;
- If service is effectuated pursuant to subdivision four of section three hundred eight of the CPLR or subdivision one of section seven hundred thirty-five of the RPAPL, a description of the color of the door to which the summons is affixed;
- The process serving agency from whom the process served was received, if any;
- Type of service effected whether personal, substituted or conspicuous;
- If service is effected pursuant to subdivision one, two or three of section three hundred eight of the CPLR, the record shall also include the description of the person served, including, but not limited to, sex, color of skin, hair color, approximate age, height and weight, and other identifying features;
- If service is effected pursuant to subdivision four of section three hundred eight of the CPLR, the record shall also include the dates, addresses and time of attempted service pursuant to subdivision one, two or three of such section;
- If the process server files an affidavit of service with the court, his record shall include the date of such filing; and

- According to the Rules of the City of New York, Title 6 (Department of Consumer Affairs), Chapter 2 (Licenses), Subchapter W (Process Servers), § 2-233(b)(4): If service is effectuated pursuant to RPAPL § 735(1), a description of the area adjacent to the door to which the process is affixed including (a) the color and composition of the hallway walls, (b) the color and composition of the hallway floor or doorstep, and (c) the location of the premises in relation to the stairs, elevator or entranceway.

[40.71] c. Number of Log Book Entries

There should be one log book entry per person served per service OR attempt.

[40.72] d. Sample Log Book Pages

Next, the authors insert three sample Log Book pages (from our custom-made Log Book) so you can see exactly what we are talking about.

RECORD OF SERVICE
Pursuant to General Business Law § 89-cc

Firm From Whom Papers Received: Itkowitz PLLC Internal
Itkowitz PLLC Account Number: _____

Title of Action: _____

Court: _____ Index Number: _____

Person or Entity Served: _____
Papers Served: _____

Type of Entry:

Attempt at Service Substituted Service
Personal Service Individual Conspicuous Place Service
Personal Service Corporation

Date : _____ Time: _____

Address : _____

Date Affidavit Filed with Court: _____

I took pictures while on this attempt or service? YES or NO

I complied with Subchapter W of Chapter 2 of Title 6 of the Rules of the City of New York § 2-233b and the latitude and longitude of the location of the attempt or service was:

Notes:

For Personal and Substituted Service Only — Description of Individual

Name: _____

Sex: M or F Skin Color: _____ Eye Color: _____ Hair Color: _____

Approx. Age: _____ Approx. Height: _____ Approx. Weight: _____

Additional Features: _____

For Personal Service on a Corporation Only — Title of Individual

Circle Title: officer / director / managing agent / general agent / cashier / assistant cashier / agent authorized to accept service / AND/OR:

Title: _____

For All Services, But Not for Attempts — Mailing

Address Papers Mailed To: _____

Date: _____ Method: _____ Postal Receipt Number: _____

Date: _____ Method: _____ Postal Receipt Number: _____

Date: _____ Method: _____ Postal Receipt Number: _____

F = Regular First Class Mail; FC = Regular First Class Mail with Certificate of Mailing; C = Certified; CRRR = Certified Return Receipt Requested; O = Overnight; R = Registered Mail

For Attempts and Conspicuous Place — Description of Place Details

Color of Door: _____ Composition of Door: _____

Color of Hallway: _____ Composition of Hallway: _____

Color of Hall Floor or Doorstep: _____ Composition of Hall Floor or Doorstep: _____

Location of Premises in Relation to Stairs, Elevator or Entranceway: _____

Names or Signs on Door: _____

For Conspicuous Place, Service Only — Previous Attempts

What earlier pages of this book or an earlier book are the attempts supporting this service contained on?

Additional Addresses

Additional Address Papers Mailed To: _____

Date: _____ Method: _____ Postal Receipt Number: _____

Date: _____ Method: _____ Postal Receipt Number: _____

Date: _____ Method: _____ Postal Receipt Number: _____

Method: F = Regular First Class Mail; FC = Regular First Class Mail with Certificate of Mailing; C = Certified; CRRR = Certified Return Receipt Requested; O = Overnight, R = Registered Mail

Additional Addresses

Additional Address Papers Mailed To: _____

Date: _____ Method: _____ Postal Receipt Number: _____

Date: _____ Method: _____ Postal Receipt Number: _____

Date: _____ Method: _____ Postal Receipt Number: _____

Method: F = Regular First Class Mail; FC = Regular First Class Mail with Certificate of Mailing; C = Certified; CRRR = Certified Return Receipt Requested; O = Overnight, R = Registered Mail

Additional Addresses

Additional Address Papers Mailed To: _____

Date: _____ Method: _____ Postal Receipt Number: _____

Date: _____ Method: _____ Postal Receipt Number: _____

Date: _____ Method: _____ Postal Receipt Number: _____

Method: F = Regular First Class Mail; FC = Regular First Class Mail with Certificate of Mailing; C = Certified; CRRR = Certified Return Receipt Requested; O = Overnight, R = Registered Mail

Additional Addresses

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Date: _____ Method: _____ Postal Receipt Number: _____

Date: _____ Method: _____ Postal Receipt Number: _____

Date: _____ Method: _____ Postal Receipt Number: _____

Method: F = Regular First Class Mail; FC = Regular First Class Mail with Certificate of Mailing; C = Certified; CRRR = Certified Return Receipt Requested; O = Overnight, R = Registered Mail

Additional Addresses

Additional Address Papers Mailed To: _____

Date: _____ Method: _____ Postal Receipt Number: _____

Date: _____ Method: _____ Postal Receipt Number: _____

Date: _____ Method: _____ Postal Receipt Number: _____

Method: F = Regular First Class Mail; FC = Regular First Class Mail with Certificate of Mailing; C = Certified; CRRR = Certified Return Receipt Requested; O = Overnight, R = Registered Mail

[40.73] IX. MOTION PRACTICE IN LANDLORD AND TENANT COURT

The Landlord and Tenant Parts of the Civil Court . . . are courts. The worst thing you can do is assume that motion practice should not be conducted with the utmost of professionalism and attention to detail just because “*it’s only L&T Court.*”

[40.74] A. Motion Practice in Summary Proceedings

Look in the following places for guidance when you are preparing to bring a motion, either on regular notice or in an expedited fashion by order to show cause.

[40.75] 1. CPLR Article 4

Article 4 of the CPLR governs Special Proceedings. CPLR 404 (Objections in point of law) states:

(a) By respondent. The respondent may raise an objection in point of law by setting it forth in his answer or by a motion to dismiss the petition, made upon notice within the time allowed for answer. If the motion is denied, the court may permit the respondent to answer, upon such terms as may be just; and unless the order specifies otherwise, such answer shall be served and filed within five days after service of the order with notice of entry; and the petitioner may re-notice the matter for hearing upon two days’ notice, or the respondent may re-notice the matter for hearing upon service of the answer upon seven days’ notice.

(b) By petitioner. The petitioner may raise an objection in point of law to new matter contained in the answer by setting it forth in his reply or by moving to strike such matter on the day the petition is noticed or re-noticed to be heard.

Thus, a pre-answer motion to dismiss (by Respondent) is allowed and a post-answer motion to strike affirmative defenses (by Petitioner) is allowed. These motions are staples in Landlord and Tenant Law.

CPLR 406 (Motions) states:

Motions in a special proceeding, made before the time at which the petition is noticed to be heard, shall be noticed to be heard at that time.

Thus, we see that the time periods for noticing a motion that we are used to in CPLR Article 22 are shortened.

[40.76] 2. Siegels on New York Practice

The authors love Siegels as an early place to look for guidance, after the statute, of course. It is not really so prolific on Summary Proceedings, but there is some good stuff in there on the higher art of things like impleader in summary proceedings at Chapter 20, Part III.

[40.77] 3. The Uniform Rules

The Uniform Civil Rules for the New York City Civil Court, Section 208.11 covers motion practice in Civil Court. Section 208.43 covers the Housing Part. These are worth reading.

[40.78] 4. The Judge's Rules

Judges have the option of making individual rules. Some judges make their own rules and some don't. The purpose of the Judge's rules is to make his or her life easier, so don't make his or her life harder by ignoring them.⁷³

Here are some examples of different rules posted by different Housing Court judges as of this writing, as examples of what you might find:

- Oral argument is required on all motions.
- All motions must be argued and may not be submitted on consent without first being heard by the judge. Parties should be prepared to resolve issues by stipulation if possible, particularly in discovery motions, and be prepared to argue the motion when all papers are before the court.
- All motions, including orders to show cause, should be made returnable at 9:30 a.m.

73 The Housing Part Judge's rules can be found online at: <https://www.nycourts.gov/courts/nyc/housing/profiles.shtml>.

[40.79] 5. The Law of the Case

To the extent that there is a conflict between the sources mentioned above, keep in mind that the more localized the source, the more authority it carries. For example, the parties may agree to a briefing schedule for motion practice, and such stipulation may be so-ordered by the judge. That order then governs the deadlines in the motion practice with more authority than the general rules of the judge the case is before.

[40.80] 6. If All Else Fails, Call the Clerk With an Intelligent Question

If you still are not sure what to do in a particular situation, call the judge's clerk. The judge's clerks will often be helpful if they are posed with a short and intelligent question about how to proceed before their judge.

[40.81] B. Use Memos of Law; Make Attorney Affirmations and Client Affidavits Very Short

There is a practice in Landlord and Tenant court of making motions without supporting memorandums of law. Rather, legal authority is included in attorney affirmations. This may be a ubiquitous practice, but it is a bad and sloppy one.

Attorney affirmations should be kept very, very short. They should only contain that which only the attorney can speak to, such as a concise procedural history of the case. For that matter, client affidavits should be kept short, and should contain only the facts within the exclusive personal knowledge of the deponent. Legal authority and arguments should be included in memoranda of law.

[40.82] C. Motion Practice Timing and Strategy

Frequently, motion practice is used as a vehicle for further tenant delay. The pre-answer motion to dismiss is a very effective tool for the tenant. It requires that the tenant find some arguable defect in the notice of petition, petition, the predicate notice, and/or the service thereof. Counsel should carefully interview the tenant regarding the circumstances of service of process and carefully review the rent demand or predicate notice and notice of petition and petition, searching for at least a few arguable defects. Failure by the tenant to include an objection to service of process

when making a pre-answer motion constitutes waiver of the claim of improper service.⁷⁴

Under the special proceeding rules that apply to a landlord-tenant proceeding, a pre-answer motion can be served as late as the return date of the petition or any adjourn date thereafter.⁷⁵ Serving a motion on the return date, or the day prior, makes it virtually impossible for the landlord to respond, thereby buying the tenant an automatic adjournment. Moreover, once the landlord does oppose the motion to dismiss, if the landlord delivers the papers too late for the tenant to respond before the next court date, the tenant can legitimately ask for another adjournment for the purpose of putting in reply papers. Therefore, if a landlord is sabotaged with a motion to dismiss served on the eleventh hour before a court date, at the court date landlord's counsel should be sure to get all parties to agree to a briefing schedule that leads up to the adjournment date so that tenant cannot ask for further adjournments.

Once the motion is fully briefed, the parties are ready to argue the motion. When the parties arrive in court to argue the motion, the judge may not be ready. There may be too many motions for the judge to hear at the appointed time, there may be a trial in progress, or the judge may simply have plans that do not include hearing you argue your motion. Usually, the judge will hear the motion even if the parties have to return to court to argue the motion after the lunch recess, or the judge may take the motion papers on submission and make a decision without oral argument. Frequently, after hearing arguments, the judge will "reserve" his or her decision and take up to and in excess of weeks or months to decide the motion. Depending on the Part and/or the Judge, motions can be *sub judice* for a number of months. All the while, the tenant is doing business and the landlord is not collecting rent. There may be too many motions for the judge to hear at the appointed time, there may be a trial in progress, or the judge may simply have plans that do not include hearing you argue your motion.

74 See CPLR 3211(11)(c).

75 CPLR 404.

[40.83] X. FREQUENTLY LITIGATED ISSUES IN COMMERCIAL LANDLORD AND TENANT LAW

[40.84] A. Actual Eviction and Constructive Eviction

Actual eviction occurs where there is a physical ouster of the tenant from the premises, whether it be in the form of physically barring the tenant from the premises, changing the locks, or depriving the tenant of essential elevator service.⁷⁶

In the case of actual eviction, even where the tenant is only partially evicted, liability for all rent can often be suspended, although the tenant remains in possession of the portion of the premises from which he is not evicted.⁷⁷

Constructive eviction, in contrast, results from a diminution in beneficial services to the premises, such as water leakage, inadequate heat or ventilation, etc., resulting in the tenant's abandonment of the premises.⁷⁸

To establish a constructive eviction, the tenant must abandon the premises or at least that portion of the premises affected by the condition and must notify the landlord of such abandonment. In a constructive eviction case, the issue at trial is usually whether it was reasonable for the tenant to abandon the premises (in whole or in part) based upon the existing condition. Minor or irritating conditions normally do not give rise to a rent abatement because a tenant's obligation to pay rent is independent of the

⁷⁶ *Barash v. Pa. Term. Real Estate Corp.*, 26 N.Y.2d 77, 82–83, 308 N.Y.S.2d 649 (1970) (“there must be a physical expulsion or exclusion . . . [not just] . . . a landlord’s wrongful acts [which] substantially and materially deprive the tenant of the beneficial use and enjoyment of the premises”); *Union City Union Suit Co. Ltd. v. Miller*, 162 A.D.2d 101, 105, 556 N.Y.S.2d 864 (1st Dep’t 1990) (deprivation of essential elevator service is actual eviction).

⁷⁷ *Barash*, 26 N.Y.2d at 83. Although *see Eastside Exhibition Corp. v. 210 E. 86th Street Corp.*, 23 A.D.3d 100, 801 N.Y.S.2d 568 (1st Dep’t 2005), where partial, rather than total, abatement of rent was appropriate remedy for landlord’s unauthorized actual partial eviction of commercial tenant, due to landlord’s installation of steel cross-bracing on premises that deprived tenant of use of approximately 12 square feet of space out of stipulated total of between 15,000 and 19,000 square feet. The First Dep’t held: “In light of current landlord/tenant realities and policies, it appears particularly untoward automatically to apply harsh and oppressive strictures derived from feudal law that mirror the policies and concerns of that earlier society. Instead, we conclude that a more realistic remedy than total rent abatement should be imposed for a partial eviction of the minimal proportions here present.”

⁷⁸ *Barash*, 26 N.Y.2d at 83 (“[C]onstructive eviction exists where. . . the landlord’s wrongful acts substantially and materially deprive the tenant of the beneficial use and enjoyment of the premises”).

landlord's obligation to maintain the building. Thus, a tenant who argues constructive eviction without abandoning the premises or who fails to prove that the conditions warranted abandonment is entitled to neither damages nor an abatement of rent.⁷⁹

If only a portion of the premises is rendered uninhabitable, a partial constructive eviction occurs, thereby entitling the tenant to a rent abatement for the value of that portion of the premises which is abandoned.⁸⁰

Standard form leases typically include clauses tracking the applicable law and barring offsets of rent for claims of constructive eviction.⁸¹

Since a claim of actual eviction can result in a suspension of the entire obligation to pay rent and entitles the tenant to remain in possession of the premises, tenants often plead both actual and constructive eviction in defense of eviction. From the landlord's perspective, it is critically important to distinguish an actual eviction from a constructive eviction because of the extreme consequences that attach to an actual eviction.

[40.85] B. Refusal to Sublet

In the commercial context, restrictions against assignment and subletting are valid, although they are not looked upon with favor. "It is settled that, unless the lease provides that the lessor's consent shall not be unreasonably withheld, a provision against subleasing without the lessor's consent permits the lessor to refuse arbitrarily for any reason or no reason."⁸²

79 *Earbert Rest. v. Little Luxuries*, 99 A.D.2d 734, 472 N.Y.S.2d 359 (1st Dep't 1984) (landlord's breach of duty does not suspend tenant's "independent obligation" to pay rent); *see also 186-90 Joralemon Assocs. v. Dianzon*, 161 A.D.2d 329, 555 N.Y.S.2d 94 (1st Dep't 1990) (dismissing defense of constructive eviction where tenant did not abandon premises and continued to use them for intended purpose); *Bomze v. Jaybee Photo Suppliers, Inc.*, 117 Misc. 2d 957, 958, 460 N.Y.S.2d 862 (1st Dep't, App. Term 1983) (tenant liable for rent "notwithstanding landlord's failure to supply services such as air conditioning and heat").

80 *Minjak Co. v. Randolph*, 140 A.D.2d 245, 528 N.Y.S.2d 554 (1st Dep't 1988) (tenant must abandon at least a portion of the premises to assert defense of constructive eviction).

81 *See, e.g.*, Standard Form Lease, Witnesseth Clause, Article 4; Article 27. *See also Lincoln Plaza Tenants Corp. v. MDS Props. Dev. Corp.*, 169 A.D.2d 509, 564 N.Y.S.2d 729 (1st Dep't 1991) (tenant liable for unpaid rent, notwithstanding ongoing dispute concerning utility service and hookups, given lease provision requiring payment of rent "without any setoff or deduction whatsoever").

82 *Dress Shirt Sales, Inc. v. Hotel Martinique Assocs.*, 12 N.Y.2d 339, 342, 239 N.Y.S.2d 660 (1963); *Gladlitz, Inc. v. Castiron Court Corp.*, 177 Misc. 2d 392, 677 N.Y.S.2d 662 (Sup. Ct., N.Y. Co. 1998) (stating, "an absolute restriction on assignment without the landlord's consent is clearly enforceable").

Typically, commercial leases provide for assignment and subletting, provided that: (1) the tenant obtains the landlord's prior written consent; (2) the assignee and/or sublessee meet adequate (and reasonable) financial criteria; (3) any sublease is subject to the same terms of the paramount lease; and (4) the tenant remains liable for the obligations under the lease. If the above criteria are met, commercial leases typically provide that the landlord will not "unreasonably withhold consent."

In the context of summary proceedings, a landlord's alleged breach of covenant by unreasonably withholding its consent to a sublease or assignment does not justify an abandonment of the premises on the part of the tenant and does not exonerate a refusal or failure to pay rent.⁸³ A tenant's remedy in such a situation is an action for a declaratory judgment action to compel consent, and/or for damages, and/or, *if the lease permits*, the interposition of a counterclaim in the landlord's action for rent.⁸⁴ Some leases will preclude damages and specifically limit tenant to a declaratory judgment action.

Again, various clauses in the Standard Form Lease arguably bar—as an offset and/or defense to rent—a tenant claim based upon an alleged unreasonable refusal to assign or sublet.⁸⁵

[40.86] C. No-Counterclaims Provision

Counterclaims interposed by a commercial tenant in a summary proceeding, alleging the breach of various covenants by a landlord (including unreasonable refusal to sublet, etc.), have been held to be barred by a "no counterclaim" provision in a lease.⁸⁶ However, the no-counterclaims provision will not apply if the tenant shows that the counterclaims are "inextricably intertwined" with landlord's claim for rent or possession.⁸⁷

83 601 W. 26 Corp. v. John Wiley & Sons, 32 A.D.2d 522, 298 N.Y.S.2d 1018 (1st Dep't 1969).

84 *Id.* at 523.

85 *See, e.g.*, Standard Form Lease, Witnesseth Clause, Article 4; Article 27.

86 *See* Standard Form Lease, Article 26; *see generally* *Amdar Co. v. Hahalis*, 145 Misc. 2d 987, 988, 554 N.Y.S.2d 759 (App. Term, 1st Dep't 1990) ("Such lease provisions are enforceable. . . ."); *Bomze v. Jaybee Photo Suppliers, Inc.*, 117 Misc. 2d 957, 958, 460 N.Y.S.2d 862 (1st Dep't, App. Term 1983); *Amazon Mgmt. Corp. v. Paff*, 166 Misc. 438, 1 N.Y.S.2d 976 (2d Dept. 1938) (striking tenant's counterclaim and holding that agreements waiving counterclaims do not offend public policy).

87 *Sutton Fifty-Six Co. v. Fridecky*, 93 A.D.2d 720, 461 N.Y.S.2d 14 (1st Dep't 1983); *All 4 Sports & Fitness, Inc. v. Hamilton, Kane, Martin Enters., Inc.*, 22 A.D.3d 512, 514, 802 N.Y.S.2d 470 (2d Dep't 2005).

Where the tenant's counterclaim is barred, tenant's sole remedy is to commence a separate action for damages for breach of contract.⁸⁸

[40.87] D. Surrender

A surrender is the giving up by a tenant of his lease term to his landlord; upon acceptance of the surrender, the term merges with the reversion and the relationship of the landlord and tenant is terminated. A tenant is thereby discharged from any further liability under the lease.⁸⁹ Thus, assuming there is a valid surrender of the lease by the tenant, and an acceptance by the landlord, all liability for rent will cease.

Landlords should be advised, therefore, that acceptance of a surrender of a lease, even orally, will terminate all future liability for rent unless the parties otherwise agree (preferably in writing).⁹⁰

The standard form lease typically includes a clause that any surrender be in writing, and that any surrender of keys be to the owner and/or landlord, not to his or her employee or agent.⁹¹

[40.88] E. Alleged Oral Agreements

Tenants often allege as a defense to eviction a purported "oral agreement" with the landlord concerning some provision of the lease, whether it be a reduction of rent, surrender, lease extension, etc.

To guard against the effectiveness of any such an argument, standard form leases typically contain a merger/no oral modification clause in the

88 See *601 W. 26 Corp.*, 32 A.D.2d at 523. See also Standard Form Lease, Article 4 ("Tenant agrees that Tenant's sole remedy at law in such instance will be by way of an action for damages for breach of contract. . .").

89 See *Elliot v. Polny*, 132 Misc. 2d 236, 238, 503 N.Y.S.2d 673 (Civ. Ct., N.Y. Co. 1986).

90 *Kottler v. New York Bargain House, Inc.*, 242 N.Y. 28, 35-36 (1926) ("[A] surrender of 'possession' is not always a surrender of a 'lease' or of the 'estate' thereby created (2 Tiffany Landlord & Tenant, p. 1307). A surrender of possession, if accepted, is evidence from which a surrender of the estate may be inferred, yet it will not have that effect if the parties otherwise agree."); *124 Realty Co. v. Diaz*, 19 H.C.R. 297, 298 (Civ.Ct., N.Y. Co. 1991).

91 See Standard Form Lease, Article 25.

lease.⁹² The inclusion by the parties of an integration/merger clause in a lease precludes the introduction of any parol evidence.⁹³

Courts interpreting such merger clauses in conjunction with the Statute of Frauds have held that attempts at oral modifications of leases are unenforceable.⁹⁴

[40.89] F. No-Waiver Claims

Tenants often allege, in defense of eviction, that the landlord, by its conduct, has waived strict adherence with the lease terms, whether it be the timing of rent payment, a violation of the use clause of the lease, etc. The standard form lease includes a “no-waiver” clause to guard against such claims.⁹⁵

Generally, New York courts have held that “no-waiver” clauses in a lease should be enforced to preclude a finding of waiver, including in cases where the tenant alleges a waiver by conduct.⁹⁶

Only in the extreme case where there has been detrimental reliance by the tenant in a well-established course of conduct with the landlord, will

92 See Standard Form Lease, Article 21.

93 *Primex Int'l Corp. v. Wal-mart Stores*, 89 N.Y.2d 594, 657 N.Y.S.2d 385 (1997); *Fogelson v. Rackfay Constr. Co.*, 300 N.Y. 334 (1950); *Unisys Corp. v. Hercules Inc.*, 224 A.D.2d 365, 638 N.Y.S.2d 461 (1st Dep't 1996) (quoting § 573 of Corbin on Contracts, “[w]hen two parties have made a contract and have expressed it in a writing to which they have both assented as the complete and accurate integration of that contract, evidence, whether parol or otherwise, of antecedent understandings and negotiations will not be admitted for the purpose of varying or contradicting the writing”); See also General Obligations Law § 15-301(1) (“A written agreement or other written instrument which contains a provision to the effect that it cannot be changed orally, cannot be changed by such an executory agreement unless such executory agreement is in writing and signed by the party against whom enforcement of the change is sought or by his agent”).

94 *Balzano v. Lublin*, 162 A.D.2d 252, 253, 556 N.Y.S.2d 610 (1st Dep't 1990) (“... the lease includes a merger clause, and parol evidence is not admissible to vary the terms of a written contract containing a merger clause”).

95 See Standard Form Lease, Article 25.

96 *Jefpaul Garage Corp. v. Presb. Hosp. in City of N.Y.*, 61 N.Y.2d 442, 446, 474 N.Y.S.2d 458 (1984) (upholding no-waiver clause in lease); *Dove Hunters Pub v. Posner*, 211 A.D.2d 494, 621 N.Y.S.2d 327 (1st Dep't 1995).

courts hold that the “No-Waiver” clause has, in effect, been waived by the landlord.⁹⁷

[40.90] G. Use of Premises

Consider the case where a lease for a small, commercial building on a quaint, quiet, residential Upper East Side street stated that the “tenant shall use the premises as a *counseling office* and for no other purpose” (emphasis added). The drafter was orally informed that the tenant was a *marriage counselor*. Then the tenant moved in and, indeed, opened a counseling office—a *psychic counseling office and sexual-surrogate-marriage counseling office*. Other tenants of the building, residents of the street, and the block association complained to the landlord regarding signs posted by the tenant and the high volume of traffic generated.

Courts have upheld language in a lease that restricts the use of the premises that contain the key words “only” and “for no other purpose.”⁹⁸ In *Qwakazi*, the court held that a tenant was in default for selling video cassettes from the premises where a clause in the lease stated that “the tenant shall use and occupy the demised premises for the sale of comic books, toys, posters, books solely” and a rider to the lease stated that if the premises were used by the tenant for any other purpose that such use “shall be deemed a default . . . and as such, a material inducement for the landlord to terminate this lease.”⁹⁹

[40.91] H. Notice Was Not Issued By the Landlord With Whom Tenant Entered the Lease

Tenant may claim that the predicate notice is defective because the notice was not issued by the landlord originally on the lease.

This defense will not lie where tenant’s express acknowledgment and course of conduct demonstrates that petitioner is no “stranger” to tenant

97 *Simon & Son Upholstery Inc. v. 601 West Assocs.*, 268 A.D.2d 359, 702 N.Y.S.2d 256 (1st Dep’t 2000) (landlord waived objection to tenant’s deviation from use clause of lease where it consented to tenant’s renovations and use of premises as a photography studio even though permitted use was for upholstery manufacturing). <http://itkowitzaccomplishments.itkowitz.com/2012/07/cut-off-elevator-service-cost-landlord.html>.

98 *Qwakazi, Ltd. v. 107 W. 86th St. Owners Corp.*, 123 A.D.2d 253, 506 N.Y.S.2d 162 (1st Dept. 1986).

99 *Id.*

and is entitled to collect the rent demanded in the notice to cure.¹⁰⁰ Examples of tenant's express acknowledgment and course of contact include:

- Tenant has previously and expressly recognized petitioner as the successor-in-interest to the landlord in the lease in a subsequent lease amendment.
- Tenant executed an estoppel letter.
- Tenant has paid rent checks to petitioner.

[40.92] I. Viability of Cross-Default Provisions

Cross-default provisions allow a party to terminate a contract based on a default by another party to the contract, where the default is made pursuant to a totally different contract made between the same parties.¹⁰¹ There are First Department cases in which cross default provisions in a lease are enforced; however, in both of those cases the companion contract was not another lease or license, as is the case here, but was a mortgage or a sale contract.¹⁰² Given the dearth of case law on the matter, the finer points of enforceability are unpredictable.

[40.93] J. Signage of Sidewalk Sheds

New York City has changed its regulations on the appearance of sidewalk sheds. Under most circumstances, storefront tenants underneath the shed may not affix a sign to the shed. This upsets the principals of many storefront tenants and can lead to legal disputes.

100 *54-55 St. Co. v. Torres*, 171 Misc. 2d 237, 656 N.Y.S.2d 591 (App. Term, 1st Dep't 1997) (default notice by managing agent, who had billed Tenant for rent for a three-month period prior to default notice, was proper and legally sufficient to advise tenants of their lease violation); *see also Ashley Realty Corp. v. Knight*, 73 A.D.3d 500, 901 N.Y.S.2d 204 (1st Dept. 2010) (notice of non-renewal sufficient where tenant had previous extensive dealings with attorney or other agent of landlord); *Melohn v. Guy*, N.Y.L.J., Mar. 21, 1989, p. 21, col 2 (App. Term, 1st Dep't).

101 *Carmania Corp. v. Kalati*, 122 Misc. 2d 334, 336-37, 470 N.Y.S.2d 316 (N.Y. City Civ. Ct., 1983) (where tenant rented two properties from landlord pursuant to two leases both containing cross-default provisions, the cross-default provision of the lease not in default was not enforceable when landlord took possession of the property subject to the lease that was in default).

102 *See Lopez v. Fernandito's Antique*, 305 A.D.2d 218, 220, 760 N.Y.S.2d 140 (1st Dep't 2003) (enforcing cross-default provisions on related sale and net-lease contracts); *Durso Supermarkets, Inc. v. D'Urso*, 193 A.D.2d 377, 378, 596 N.Y.S.2d 827 (1st Dep't 1993) (enforcing cross-default provision in lease based on default in mortgage); *see also Koylum, Inc. v. Peksen Realty Corp.*, 2004 WL 5599307 (E.D.N.Y. Dec. 2, 2004) (enforcing damages from leases where there was a breach in a supply contract and the supply contract and lease had cross-default provisions).

1 RCNY § 27-03, Signs on any Sidewalk Shed, Fence, Railing, Foot-bridge, Catch Platform, Builder's Sidewalk Shanty, and Over-the-Sidewalk Chute Erected at Demolition or Construction Sites, states:

(a) Applicability. These rules and regulations shall apply to all protective structures erected at demolition or construction sites, including but not limited to, sidewalk sheds, fences, railings, footbridges, catch platforms, builders sidewalk shanties, and over-the-sidewalk chutes as specified in Administrative Code § 26-252(a).

(b) Other than the signs required by 1 RCNY §§ 8-01 and 26-01 or as set forth below, there shall be no information, pictorial representations, or any business or advertising messages posted on such protective structures at demolition or construction sites.

(d) Signs. A sign may be posted on such protective structure when the structure is adjacent to any building and obscures from view a lawful and existing sign and shall comply with the following requirements:

Signs shall be securely fastened to the face of the protective structure at a location directly in front of such business storefront;

No projecting signs shall be permitted and all signs shall be limited to a maximum height of three feet six inches and when affixed to a sidewalk shed, shall not project above the parapet;

No signs shall be permitted on the ends of any protective structure, unless the lawful and existing sign would otherwise be obscured from view by a deck or parapet of a sidewalk shed or bridge; and

(4) No sign shall project below the deck of any sidewalk shed.

(e) Materials. Such signs shall be constructed of three-fourths inch plywood or sheet metal.

(f) Area and height limitations. The maximum height for the erection of such sign shall comply with the applicable

zoning regulations, statutes and these rules, and in no event shall the height of such sign be greater than three feet six inches.

(g) Non-illumination. No illuminated signs shall be permitted on any protective structure subject to this rule.

[40.94] XI. STRATEGY AND GAMESMANSHIP

Litigation is gamesmanship. Most people do not like that. They view the litigation process as one that should yield the truth and result in justice. Alas, this is not the reality of what we deal with as lawyers or litigants. Truth and justice may be factors contributing to the outcome; however, there are many instances where the tactics utilized (or not utilized) dictate the final result. This is particularly true in summary proceedings.

Why are the results of summary proceedings more susceptible to a lawyer's strategizing and use of tactical gamesmanship than in other types of litigation? The answer is simple: speed (or delay) is of the essence in these proceedings. The tenant who is having trouble paying the rent, but needs some breathing space to get the rent, needs to delay the aggressive landlord. The landlord seeking to pressure a tenant to vacate where the lease is undervalued loses money each day the tenant occupies the space. The landlord seeking to evict a tenant who is judgment-proof, and who therefore will never pay the rent even after eviction, faces even greater time pressure. The tenant suffering a loss of services needs them restored today, not tomorrow, in order to conduct its business. The landlord seeking to vacate a building to commence a development project cannot begin construction until the tenant leaves. Sometimes hundreds of thousands of dollars, even more, may be at stake when a tenant's possession stands in the way of a development project. So, as you can see, the aphorism, "time is money" has particular application to these kinds of summary proceedings.

When analyzing summary proceedings as a game in which the object of the tenant is to delay as much as possible, and the object of the landlord is to obtain a judgment of possession and eviction as soon as possible, one must assume a worst-case scenario at every turn and be prepared for it. How do the landlord and his or her counsel protect themselves? This is accomplished by taking every effort to make sure that the case is procedurally correct, as discussed above. And what can the tenant do in

response? Capitalize on any seeming procedural or substantive issue to place pressure on the landlord.

[40.95] A. When to Start Litigation

The first tactical decision a landlord makes is when to call counsel to initiate proceedings. Of course, the longer a landlord delays in commencing a proceeding, the more time it takes to evict. It is useful for a landlord to remember that each day of delay in commencing the proceeding gives the tenant a free day where the intent of the tenant is to utilize the space without paying rent until eviction, thus leaving the landlord with a money judgment, which quite possibly may be useless.

[40.96] B. Trial Readiness

As speed is of the essence, the appropriate stance of the aggressive landlord is to be ready to go to trial on each and every date the case comes before a judge, including the first date, with witnesses. Landlords and their agents sometimes do not like to testify. It is not unusual for them to be busy on the day the court has scheduled for a hearing. They sometimes need to have it explained to them, sometimes repeatedly, why it is that they have to be there, or on call, to testify on that date. Landlord's counsel should make certain that his process server is available on the first day of trial. If different process servers are used for the rent demand or predicate notice and notice of petition and petition, both process servers will need to be available on the day of trial, which is a very good reason to have the same process server fulfill both tasks.

Have the same process server serve the rent demand or predicate notices and the notice of petition and petition.

If the witness cannot be available on a court date, then landlord's counsel should know dates certain thereafter when his witnesses are available. Failure of the landlord's counsel to know for sure when his or her witnesses are available before a court date is scheduled can be significant, because if a date is selected and the landlord does not have his or her witnesses available that day, then he will have to adjourn the case again. This is another temporal victory for the tenant.

Landlord's counsel should be ready to go to trial on each and every date the case comes before a judge, including the first date, with witnesses on call.

[40.97] C. Adjournments

The landlord's counsel should not consent to any adjournment. Of course the tenant, or his counsel, should have a ready explanation to adjourn. The tenant's application for an adjournment should precipitate a demand by the landlord that no adjournment be granted without an interim rent payment. By law, "upon the second of two adjournments at the request of the respondent, or, upon the thirtieth day after the first appearance of the parties in court less any days that the proceeding has been adjourned upon the request of the petitioner, whichever occurs sooner, the court shall direct that the respondent" either pay interim rent to the landlord or deposit same with the court on an ongoing basis throughout the litigation.¹⁰³ Faced with a demand that the tenant pay rent, the counter-move for an aggressive tenant's counsel is to withdraw the request for an adjournment and state the tenant is ready for trial! So long as the tenant is not asking for any time, there is no basis for the court to order interim rent. This tactic is most useful when the tenant knows that either the landlord is not ready to proceed with witnesses and/or the court does not have a judge ready to try the case at that moment. In this situation, a landlord trying to bluff readiness in this situation to try and pressure the tenant to pay interim rent runs the risk of dismissal of the case in its entirety if the case is ordered to immediate trial and the landlord is unable to produce witnesses and/or requisite documentary evidence to demonstrate its *prima facie* case. On the other hand, if the landlord is truly ready with witnesses on call (or even better, in the courtroom), and the tenant insists he is ready (for the purposes of avoiding an interim rent order), then the landlord can get a quick trial and possible judgment if the case goes well.

Pursuant to RPAPL § 745(2), in a summary proceeding upon the second of two adjournments at the request of the tenant, or, upon the thirtieth day after the first appearance in court, less any days that the proceeding has been adjourned at the request of the petitioner, whichever is sooner, upon the landlord's application the court may direct that the tenant deposit with the court use and occupancy accrued as of the date of the petition and on an ongoing basis thereafter. Failure of a tenant to comply can lead to a default judgment. This is subject to the tenant not being able to establish a defense upon certain enumerated grounds.

103 RPAPL § 745(2).

[40.98] D. Traverse

A traverse is a hearing to determine whether a tenant was validly served process. From the landlord's standpoint, it should be assumed that the tenant will contest service of process of the rent demand or predicate notice and the notice of petition and petition. A factual hearing may be required in such a circumstance to determine if the process server delivered the rent demand and/or petition according to the exact specifications of the law, as fully discussed above. In order to merit a hearing on whether or not the papers were properly served, tenant's answer or pre-answer motion must list specific factual allegations that raise a genuine issue of fact as to the effectiveness of service.

A general denial of the receipt of pleadings will not be sufficient to overcome a general presumption of delivery.¹⁰⁴ If service of process is defective, the case must be dismissed, the landlord must start over. The tenant has "won" a delay and the landlord has lost the rent for the period of that delay, probably forever. There are all kinds of issues surrounding the hearing on service, known as a "traverse," which can defer the day of dismissal or judgment and eviction. Frequently, service of process is the only real defense that a tenant may present. Since proving effective service of process requires the testimony of witnesses, everyone has to be available on the hearing date. Therefore, from the tenant's perspective, the scheduling of the hearing becomes a further means for delay. Tenant's counsel is (or should be) invariably occupied on the first dates suggested by the judge, and since most practitioners have a busy schedule, you can be sure that he will have difficulty finding an "opening" in his or her schedule for a traverse.

For a detailed analysis of the elements of a valid service of process, see the preceding section of this chapter.

[40.99] E. Calling the Tenant As Your First Witness

There is no rule that says that Petitioner's counsel must call the landlord as his first witness. Counsel may call respondent-tenant as his first witness. This may surprise and possibly unsettle the tenant and his counsel.

104 *Colon v. Beekman Downtown Hosp.*, 111 A.D.2d 841, 490 N.Y.S.2d 581 (2d Dep't 1985); *Carli-no v. Cook*, 126 A.D.2d 597, 511 N.Y.S.2d 38 (2d Dep't 1987).

The general rule under New York law is that “where a witness testifies as to a fact material to the case, the adverse party may, for the purpose of showing that the fact is otherwise, contradict the witness, either by cross-examination or by introducing other evidence.”¹⁰⁵ “[A] party has the right to impeach or discredit the testimony of an opponent, and such evidence is always competent.”¹⁰⁶

In any event, tenant may be a very useful witness for landlord. If landlord does not have anyone to testify as to tenant’s signature on the lease, often tenant will do so for him, readily admitting that this is the lease he signed. Or maybe landlord lacks documentation demonstrating that tenant is aware of the managing agent’s authority; in such case tenant may testify to interactions with the managing agent.

[40.100] XII. STIPULATIONS OF SETTLEMENT

The following provisions help create a robust stipulation.

[40.101] A. Judgment of Possession and Warrant of Eviction

A landlord’s attorney should always attempt to get a final judgment of possession in favor of landlord, granting legal possession of the premises sought to be recovered and the *immediate* issuance of a warrant of eviction with execution stayed through a certain date or pending any default by tenant as provided for in the stipulation, whichever shall occur earlier.

Where tenant is agreeing to leave, this is obvious. But even where tenant is intending to stay and pay out arrears over time, it is still prudent to get a judgment of possession and warrant of eviction so that the stipulation has real teeth if tenant does not pay or otherwise comply. Tenant’s attorney however, should resist giving a judgment of possession and warrant of eviction.

In a stipulation to pay arrears in a residential matter, Housing Court judges will not always allow a judgment of possession and warrant of eviction if it is the first stipulation between the parties. If Landlord cannot get a judgment of possession and warrant of eviction, he or she should

105 58A N.Y. Jur. 2d Evidence and Witnesses § 932; *Rossenbach v. Supreme Ct. of Ind. Order of Foresters*, 184 N.Y. 92 (1906); *Howe v. Ampil*, 185 A.D.2d 520, 585 N.Y.S.2d 869 (3d Dep’t 1992).

106 *Ankersmit v. Tuch*, 114 N.Y. 51 (1889); *Elm Costume Co., Inc. v. David, Inc.*, 111 Misc. 610, 182 N.Y.S. 312 (App. Term, 1st Dep’t 1920).

insert a provision allowing Landlord to restore a judgment of possession and warrant of eviction in the event of default.

[40.102] B. Itemize Arrears—Money Judgment—Satisfaction of Money Judgment

Landlord's attorney should also make sure that if part of the settlement involves tenant paying arrears that tenant admits and concedes the exact amount tenant owes landlord, and includes a breakdown of how that number is reached. Lay out everything owed, even if part of the settlement involves waiving some of what is owed, itemize it, and then indicate that those items are waived, pending tenant's compliance. If possible, any waiver of rent or other concession to tenant should be conditional on full compliance with the terms of the stipulation.

Moreover, rather than merely stating in a stipulation that arrears are owed and setting up a payment schedule, a stipulation should contain a money judgment for the arrears owed. In that case, you can make a stay of enforcement of the money judgment contingent on tenant's compliance with the stipulation. This can be a very powerful tool.

It can take up to six weeks for a warrant of eviction to be issued from the Clerk of the Court. The money judgment, however, is immediately effective.

Jay B. Itkowitz, one of the authors of this chapter, once represented a commercial landlord against a restaurant tenant who made a stipulation consenting to a judgment of possession and warrant of eviction and a money judgment. Part of the stipulation required the tenant to give back possession of the premises almost immediately. The tenant did not, however. Instead, he preferred to stick around and stay in business as long as he could, probably anticipating staying open right up until the Marshal showed up, which this savvy tenant probably knew would not be for about a month. The landlord, however, desperately wanted immediate possession of the space. Unfortunately, the warrant had not yet been issued from the Clerk's office. What could the landlord do? Mr. Itkowitz showed up at the premises of this restaurant-tenant at lunchtime on a weekday with a City Marshal, and they began executing on the *money judgment* by impounding the tenant's tables and chairs, liquor, and cash in the cash register. The tenant agreed to leave if the landlord allowed him to keep his liquor and stereo system.

If a money judgment is going to be issued pursuant to a stipulation and there is a payment schedule in the stipulation that anticipates that tenant will pay the judgment amount, tenant's attorney should provide in the stipulation that landlord will give a satisfaction of judgment after tenant has made the last payment required.

[40.103] C. Payment Applied First to Current Rent Due

If tenant is promising to comply with a payment schedule for arrears, it is very important that he agree that all monies received by landlord are applied first to any current rent or additional rent due and that the balance is then applied to arrears.

Without this stipulation, the following situation may arise: Let us say that the rent is \$1,000.00 per month. Landlord takes tenant to court in March, suing for rent due in January, February, and March. You, as landlord's attorney, make a stipulation calling for tenant to pay January's rent on April 1st, February's rent on May 1st, and March's rent on June 1st. Then in April, tenant pays \$1,000.00, but does not pay the April rent. The same thing happens in May and June; tenant pays \$1,000.00 each month but does not pay the rent due for May and June. If you take tenant back to court he can tell the Judge, "I kept up with the payment plan in the stipulation and the stipulation did not say anything about my future rent." And indeed, tenant would be right and the case would be dismissed. Landlord would then have to sue all over again for April, May, and June.

However, if tenant agrees that all monies received by landlord are applied first to any current rent (or additional rent) due, and only then applied to arrears, the above problem would be alleviated. In that case, the payment received in April would be applied to April rent, May to May rent, June to June, and tenant would, therefore, not be held to have met his obligations under the payment plan in the stipulation.

[40.104] D. Security Deposit

Landlord's attorney should state in the stipulation how much security Landlord is holding, especially if it has been diminished by a draw down at some point during the tenancy. The stipulation should also explain exactly what is happening to the security, i.e., maybe the security is being applied to arrears or it is still functioning as security, which case it does not hurt to specifically establish (although the lease already covers this) that the parties intend that the security will be returned 30 days after the premises are vacated and *all terms of the stipulation have been complied*

with. If the issue is not specifically addressed, many tenants will try to “live out the security” at the end or claim that an arrears payment pursuant to the stipulation should be met by application of the security.

[40.105] E. Further Orders to Show Cause

Landlord cannot stop tenant from seeking an order to show cause; landlord can write whatever it wants in the stipulation, but the court ultimately retains the power to sign anything it wants to. What landlord can do, however, to guard against tenant making many orders to show cause, is to have tenant agree in the stipulation to indemnify landlord for any and all expenses incurred in connection with any such application, including but not limited to costs, disbursements, and reasonable attorney’s fees if landlord prevails. This obviously is not very meaningful against an insolvent tenant, but it is better than nothing.

For a vacating tenant, landlord can also include a per diem, week, or month charge if tenant remains beyond the vacate date. As long as the charge is not exorbitant—for example, many multiples of the rent—such charges will be upheld.¹⁰⁷

The stipulation should also make any application referable to the judge on the case and require tenant to give landlord’s attorney two business days’ prior notice before making an *ex parte* application, as well as the opportunity to be present at such application.

[40.106] F. “Broom Clean,” What to Do With the Keys, and Property Left Behind

If tenant is vacating, the stipulation should define exactly where tenant is to drop off the keys and with whom together with an acknowledgment of surrender. If the stipulation does not cover this information, then tenant is likely to leave without any goodbyes, leaving landlord unsure as to whether tenant has actually vacated. This can become a huge issue if tenant is expecting a payment for getting out by a certain date.

Moreover, although a tenant almost always agrees in the stipulation that he or she will leave premises in “broom clean” condition, many do not. In that case, there is not a lot a landlord can do, i.e., it is difficult to undo benefits given under the stipulation just because the floor was not swept. Landlord will, however, be glad to have a clear stipulation stating

¹⁰⁷ See *City of Rye v. Public Serv. Mut. Ins. Co.*, 34 N.Y.2d 470, 358 N.Y.S.2d 391 (1974).

that the junk left behind shall be deemed abandoned by tenant and may be removed and disposed of by landlord at tenant's sole cost and expense, and that tenant further agrees that landlord shall bear no liability for any such removal or disposal of property which is deemed abandoned.

[40.107] G. Sole Possession

If tenant is vacating pursuant to the stipulation, it is very important that tenant represent in the stipulation that: (1) tenant is the only person or entity occupying the premises; (2) no sub-tenant, licensee, assignee, or any other individual or entity of any description who may claim any right to remain in the premises presently occupies the premises; and (3) tenant will not allow any such person or entity to occupy the premises between the date of the stipulation and vacatur.

[40.108] H. Holdover Period

If there is a holdover period—a period between tenant vacating pursuant to the stipulation and the date of the stipulation—especially if tenant is paying use and occupancy during the holdover period, tenant must agree that (1) acceptance of use and occupancy payments does not create a new landlord-tenant relationship and (2) during the holdover period, tenant shall comply with all obligations under the lease, although tenant acknowledges the lease is terminated.

[40.109] I. Guarantee

It may be possible in certain situations to get tenant's obligations in a stipulation personally guaranteed.

[40.110] J. General Releases

It is a good idea when the tenant is vacating, especially if the litigation has been complex, for all parties to exchange general releases. Such releases should be exchanged upon satisfactory compliance with the terms of the stipulation. If a tenant is remaining in occupancy there should be no general release as both parties remain in contractual obligation with each other and a general release would have the effect of releasing the parties from the continuing obligations of the Lease. At most, upon satisfactory compliance a limited release can be given for only those claims comprehended by past activities of the parties, which have been cured, but should make clear that the parties are not releasing each other from continuing obligations they have to each other per the Lease.

[40.111] K. Attorney Fees

The stipulation should explicitly mention the deal between the parties regarding attorney fees. If the intention is that no party should pay the other's attorney fees, then both parties should waive any right to such fees through the date of the stipulation. However, particularly for landlords, even if there is no legal fee provision in an applicable lease, attorney fees should be provided for fees arising from the breach of the stipulation. This is hard to argue with because at the time of the stipulation both sides should be in full agreement that each side will do that which they commit to do in the stipulation. In this respect, an attorney fees provision is an expression of good faith.

[40.112] L. Routine Matters

- In the stipulation, tenant should admit the validity of the allegations in the petition and waive any personal jurisdictional defenses with respect to the proceeding.
- If there are any outstanding motions when the stipulation is executed, the stipulation should mention them and how they are being disposed of.
- The stipulation should mention that it may be signed in counter-parts and that a facsimile signature will be deemed an original.
- The stipulation she specify that “No exchange of electronic correspondence between the parties shall operate to amend, modify or waive any term or provision of this stipulation.”

[40.113] XIII. MAKING EVICTION DAY HAPPEN**[40.114] A. Obtaining the Warrant**

With almost no exceptions, no one except for a New York City Marshal may physically evict someone from a space they occupy in the City of New York. A Marshal may not evict someone without a warrant of eviction, and a warrant of eviction may not be obtained without a judgment of possession. As these materials have discussed at length above, a judgment of possession may only be obtained if landlord has a lawsuit against tenant, which results in either tenant stipulating to give landlord a judgment of possession or the court awarding a judgment of possession.

The Marshal then deals with the Clerk of the Court, who eventually (it can take anywhere from two to six weeks and often involves solving a problem or two) issues the warrant.

[40.115] B. Scheduling the Marshal

Once a good warrant has been obtained, the Marshal will notify the lawyer or landlord who requested it by mail. Thereafter, the Marshal must be contacted to schedule the eviction and have available the index number and docket number for the case. The Marshal will provide a date for the eviction, which will usually be within two to three weeks.

The Marshals in the City of New York are supervised by the Department of Investigation and the regulations for evictions are set forth in the New York City Marshals Handbook of Regulations which can be accessed via the nyc.gov website.¹⁰⁸

[40.116] C. Marshal's Notice

The Marshal is required to serve tenant with a notice of eviction at least five days prior to the eviction if the notice is served personally ("Marshal's Notice"). If the Marshal's Notice is served by mail, there must be five (5) business days' notice. The Marshal's Notice does not begin to run until the day after it is served and weekends and holidays are not included in the time calculations. The eviction may take place at any time after the expiration of the Marshal's Notice.¹⁰⁹ It can only take place in the hours between sunrise and sunset.¹¹⁰

The eviction must take place within 30 days of the service of the Marshal's Notice or the notice must be reserved.¹¹¹ For example, if after the Marshal's Notice is served tenant gets an order to show cause staying the eviction, but the order to show cause is subsequently denied after 30 days from the earliest eviction date on the Marshal's Notice, the Marshal needs to re-serve the Marshal's Notice. One can request, however, that the Court mark the file "no new orders to show cause." While some judges may not honor that remark on the Court file or the order, it may discourage the

108 www1.nyc.gov/site/doi/offices/marshals-handook.page.

109 New York City Marshals Handbook, Chapter IV, § 5.

110 See RPAPL § 749(2).

111 New York City Marshals Handbook, Chapter IV, § 5.

tenant from attempting a new order to show cause or may result in quick disposal of any new application by the tenant.

[40.117] D. Meeting the Marshal

Arrangements must be made with landlord to have someone meet the Marshal (usually the building manager or the superintendent). The contact person's name and contact information will need to be provided to the Marshal. Sometimes an eviction is important enough that the attorney should attend, especially if last minute negotiations are expected.

Some Marshals will change the locks for an extra charge although landlord can have someone attend the eviction that has the skills and tools to change the locks. The authors of this chapter usually recommend that the superintendent of the building attend the eviction (whether an attorney comes or not) and change the locks. In that case, it is imperative that the superintendent understands that he or she must not be late.

After these arrangements are made, the Marshal should then be called or emailed to confirm that the eviction is still necessary. The Marshal will also usually call or email back the day before the eviction to give the scheduled time for the eviction. Landlord must be flexible with his/her schedule on eviction day, because the Marshal will sometimes need to rearrange the time of the eviction at the last minute.

Landlord should contact counsel immediately if anything happens—for example: Tenant attempts to communicate with landlord or pay landlord money, or if landlord receives any court papers, such as an order to show cause to stop the eviction.

[40.118] E. Two Options on Eviction Day

Landlord has two options on eviction day. Landlord can ask the Marshal to deliver either full possession (otherwise known as a “move out eviction”) or legal possession.

A full eviction is the removal of the tenant and the tenant's belongings, both of which the Marshal oversees and is considerably more expensive because the landlord has to retain a moving company. Move out evictions should be done where the landlord is very serious about removing the tenant as it will not only be more expensive for the owner but will be costly for the tenant too because the tenant will have to pay the moving

company to move his or her possessions to any location where the tenant relocates.

Legal possession removes the occupant from the space but the personal property of the former tenant remains under the care and control of the landlord. Most “evictions” are actually the Marshal returning legal possession to the landlord even though the terms are commonly used interchangeably.

[40.119] 1. Legal Possession

If only legal possession is being given back to landlord, the Marshal will, and is required to, take an inventory of everything inside the premises; “[t]he inventory must be complete and accurate, given a description of all appliances, household furniture, goods, and properties present. Both the quantity and condition of the property must be noted.”¹¹² After the Marshal takes an inventory, landlord will have to sign a statement releasing the Marshal from all liability for any damage to tenant’s property. Landlord should make sure he or she gets a copy of the inventory.

Many people seem to think that landlord must keep the property in the apartment for 30 days. However, there is no statute that requires this. Many leases, however, do have something to say about the issue, and that is what controls in these situations.

It is still very prudent for landlord to maintain the tenant’s personal property in the premises for at least a short period of time so that if tenant comes to retrieve the property they can and no further litigation is engendered. There is nothing worse than being accused of stealing an evicted tenant’s Rembrandt. This is probably where the unofficial “30-Day-Rule” comes from. If tenant does come back to get his or her things, landlord must make sure tenant is supervised when entering the premises. Landlord must not give tenant a copy of the new keys. If landlord removes tenant’s belongings to a different location for storage, landlord can be exposed to liability for any damage to tenant’s belongings.

[40.120] 2. Move Out Eviction

Special moving/storage companies may be engaged to move tenant’s belongings to a warehouse at the time of eviction, thus immediately delivering full possession to landlord. Landlord is responsible for moving

¹¹² New York City Marshal’s Handbook, Chapter IV, § 6.

charges, and tenant is responsible for storage charges. Usually once the property is removed, the storage company will not release tenant's belongings until tenant pays for storage.

The following is from the Marshal's Handbook:

In the event the landlord demands that the premises be turned over in "broom clean" condition, the marshal must conduct an eviction. The marshal must hire a bonded moving company which is licensed by the New York State Department of Transportation. The marshal must also direct the moving company to deliver the items removed from the premises to a warehouse licensed by the Department of Consumer Affairs . . . the cost of removal of the tenant's property and its delivery to a bonded warehouse must be borne by the landlord.¹¹³

[40.121] 3. For Both Types of Evictions

[40.122] a. Take Pictures

Whether the Marshal is delivering legal possession or full possession, it is useful for the landlord to photograph the premises immediately after the eviction, to establish the exact state of the premises at that time.

[40.123] b. Marshal's Inventory

All marshals are required to prepare a written inventory of all items contained in the premises of any tenant to be evicted. The inventory shall be prepared regardless of whether the Marshal does an eviction or a legal possession.

[40.124] F. Preventing/Delaying the Eviction

[40.125] 1. Order to Show Cause

If tenant goes to a judge and can show a possible reason why he or she should not be evicted, the court in most instances will grant tenant's application by order to show cause to temporarily stay the eviction, pending a court hearing on why tenant should not be evicted.

113 New York City Marshals Handbook, Chapter IV, § 6-4.

[40.126] a. Service of An Order to Show Cause is Important

Service of the order to show cause will be required upon the Marshal and landlord's attorney. Often *pro se*, less sophisticated tenants botch the service of the order to show cause by serving it too late. A court will have to deny tenant's application for more time if the order to show cause is served late. However, it might not always be the best course of action for landlord to have an order to show cause that was untimely served denied on that basis, because there is a likely possibility that tenant will just go back to court seeking another order to show cause and further delay any possible eviction. This may not be the case, however, if tenant has done other orders to show cause and all the tenant's leeway with the court has been exhausted.

[40.127] b. Check Stays In Order To Show Cause Carefully

Landlord's attorney should carefully check what stays are provided for in an order to show cause and should not assume that the judge stayed the eviction. It is not typical, but also not unheard of, for a judge to allow tenant to make an application, but nevertheless to allow the eviction to go forward. If this is the case, it is important to point this out to the Marshal so the eviction is not canceled.

[40.128] c. Post-Eviction Order to Show Cause

Even after the eviction occurs, tenant may still have one last chance to regain possession. Tenant can go to the court and apply for a post-eviction order to show cause, showing a judge that he or she has some or all of the money or can present another reason why he or she was wrongfully evicted. If a judge signs a post-eviction order to show cause, the court will usually stay landlord from taking any further action in relation to the premises, such as efforts to re-let the space or conducting any further renovation/construction. A general rule is that the longer a tenant waits from the day of eviction to get the post-eviction order to show cause, the less likely it is to be granted. If the apartment gets rented immediately after eviction and the tenant seeks to be restored, the new tenant will have to be made a party to such application as the new tenant will be "in possession."

[40.129] 2. Marshal Is Uncomfortable Evicting

If conditions exist in the premises that the Marshal is unaware of, such as the presence of an elderly or disabled person, the Marshal will not con-

duct an eviction until those conditions can be remedied or the appropriate arrangements can be made.

[40.130] XIV. ATTORNEY FEES

[40.131] A. Landlord and Tenant Cases and Attorney Fees

Landlord and tenant law has yet another interesting aspect to it; unlike many other areas of law, attorney fees can often be awarded to the prevailing party. Generally, a litigant in New York State is not entitled to recover his or her attorney fees in the absence of a statute that establishes such entitlement (and very few do), or a contract wherein the parties to the contract have agreed as such. Leases, on the other hand, often do call for attorney fees under certain circumstances.

The REBNY Lease typically allows landlord—but *not* tenant—to recover attorney fees and costs if landlord is the prevailing party in the litigation.¹¹⁴

[40.132] B. Prevailing Party Status

The big question then becomes, Who is the prevailing party? This is an oft-litigated issue. The determination of which party should be accorded the status of “prevailing party,” thereby allowing recovery of attorney fees, requires a two-step analysis: (1) an initial consideration of the true scope of the dispute litigated, followed by, (2) a comparison of what was achieved within that scope.¹¹⁵ It is not necessary that a party prevail on

114 See REBNY Standard Form Lease, Article 19; see also *Nestor v. McDowell*, 81 N.Y.2d 410, 415–16, 599 N.Y.S.2d 507 (1993) (prevailing party entitled to fees and costs); *Peachy v. Rosenzweig*, 215 A.D.2d 301, 302, 626 N.Y.S.2d 784 (1st Dep’t. 1995). In the residential context, a reciprocal right to recover fees is implied by law in favor of Tenant even if it is not explicitly provided for in the lease. Real Property Law § 234 provides that

[w]henver a lease of residential property shall provide in any action or summary proceeding that the landlord may recover attorney’s fees and/or expenses incurred as the result of the failure to perform any covenant or agreement contained in such lease, there shall be implied in such lease a covenant by the landlord to pay to the tenant the reasonable attorney’s fees and/or expenses incurred by the tenant as the result of the failure of the landlord to perform any covenant or agreement on its part to be performed under the lease, or in the successful defense of any action or summary proceeding commenced by the landlord against the tenant arising out of the lease.

115 *Excelsior 57th Corp. v. Winters*, 227 A.D.2d 146, 641 N.Y.S.2d 675 (1st Dep’t 1996); *Solow v. Wellner*, 205 A.D.2d 339, 613 N.Y.S.2d 163 (1st Dep’t 1994), *aff’d*, 86 N.Y.2d 582, 635 N.Y.S.2d 132(1995).

every contention to be determined a prevailing party.¹¹⁶ In *Excelsior*,¹¹⁷ the landlord was found to be the prevailing party when it was awarded 49.5 months of the 54 months of rent it sought. and in *Peachy*,¹¹⁸ the court found that the landlord had obtained the status of prevailing party after 10 days of trial during which time the tenant had imposed 13 affirmative defenses and all but one of those defenses had been defeated.

[40.133] C. How to Make a Motion for Attorney Fees

Going after attorney fees is a lot of work. It has been the experience of the authors of this chapter that even if you prevail, you do not always get 100 cents on the dollar from the court; indeed, the higher your fees, the less likely it becomes for you to recover all your fees. Moreover, before one invests in an attorney fees motion, one should be reasonably certain that the fees can be collected from the party they are sought from. It does not pay to seek fees from a defunct corporation. The following are some suggestions for winning fees if you decide to make an attorney fees motion.

[40.134] 1. Cite the Lease and the Relevant Statute

Begin an attorney fees motion by citing to the lease provision that calls for such fees.

[40.135] 2. Explain Why Your Fees Are Reasonable

Next, explain to the court why the fees sought are reasonable. What constitutes “reasonable” attorney fees is a discretionary determination by the court.¹¹⁹ Courts should be guided by, among other things, the hours reasonably expended and a reasonable hourly rate.¹²⁰

Present the biographies of the attorneys in the firm (including information such as bar admissions, years spent practicing in this area, education, teaching posts, professional associations, press, published writing) as well

116 *Botwinick v. Duck Corp.*, 267 A.D.2d 115, 117, 700 N.Y.S.2d 143 (1st Dep’t 1999); *Senfeld v. I.S.T.A. Holding Corp.*, 235 A.D.2d 345, 652 N.Y.S.2d 738 (1st Dep’t (1997); see also *Glorious 84 Realty Co. v. Daly*, N.Y.L.J., Mar. 7, 2001, p. 18, col. 1 (1st Dep’t 2001).

117 227 A.D.2d at 146.

118 215 A.D.2d at 302.

119 *DeCabrera v. Cabrera-Rosete*, 70 N.Y.2d 879, 881, 524 N.Y.S.2d 176 (1987); *Lefkowitz v. Van Ess*, 166 A.D.2d 556, 560 N.Y.S.2d 838 (2d Dep’t 1990).

120 *Rahmey v. Blum*, 95 A.D.2d 294, 466 N.Y.S.2d 350 (1st Dep’t 1983).

as the general accomplishments of the firm. Perhaps include a list of noteworthy institutional clients or mention particularly noteworthy victories. Then list the rates charged for each attorney and support staff person in the firm and inform the court that the rates charged are the same as those charged by the firm in the ordinary course of business.

[40.136] 3. Invoices

Annex the invoices reflecting the time that you spent litigating the case from its inception right through to the preparation of the attorney fees motion.

[40.137] a. Proper Invoicing

It is vital here to note that attorneys are required to maintain contemporaneous time entries. It is not acceptable for attorneys or support staff to go back and “recreate” time spent on a case after the day on which the task took place. A good attorney cross-examining the proponent of a motion for legal fees will ask the lawyer testifying in support of the fee application all about the firm’s timekeeping methods.

[40.138] b. Defending Your Bills

Before annexing the invoices to a legal fee motion, study the supporting invoices. Often times the attorney litigating for attorney fees is not involved in the firm’s actual invoicing process. The attorney preparing the motion should read every line critically, as opposing counsel and the court will at the hearing. Understand the story of what happened in the case and be able to tell it logically and consistently. Also perform this analysis on the expense section. If opposing counsel at the legal fee hearing asks, “What were these 300 photocopies for?” the testifying attorney should be able to say, “Those were for the brief of which we needed to file six copies with the court.”

[40.139] 4. Exhibits for Attorney Fees Hearing

A strategy for the attorney fee hearing is to arrive with multiple copies of pre-marked exhibits for each piece of important paperwork in the case, i.e., the pleadings, the motion practice, the memos, the briefs, even transcripts. By using these exhibits when testifying it is possible to demonstrate to the court how much work you did.

[40.140] XV. STAYS PENDING APPEAL**[40.141] A. In General**

The first question landlords are likely to ask when they engage a lawyer to evict a tenant is “How long is it going to take to get my space back?” Sounds like a simple question that should yield a simple answer, but it is not.

The question is really a two-part question: (1) How long does it take to get a judgment of possession and a warrant of eviction? and (2) How long does it take to get a tenant out if the tenant loses and appeals?

The first question is tricky enough to answer. It could be done as quickly as a month to six to nine months depending on a number of variables. Will the tenant concede possession? Or will the tenant agree to a stipulation for any number of reasons etc.?

The second question, however, is not so easily answered. An appeal can lengthen a summary proceeding by one to three years! How can that be?

It starts with the fact that CPLR 5519(a)(6) provides that when possession of real property is in dispute, the tenant is entitled to a stay of appeal provided the tenant applies to the court of original instance for the court to set a bond to prevent “waste” to the property pending appeal. So once the court sets a bond and/or undertaking pending appeal, the tenant is entitled to a stay pending the outcome of the appeal to the appellate court. A stay for preventing “waste” to property is to be contrasted with a stay on execution of a judgment of money which requires that the amount of the judgment be bonded.¹²¹

When it comes to real property assets, an appellant is entitled to a stay *as of right*; this stay is not discretionary and is available to any appellant who is willing to give the necessary undertaking. CPLR 5519(a)(6) states, in pertinent part:

[Where] the appellant or moving party is in possession or control of real property which the judgment or order directs be conveyed or delivered, and an undertaking in a sum fixed by the court of original instance is given that

¹²¹ CPLR 5519(a)(2).

the appellant or moving party will not commit or suffer to be committed any waste and that if the judgment or order appealed from, or any part of it, is affirmed, or the appeal is dismissed, the appellant or moving party shall pay the value of the use and occupancy of such property, or the part of it as to which the judgment or order is affirmed, from the taking of the appeal until the delivery of possession of the property; if the judgment or order directs the sale of mortgaged property and the payment of any deficiency, the undertaking shall also provide that the appellant or moving party shall pay any such deficiency[.]

While the plain language of CPLR 5519(a)(6) indicates it should be applicable to summary proceedings, no appellate cases have directly so ruled.¹²² Nonetheless, many trial courts have held the statute directly applicable,¹²³ and that is undoubtedly because of the straightforward language of the provision. The statute has even been held applicable even where the appellant first sought a discretionary stay which was denied.¹²⁴ It has also been applied to the benefit of a landlord where the owner locked out a tenant, such lockout was upheld and the owner sought an undertaking to prevent the tenant from regaining occupancy during the pendency of the appeal.¹²⁵

Notwithstanding the direct language of 5519(a)(6), petitioners can be expected to argue that it should not automatically apply. However, it should be anticipated that most such arguments will be defeated and the absence of the appellate case law on the subject is a sign that such arguments have not gained traction in the lower courts. The real battleground of 55129(a)(6) tends to involve the undertaking with owners arguing for the biggest undertaking possible and tenants arguing for the lowest possible undertaking. Thus, in *Andrada*, which contains an excellent discussion of 5519(a)(6), the court declined to accept that Petitioner's argument in a case against a proprietary lessee that the undertaking should include payment of "fair market" rent instead of the maintenance because the purpose of the section would be met by requiring the tenant to pay the charges that were due under the applicable agreement. The court, how-

122 *Andrada Owners Corp. v. DiGrazia*, 38 Misc. 3d 1219(A), 967 N.Y.S.2d 865 (Table) (Civ. Ct., N.Y. Co. 2013).

123 *See e.g. Andrada*, 38 Misc. 3d 1219(A), and cases cited therein.

124 *Id.*

125 *Brown v. 99 Sutton LLC*, 2002 WL 1275171 (Civ. Ct., Kings Co. May 22, 2002).

ever, held that a hearing would be required to set an undertaking for the attorney fees incurred by the Petitioner.¹²⁶

In summary proceedings prosecuted in the Civil Court of the City of New York, appeals are taken to the Appellate Term of the Supreme Court. Moreover, if the appeal is unsuccessful in the Term, the stay can be continued automatically if the appellant moves for leave to appeal to the Appellate Division.¹²⁷ From a tactical and strategic standpoint, that motion is first made in the Appellate Term and, if unsuccessful, it is made directly to the Appellate Division. If that motion is successful that leads to another round of briefing in the Appellate Division.

In sum, the package of rights provided for in 5519 can provide ample opportunities for a tenant to keep a litigation going for years while the case winds through the court system. This possibility must be kept in mind in particular where it is urgent for the landlord to get prompt possession merely because delay can provide powerful leverage to a tenant.

[40.142] B. Time Frames for Perfecting Appeals

The requirements vary depending on which Appellate Term you are in. In the Appellate Term First Department must obtain the Clerk's Return from the original court and perfect the appeal in the Appellate Term within 30 days after filing the Notice of Appeal.¹²⁸ Any appeal not perfected within the 30-day period is subject to dismissal on motion by opposing counsel. In practice, the Appellate Term will accept an appeal past this 30-day rule due to delays in ordering and settling the transcript. In fact, an appeal can be perfected almost any time, without limit, so long as the opposing party has not moved to dismiss the appeal. Even if the opposing party moves to dismiss the appeal, the appellant can oppose and cross move for an extension, which would be typically granted with a time limit imposed to perfect the appeal.

[40.143] C. Time Frames for Arguing Appeals

Pursuant to Section 640.6(a)(2) of the Appellate Term rules, each appeal shall be noticed for a certain term of the court. Upon filing the

126 *Id.*

127 CPLR 5519(e).

128 Appellate Term, First Division Rules § 640.6(a)(1). (The Clerk's Return is obtained by presenting to the Appeals Clerk of the Civil Court five sets of the reproduced and bound Record on Appeal with proof of service, along with Transcript of proceedings).

Record on Appeal and the Appellant's Brief in the Appellate Term, First Department, the Appellant shall also file a Notice of Argument with proof of service. This form places the appeal on the court calendar for a specified term. The date of oral argument shall be published in the New York Law Journal, commencing two weeks before the first day of the term.

In the Appellate Term, Second Department, the appellant then has 90 days within which to perfect the appeal. A written notice is sent by the court to the appellant notifying him or her of the deadline and also telling him or her that if the deadline is not complied with the appeal will go on a specified dismissal calendar and will be dismissed for lack of prosecution.¹²⁹

As a practical matter, in both Departments, once you perfect and file your notice of argument, the parties can wait months for the matter to be scheduled for argument and then after argument can wait months for a decision.

[40.144] D. Further Appeals

In the event one of the parties is unhappy with a decision in the Appellate Term, such party can move for leave to appeal, usually first in the Term and, if unsuccessful, in the Appellate Division. Each of these motions can take a few months to decide. In the meantime, if the party facing dispossession moves promptly, the stay remains in place.¹³⁰

If a motion for leave to appeal is granted, unless the Court has specified a deadline for the filing of briefs and record, in the First Department, an appellant has nine months to perfect an appeal.¹³¹ Rule § 600.5(d) says that you have 30 days to perfect your appeal if there are no transcripts, however. In the Second Department, an appeal must be perfected within 6 months of the date of the notice of appeal or order granting leave to appeal.¹³²

In a situation where an automatic stay is not available or might be less desirable because the undertaking might be regarded as potentially onerous, the party seeking a stay may apply for a court-ordered stay with less

129 See 22 N.Y.C.R.R. §§ 731.8(a), (c), 732.8(a), (c).

130 CPLR 5519(e).

131 Appellate Division, First Department Rules § 600.11(a)(3).

132 22 N.Y.C.R.R. 670.8(e)(1).

strict requirements for an undertaking pursuant to 5519(c). Under CPLR 5519(c), the court also has the authority to grant a limited discretionary stay modifying the terms of a lower court stay or may be applied for directly to the Appellate Term. As seen in *Andrada*,¹³³ if unsuccessful, one still can seek an “as of right stay” in the lower court pursuant to 5519(a)(6).

[40.145] E. The Bond

The party seeking the stay must give something valuable in order to obtain the stay. For non-governmental entities, in order to secure an automatic stay, the losing party must post an undertaking in the amount of the judgment.¹³⁴ An undertaking “is in either the form of an obligation by a surety or an amount deposited with the Court.”¹³⁵ A “surety,” essentially a guarantor, is either a corporate entity or individual, who issues the bond or undertakes to guarantee the bonded persons promise.

Pursuant to CPLR 2505:

[a]n undertaking together with any affidavit required by [CPLR article 25] shall be filed with the clerk of the court in which the action is triable, or, upon an appeal, in the office where the judgment or order of the court of original instance is entered, and a copy shall be served upon the adverse party. The undertaking is effective when so served and filed.

Under CPLR 5519(a)(6), service of the notice of appeal alone is insufficient for an automatic stay to be granted. A court must set, either prior to or contemporaneously with the filing of the notice of appeal,¹³⁶ the amount of the undertaking, which the appellant is obligated to pay.¹³⁷

133 *Andrada Owners Corp. v. DiGrazia*, 38 Misc. 3d 1219(A), 967 N.Y.S.2d 865 (Table)(Civ. Ct. NY Co. 2013).

134 CPLR 5519(a)(2); *Dis v. Bellport Area Community Action Committee*, 2010 WL 2897843 (Sup. Ct., Suffolk Co. July 15, 2010).

135 *Morgan v. Morgan*, 2 Misc.3d 1011(A), 784 N.Y.S.2d 921 (Table) (Sup. Ct. Kings Co. 2004); CPLR § 2501.

136 *See, e.g., Tencza v. Hyland*, 149 Misc.2d 403, 565 N.Y.S.2d 377 (Sup. Ct., Oneida Co. 1990); *Pauk v. Pauk*, 232 A.D.2d 386, 648 N.Y.S.2d 621 (2d Dep’t 1996).

137 *See Oleck v. Pearlman*, 49 Misc. 2d 202, 203, 267 N.Y.S.2d 76 (Sup. Ct., Kings Co. 1966); *Jennings v. City of Glens Fall Indus. Dev. Agency*, 9 A.D.3d 773, 774, 780 N.Y.S.2d 672 (3d Dep’t 2004); *Maldonado v. New York Cnty. Sheriff*, 2006 WL 2588911 (S.D.N.Y. Sept. 6, 2006).

In the Landlord-Tenant nonpayment context, where a judgment in a summary eviction proceeding is rendered in favor of the petitioner, tenant can effect a stay under RPAPL § 751(1) by depositing the amount of rent due in court prior to the issuance of the warrant of eviction.¹³⁸ Alternatively, landlord's receipt of the monthly rent during the period from the taking of the appeal through its dismissal and until landlord obtains possession is also sufficient to satisfy the appellant's obligations under CPLR 5519(a)(6).¹³⁹

In the event that the order or decision appealed from directs the appellant to perform two or more of the acts specified in subparagraphs (a)(2)–(a)(6), then the appellant is directed, under CPLR 5519(a)(7), to comply with the provisions of each applicable subparagraph in order to obtain an automatic stay.

Generally speaking, once the bond or undertaking is given, it will only last for the pendency of a particular appeal and will dissolve if the appellant is successful in his or her appeal.

138 See RPAPL § 751; *People ex rel. Kilgallon v. Nuhn*, 92 Misc. 312, 317, 156 N.Y.S. 559 (Sup. Ct., Kings Co. 1915), *aff'd.*, 173 A.D. 895, 156 N.Y.S. 1151 (2d Dep't 1916).

139 See *Horowitz v. Safeco Ins. Co. of Am.*, 50 A.D.2d 1042, 1043, 377 N.Y.S.2d 750 (3d Dep't 1975); *Freidus v. Eisenberg*, 123 A.D.2d 174, 177, 510 N.Y.S.2d 139 (“The measure of the value of the use and occupancy is the rental value of the property[.]”).

CHAPTER FORTY-ONE

HOW LENDER'S COUNSEL REVIEWS A LEASE

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[41.0] I. WHY MORTGAGE LENDERS CARE ABOUT LEASES

Leases in place provide a major source of value for commercial real estate. The rent pays the owner's debt service and more. For those reasons, a mortgage lender wants to understand the space leases that affect—and are a crucial part of—any proposed real estate collateral.¹

When a mortgage lender begins to prepare for a commercial mortgage loan closing, the lender will often ask its counsel to review some or all of the leases.² That review will focus on a handful of concerns driven by the lender's basic assumptions and desires about the leases. Those concerns are:

- *Confirmation of Income.* Do the leases support and substantiate the rent roll that the lender reviewed in estimating the value and cash flow of the mortgaged property? Does the rent roll accurately describe the tenants' obligations to contribute to the property's operating expenses and real estate taxes?
- *Constancy of Cash Flow.* Does anything in the leases create a risk, or at least an atypical risk, of any interruption of cash flow to the borrower and hence loan payments?
- *Continuation of Leases.* Will the leases probably stay in place, so the value the lender saw in them is likely continue over the life of the loan and even after a possible foreclosure?
- *Concerns of a Landlord.* Recognizing that any mortgage lender is a landlord-in-waiting (or a possible seller of the property to a future investor), do the leases contain anything that a typical landlord would find unacceptable? Do they impose on the landlord any unusual,

1 This Chapter considers only "space leases," from the mortgage borrower as landlord to users of the real property for occupancy. These leases produce income to the borrower. In contrast, a "ground lease" runs from a third-party owner of the real property to a developer or investor that pays rent and often obtains a loan backed by a mortgage on those valuable leasehold rights. The negotiation and structuring of a ground lease is more a financing transaction than a leasing transaction. It lies outside this discussion. The author has written extensively on ground leases. For details, visit www.joshuastein.com.

2 Sometimes the lender will engage a due diligence contractor, perhaps overseas, for this purpose. In those cases, counsel may have no role at all, but should confirm that understanding early in the process. Otherwise, counsel's role may consist only of taking the blame or cleaning up the mess when something goes wrong. If the lender expects its counsel to review many leases, this can become a large and expensive job, which should be started early in the closing process.

unmeasurable, unexpected, or burdensome obligations? Do they create any other issues, such as inconsistencies in the landlord's obligations to different tenants?

Beyond those questions, a lender will also assess the likelihood that the income stream from a lease will vanish as the result of the tenant's default or financial distress—an underwriting risk inherent in any commercial real property that arises outside the terms of the leases themselves, which probably leads to more loan defaults than anything the leases or the loan documents do or do not say. The likelihood of tenant default represents a credit analysis and part of the lender's business underwriting of the loan. A lender will typically not rely on counsel to assess these business issues.³

The level of lease review that a lender will require for any particular loan will depend on the circumstances. As with most other issues that arise in commercial mortgage loan closings, much depends on the ratio between the loan amount and the value of the mortgaged property. A lower loan-to-value ratio makes it easier for a lender to make a business judgment and cut any number of corners, including the degree of scrutiny the lender applies to leases. If, on the other hand, a transaction is “stressed” from the beginning because of a high loan-to-value ratio, the lender and its counsel must approach leases—and everything else—that much more carefully.

If a single tenant occupies much or all of the landlord's building, that Lease will probably have been extensively negotiated by the tenant, and may be very tenant-friendly. A careful landlord will worry that the lender may review a lease of this type with special care and find problems that the lender might or might not otherwise have overlooked. Under this type of circumstance, it may make sense for the landlord to ask the lender to pre-approve the major lease before the landlord and the lender go any further down the road toward a closing. Otherwise, the lease could create problems along the way. Moreover, if the landlord makes this request early in the closing process, when the lender is still trying to get the business, the lender may be more flexible about major leases than if the lender knows it is already the only game in town and the borrower doesn't have alternatives.

3 If lender's counsel sees anything in a lease that increases the likelihood of tenant default or other issues beyond whatever is “typical,” counsel should try to mention it.

As another fundamental issue, the lender must decide and advise counsel whether the lender plans to rely on the particular leases presently in place, or whether the lender looks to present and future rental income of the building generally—the rental value of the space whether occupied by today's tenants or by any potential future replacement tenants. To the extent that a mortgage lender places weight on general rental value rather than actual leases in place, the terms of the current leases become less important.

Commercial mortgage lenders, though, usually care much more about actual rental income from leases in place than about hypothetical future rental income. In a frothy market, when lenders fight to get deals, they may place more weight on hypothetical future rents from hypothetical future tenants. That type of underwriting often drives a lending boom, often followed by a foreclosure boom. These things can change from month to month, from lender to lender, and from transaction to transaction.

Although any lender recognizes that today's leases will all eventually expire and today's tenants may all simply default or move out, a lender will also know that any effort to replace those tenants will take time and cost money, and even then may not replace the cash flow in place. If a property has significant short-term risk related to scheduled lease expirations and the need to find new tenants, a lender will regard the project as being not entirely stabilized, and will reassess the risk of the deal, perhaps restructuring the loan accordingly.⁴

The more important any particular lease is, the more carefully lender's counsel needs to review it. Anchor leases⁵ in a retail property or large office leases in particular will often require more careful review. First, those leases will often contribute a large share of the borrower's cash flow. Second, the tenants under those leases will have negotiated more heavily and the terms may have become more heavily tailored or tenant-friendly and correspondingly unfriendly to landlords and their lenders.

4 For a description of how a lender might view such a redevelopment project and restructure the loan, see Joshua Stein, "Retail Redevelopment Projects," *Real Estate Review*, Summer 1999, at 16. At a minimum, if the lender sees significant lease rollover ahead, the lender may want to establish reserves to pay for leasing commissions and tenant improvements, or allowances for future re-tenanting.

5 An anchor lease will drive an entire retail property by bringing in shoppers and hence other tenants. Without anchor(s), a project might drift or fail. Although a landlord can replace anchors, it takes time, costs money, and depends on whether alternative anchors like the particular space. Long vacancy periods for anchor tenants can create a domino effect for other tenants.

Particularly in retail projects, major tenants may have imposed their own forms of lease, rather than bothered with negotiating from the landlord's form.

On the other hand, to the extent that existing leases are below market, in default, or about to expire, or to the extent that the existing tenants are not creditworthy and hence are likely to vanish (or in any event cannot be relied upon), the lender may care more about hypothetical future rental value, on the assumption the space will soon need to be leased to new tenants, than about the details of the existing leases. In such cases, the lender may require only a minimal (if any) review of the terms of the leases—perhaps merely verifying the rent and term, and then checking for lease terms that are so bizarre and undesirable that they would, on their own, cause substantial concern for any lender or landlord, even if they will probably go away soon enough.

A lender's instructions to its counsel on lease review will also vary depending on whether the lender believes in the borrower's competence in negotiating leases and operating the property or in analyzing an existing property being acquired, and sharing the results. If the lender obtains meaningful representations and warranties on the leases, backed by credit beyond the borrowing entity, this would also be a good reason to cut back on the lender's lease review.

This chapter describes the items that a lender will usually want its counsel to consider in any lease review project. Because of the variety of issues any lease will address, many of which will make a difference under some circumstance or another (or the lease wouldn't need to cover them), one can easily find items to add to this list. More generally, anyone who thinks about it carefully can expand any lease review project, almost without limit, if a lender decides it wants to be as exhaustive as possible.

Nevertheless, the discussion in this chapter should cover the major "hot buttons" for a typical commercial mortgage lender in most transactions. Different lenders may, however, have different expectations for lease reviews in different transactions. Any lender's expectations will be completely different—and this list will be inadequate—for any credit tenant lease, bondable lease, synthetic lease, or ground lease.

This chapter begins by describing, in section II, some questions that counsel should answer before starting a lease review project, to define its scope and exactly what the lender wants its counsel to deliver.

Once counsel starts the lease review process, that process might identify problems and issues in the leases. Section III briefly discusses some common solutions to those problems and issues, and how the problem resolution process ties to the loan closing process more generally.

Section IV offers an overview of the basic general and financial questions that counsel should try to answer in any lease review, or questions whose answers counsel should confirm against the rent roll that the borrower provided. The latter approach will usually save time and cost less than having counsel undertake the lease review project without a reference point against which to check the leases.

Section V then turns to a broader group of issues of a less directly economic nature—issues where a lender's concerns are about the same as those of any other potential owner of the mortgaged property, and therefore the lender's and the borrower's interests are fairly well aligned, except that a borrower will usually have a greater appetite for risk even on these issues. A careful lender may want its lease review process to cover these issues as well.

Finally, section VI examines some issues that a lender will care about, but where a landlord (borrower) will probably have no direct interest. These issues relate to protecting the lender's interests, without particularly helping the landlord, when the lender does not (yet) own the mortgaged property.

Although this chapter addresses lease review in the context of a mortgage loan closing, many of the same issues arise when an investor considers acquiring the same property. And the same issues also arise when a landlord and its counsel negotiate new leases, thinking ahead to a future mortgage loan and ultimate sale.

[41.1] II. SOME PRELIMINARY QUESTIONS: DEFINING THE LEASE REVIEW

When lender's counsel begins to think about the existing leases in a building that will secure a new mortgage loan, he or she should ask some preliminary questions to help define the job to be done, even before anyone reads the first word of any lease.

[41.2] A. What Lease?

Landlords and tenants often amend leases. If amended more than three or four times, they readily become a confusing mess because of sloppiness and imprecision in drafting.⁶ Some amendments won't look like amendments. Instead, they'll take the form of letter agreements that, for example, confirmed the exercise of an option and added some space, perhaps adjusting the rent for that space. Sometimes landlords and tenants amend leases in other strange ways, such as through estoppel certificates.

It usually makes sense to read the most recent amendment first, then go backwards in time. The more recent amendments will often amend and restate the most important financial terms. In an extreme case, counsel may want the borrower to agree to try to amend and restate the entire lease after the loan has closed, to mitigate the risk of issues, inconsistencies, and uncertainty (which will produce issues and concerns if the lender ever tries to sell or securitize the loan) resulting from the messiness and complexity of the lease documents.⁷

As the first step in any lease review, lender's counsel should try to confirm that the borrower has provided not only the lease, but also every amendment that affects it. Any lease review should indicate exactly which amendments counsel received. This is true even if the lender has requested only the most minimal and abbreviated lease review.

Amendments will tend to address important issues. Any lease review must fully reflect them.

[41.3] B. Missing Documents

If documents appear to be missing (which usually happens, particularly as a result of disguised amendments as mentioned above), request copies from the borrower (or notify the lender client) immediately. As a common

6 See Joshua Stein, *A Practical Guide to Real Estate Practice*, "How to Amend Transactional Documents" (2001). Another chapter of this book addresses lease amendments and renewals in depth.

7 The borrower will rarely agree to undertake such a process. Even if they do agree to undertake it, they will rarely follow through. Therefore, if a lender genuinely wants to see a "lease mess" turned into a single amended and restated lease, the lender should build in some meaningful incentives to get the job done. One of the problems with amending and restating an existing lease mess is that it will often trigger renegotiation of the entire lease, so isn't as mechanical and straightforward as it may sound. As an intermediate approach, landlord and tenant could consolidate all the various amendments, side letters, certificates, etc., into a single lease amendment without touching the original lease.

example, if the lease gives the tenant options that the borrower treats as having been exercised, ask for some written confirmation of the exercise—at least the notice of exercise and ideally a letter agreement confirming the exercise and whatever economic adjustments it produced. Absent such documentation, the borrower can usually eliminate any uncertainty through an estoppel certificate, but one needs to identify the requirement early in the closing process, while the estoppel certificates are being prepared.

[41.4] C. What Deliverable?

A lender should decide early in the process exactly what form of lease review the lender wants its counsel to deliver for the particular transaction. At one extreme, the lender may want formal abstracts of each lease, a summary of the business terms and of any special lender issues the lease might create. Such abstracts often take more time than they justify, creating billing issues and delays. Summaries or charts, even handwritten, may suffice.

Lenders that desire to control costs instead often request an extremely abbreviated memorandum that summarizes only bullet points of concern on the leases, not a complete abstract of every lease. Such a memorandum can be informal and need not use complete sentences.

Sometimes, the right deliverable consists of nothing at all, beyond a confirmation that the leases reviewed seemed generally consistent with the rent roll, and that nothing jumped out as troublesome.

If lender's counsel provides anything less than a thorough review of every lease sufficient to identify all problems, then lender's counsel should think about what happens if counsel's review turns out to be wrong or incomplete. Did counsel clearly indicate the scope of the lease review conducted? If so, is that enough to protect the counsel from blame or even liability? Should counsel advise the lender of the risks of conducting a less-than-complete lease review?

In any event, the subject of deliverables represents a subject that the lender and its counsel should resolve before the lease review begins—so the lease review doesn't have to be done twice—and, in any case, before counsel responds to any request for an estimate of legal fees or timing for the closing. Large and open-ended lease review projects can cause billing problems, surprises, and delays. Changing the scope of the project once it has started will only make it worse.

Here are some more thoughts on techniques to control the lease review process:

- *Existing Abstracts.* If the borrower has already prepared abstracts of the leases, the lender may be willing to rely on them, particularly if competent counsel prepared them and lender's counsel can randomly spot-check them. But did the borrower sign any further lease amendments after preparing the abstracts?
- *Shared Abstracts.* Borrower and lender can engage a single law firm or due diligence contractor to prepare lease abstracts, taking into account the directions of both borrower and lender. Borrower's counsel may be willing to address its due diligence memos and lease reviews to the lender as well, although any such additional reliance will often create its own issues. When borrower's counsel learns that someone else may rely on its work product, the exercise sometimes attracts the same scrutiny as issuance of an opinion of counsel, whereas until that point it was just a routine due diligence process.
- *Marked Copies.* A borrower might have, or easily be able to prepare, copies of its leases marked to show changes from its standard form of lease. Those marked copies would let lender's counsel focus on deviations from the standard form rather than potentially considering every paragraph of every lease. Occasionally, property owners prepare their execution leases in the ordinary course in a way that highlights deviations from the standard form, just as a marked copy of the lease might.
- *Compromise on Presentation.* Instead of requiring beautifully word-processed abstracts, the lender might settle for lease review forms, filled in by hand and not thereafter edited or reformatted.

[41.5] III. DEALING WITH PROBLEMS

The lease review process exists to identify any problems or issues that might exist in the leases. Once a lender or its counsel identifies those issues, some may occasionally (rarely) rise to a level high enough that they would lead the lender not to close the transaction. Others may lead the lender to establish reserves, tailored covenants, or other measures to resolve or mitigate whatever risks the lease review process identifies. In other words, the lease review process does not occur in a vacuum. It represents part of the process of structuring and closing the larger transaction, and in extreme cases even defining some of its economic terms. For

that reason, a lender and its counsel should keep these points in mind in any lease review process:

- *Problems and Exceptions.* Although the lease review process must in part confirm that the leases support the rent roll, the lender and its counsel should try to focus on exceptions and problems, and report them and act on them when found.
- *Assumptions.* Don't assume that the leases are correct. To the contrary, assume they hide mistakes and surprises, or at least might do so. That's the whole purpose of the exercise.⁸
- *Early Identification.* Try to identify any problems as early as possible in the process. They may require lease amendments or other cooperation by the tenant, all of which will take time and may drive the closing documentation. Because the importance of any problem will usually multiply for a larger or more important lease, start reviewing those leases first.
- *Remedies.* Any analysis of a problem in a lease is not complete without taking a look at the rights and remedies the lease creates if an issue ever arises. For example, a lease might grant a tenant an exclusive right to sell a particular type of product in its space. But the lease may also say that if landlord violates the exclusive, the tenant can only claim a nominal and meaningless credit against rent—with no right to terminate the lease. The limited nature of the tenant's remedy would probably make any lender less concerned about the exclusive clause. More generally, whenever any problem shows up in a lease, lender's counsel should also focus on: (a) what landlord might have already done to mitigate the problem; and (b) the parties' rights and remedies in the context of that particular problem.
- *Sounding the Alarm.* To the extent that a lease review discloses discrepancies or concerns, counsel should note and report them to the client, quickly, in a way that brings them to the appropriate people's attention. Don't mention them as footnotes or textual discussion buried in a voluminous report about the leases as a whole, most of no

8 Even something as dumb as having missing pages may turn out to create issues. The author once worked on a transaction where a copy of a crucial retail lease was mysteriously missing a page. When the page turned up, it just happened to provide for a huge rent abatement until the landlord obtained a crucial zoning approval for the project, without which the tenant could not operate. The moral of the story: identify any missing pages early, and do something about them immediately.

particular concern to the lender. Merely writing a little note somewhere, which someone else will have to notice, read, and think about, doesn't necessarily do the job of calling attention to the problem. Don't assume anyone will actually read or think about whatever report you write.

In general, if lender's counsel discovers a problem with a lease, the lender will usually have only five choices, some of which may lead to changes in the loan documentation:

- *Do Nothing.* In most cases, the lender will decide to live with the problem and whatever risk it creates. If the risk later "hits," whoever reviewed the lease will simply need to show that he or she identified the problem and disclosed it.
- *No Loan.* Decline to make the loan. Although lenders occasionally do choose this option, it can damage relationships and sometimes conceivably lead to liability, or more often just threats of liability, if the documentation to date (application, term sheet, or commitment letter) does not give the lender adequate escapes. Lenders also sometimes use the possibility of not closing the loan as a mechanism to encourage borrowers to go solve the problem some other way—essentially a game of chicken between borrower and lender.
- *Mitigating the Risk.* Figure out a way to mitigate the problem and whatever risk it creates. For example, the lender might establish a reserve or tailor additional documents to give the lender further controls or protections tailored to the circumstances.
- *Borrower Quick Fix.* In rare cases, the borrower will be able to fix the problem before closing. When this option is available, it will usually be the lender's first choice. This could, for example, involve a lease amendment or waiver, or adding a paragraph to the estoppel certificate⁹ to be signed by the tenant. A tenant may and may not cooperate, though.¹⁰

9 Estoppel certificates are usually not the best way to solve lease problems. They don't necessarily benefit the next landlord or the next lender. They get lost. If they change the lease, this doesn't necessarily always work. A careful lender will use them only to remove uncertainty about factual matters that cannot be confirmed from the words of the lease.

10 Leases sometimes obligate the tenant to sign amendments if a lender requests. The conditions to that obligation are typically so extensive (if tenant's counsel is even minimally competent) that they dilute the obligation almost to nothing.

- *Borrower Slow Fix.* The borrower might conceivably be able to solve the problem after closing. In these cases, the loan documents will need to define the borrower's obligations. If the "fix" will require cooperation from third parties, as it usually will, the parties need to recognize that those third parties might not cooperate. Therefore, they need to deal with backup measures, instituted either at closing or if the borrower has not fixed the problem after a certain time.

To the extent that the lender and the borrower agree on measures to solve a problem in a lease, the lender will also usually want to satisfy itself that those measures will work not only for today's loan closing, but also for any future loan closing with some other lender that might later refinance this lender. Today's lender cares about future lenders because today's lender wants to make sure the borrower can later refinance the loan. Otherwise, this lender may find itself left holding the bag.

On the other hand, each possible future lender may have its own agenda and own concerns. Something that one lender cared about a lot, another lender may disregard. And tomorrow's lender may care about issues that today's lender never even considered. Still, the universe of concerns of a future lender seems relatively limited and predictable, and today's lender will want to consider them.

If a lease lacks some provision that today's lender regards as important, the borrower might suggest a mechanism that gets past the problem for today's closing but will not necessarily help for the next closing, the one that will refinance today's loan. For example, the tenant might issue a letter to the current lender that solves the problem, but the letter might not also benefit the next lender. In that case, although today's lender can go ahead, it may also look ahead and be concerned about a future refinancing, and insist that the borrower develop a longer-term solution to the problem, perhaps in this case as simple as having the letter addressed to the borrower and its present and future lenders.

Once lender's counsel identifies a problem and the lender decides borrower will need to solve it, the lender will need to fit that requirement into the larger closing. It will become part of the closing checklist. The lender and its counsel should track it and make sure it gets done and doesn't fall between the cracks.

[41.6] IV. GENERAL AND FINANCIAL QUESTIONS

This section offers a more specific checklist of the basic points that typically matter when counsel reviews any lease to confirm its basic financial terms. In each case, lender's counsel should check these points against the rent roll.¹¹ To the extent that any item does not match the rent roll, lender's counsel should mention the inconsistency in the lease summary and for significant matters bring it to the lender's attention immediately—whether it is “good” inconsistency (the facts are better than the rent roll suggests) or “bad” inconsistency (the opposite). Either type of inconsistency may affect the lender's decision process or even the ultimate business terms of the loan. At a minimum, “good” inconsistency may raise doubts about the reliability of the rent roll and the borrower's management.

[41.7] A. Tenant

In their zeal to uncover hidden issues or problems in a lease, anyone reviewing a lease should not lose sight of a dumb basic issue that will jump out from any lease for anyone who pays attention: Exactly what party signed the lease as tenant? If the lender assumes the tenant is a creditworthy chain or other large company, is that creditworthy entity in fact the tenant? Or is the tenant some less creditworthy affiliate with a confusingly similar name? Discrepancies and differences in the tenant's name may not jump off the page, but catching them may represent the most important issue—as well as the easiest issue to explain and the easiest one to miss—in any lease review project. Although courts sometimes look beyond confusingly similar names and find a parent company liable under a lease that a subsidiary signed, no lender wants to rely on any such result. No counsel wants to miss that issue.

[41.8] B. Space

The lease should identify the address of the building and the leased premises within the building. Uncertainty can lead to disputes, and not only because the tenant may claim more space than the landlord thought the tenant occupied. For example, an area might be burdensome to maintain or repair, and neither landlord nor tenant really wants responsibility for it. Larger premises are not always better premises for a tenant. Some-

¹¹ Usually counsel should confirm the rent roll (or a pro forma summary of the rents over time), rather than collect and organize the same information from the leases. The first approach saves time and money and prevents mistakes. Counsel must take care to keep track of what has been checked and what still remains to be checked.

times the lease will need to identify the size of the leased premises, though by no means always. Any lease review should indicate whether the tenant has exercised shed rights or expansion rights and should note the existence of any unexercised rights. Do any unresolved issues exist on the consequences of a tenant's exercise of those rights?

[41.9] C. Term

When does the lease expire and what extension options does it give the tenant? Flag the existence of any expired lease or informal month-to-month extensions, as these potentially impair reliability of income. Does the file suggest any ambiguity, uncertainty, or dispute on whether a tenant in fact exercised an option and, if so, how that affected rent, the tenant's other obligations under the lease, or the expiration date? To the extent that the tenant has renewal options, must the tenant make its decision far enough in advance so that if the tenant doesn't want to renew, the landlord (or the lender or other owner of the property after foreclosure) still has enough time to re-rent the premises without risk of an interruption in rent?

[41.10] D. Rent

Check the tenant's main rent obligations, which will typically consist of some combination of these: (1) fixed or base rent, payable based on a schedule (almost always monthly) in the lease; plus (2) escalations, whereby the tenant contributes to (i.e., protects the landlord and lender from increases in) real estate taxes, operating expenses, or other expenses of the building; and sometimes (3) percentage rent, a percentage of the tenant's gross sales.

Sometimes leases will allow the tenant to claim credits against some of these rent obligations. For example, if the lease requires the tenant to pay real estate taxes, the lease may allow the tenant to credit those payments against percentage rent above a certain level. Those credit rights may not appear in the percentage rent section of the lease. The lease reviewer will need to watch for them elsewhere, often at the very end just before the signatures or in an amendment.

Anything that allows the tenant to reduce rent or claim an offset against rent merits attention for two reasons. First, it could of course reduce rent. Second, this type of provision often tends to produce disputes because it is poorly written and the facts end up playing out differently than anything the parties imagined. So if the lease does provide for a reduction or offset,

lender's counsel should watch for excessive complexity and make sure the clause works right.

Especially for leases signed relatively recently, the lease reviewer should look for any uncertainty on the base amounts that define the tenant's obligation to contribute to real estate taxes or operating expenses. If these base amounts have not yet been determined or finalized, the tenant may later be able to reduce its escalation rent by asserting a higher base amount than whatever the parties assumed. In these cases, the lease may set up a calculation or definition to determine, in the future, what the tenant's base amount will be. Like any other formula that directly affects payments, this represents particularly fertile ground for disputes and interpretational issues. If any lease raises this concern, counsel may simply want to note it for discussion. There may be ways to deal with it, or it may simply amount to a risk that the lender will need to understand and accept.

[41.11] E. Security Deposit

How much security deposit did the tenant provide? Watch particularly for any form of security deposit other than cash, such as a letter of credit. If these security deposits are substantial, the lender may want to hold—or at least control—them, particularly if the lender requires a lockbox or other cash-management measures for the mortgaged property. The measures to allow a lender to take control of unusual security deposits may require attention early in the closing process, particularly to the extent that they may require cooperation from third parties, starting with the tenant but also often including a bank or other financial institution.¹²

At a minimum, counsel may want to suggest that the lender confirm the landlord still has the security deposit. If the security deposit arrangements take the form of something other than cash, the lender will also want to know that they still exist and, for example, that any letter of credit has not expired and the original document has not been lost.

[41.12] F. Construction Obligations

If the building is still under construction, or if the lease for some other reason was signed only recently, it may still obligate the landlord or tenant to complete or pay for certain construction to prepare the space for the tenant's business. Any such obligations will typically concern a lender,

¹² Other chapters in this book focus on issues regarding letters of credit in leasing.

because they introduce construction-related risks that should not arise for a stabilized building. Lender's counsel will typically want to answer at least these questions:

- *Landlord's Obligations.* What construction must the landlord still perform, whether on the premises, in the common areas, or elsewhere, even potentially off site? Does the lease clearly define these obligations? Does the file suggest any sign of disputes, delays, or uncertainty about the landlord's completion of its work?
- *Remedies for Late Delivery.* If the landlord does not finish its construction on time, what can the tenant do? Can the tenant claim a rent credit? Can the tenant terminate the lease? May the tenant perform the work itself and offset rent?
- *Monetary Obligations.* If the landlord has agreed to make a cash contribution to the tenant's construction work, how much is that contribution and what conditions must the tenant meet in order to receive it? The lender will also want to understand how the landlord plans to fund the contribution and assure it will be available when required. Often, the loan will include a line item to fund these landlord obligations. In those cases, the lender and its counsel will want assurance that the lease requirements and the loan availability match up. If the lender does not anticipate making advances to fund any remaining landlord obligations, how can the lender obtain comfort that the money will be there when needed? Depending on the dollars involved, these issues may lead to changes in the loan documents.¹³
- *Tenant's Remaining Work.* How much work does the lease say the tenant will perform? Is there anything about the work that makes it appear uncertain or difficult? Must the landlord participate in the tenant's work in ways that may become expensive or complicated or cause delay? And, again, does anything in the file suggest disputes or problems have arisen about that work?

13 A thoughtful borrower/landlord will recognize these concerns before they actually arise, and make sure that the letter of intent or other preliminary documents for the loan already deal with them.

[41.13] V. LANDLORD AND LENDER SHARED CONCERNS

Beyond the basic economic issues listed above, a lease raises a wide range of issues about the relationship between landlord and tenant—every possible event or circumstance that can occur in a potentially complicated piece of real estate over a long period. For most of those issues, the lender’s concerns largely match the landlord’s. A lender will, however, often worry more than the borrower—particularly about any issue that might interfere with the reliability of cash flow—based on the lender’s more “downside” orientation.

A borrower may, for example, be willing to tolerate some small risk of an impairment of rental income if that is the price of getting the lease or if the borrower regards the risk as immaterial in the grand scheme of things. In making that decision, the borrower has probably identified both the downside and the upside in the project as a whole, and accepts the former as the price of the latter. A lender attaches less weight to the possible upside and cares more about preventing the downside. Hence it will weigh risks differently than might a borrower. A lender will care about small risks that a borrower might ignore. A borrower, innately more optimistic, will also be more likely than a lender to believe that it can control or mitigate any risk that the lease creates, whereas the lender may see only risk.

Because a routine space lease can potentially deal with hundreds of issues,¹⁴ the range of possible concerns to a lender is almost limitless. A lender could, if it wished, have its counsel review any lease—or selected leases in a building—with the same level of detail and concern as if the lender were negotiating the entire lease in the first instance. This approach is unusual and highly inefficient.

Instead, a lender will typically assume that most of the nonfundamental terms of an existing lease are commercially tolerable, because: (1) the lender isn’t really the landlord; (2) the lender’s loan-to-value ratio gives the lender a cushion to accept some imperfections in the leases, except potentially substantial direct threats to reliability of cash flow; (3) such imperfections will probably not lead the lender to walk from the deal, so they are not worth the time they would take to find; (4) the lender has some confidence in the borrower’s ability to negotiate and manage leases—a process that is fairly well-defined and manageable by most bor-

¹⁴ See Chapter 6, Tenant’s Checklist of Silent Lease Issues, and Chapter 7, Landlord’s Checklist of Silent Lease Issues, both updated for this book.

rowers if they have any experience or competence; and (5) a full review of every term of every lease makes no practical or economic sense.¹⁵

The issues that lenders and landlords share tend to relate to hypothetical eventualities that are not directly economic, but certainly can have indirect economic consequences. As so often happens, the concerns that are fundamentally important to both landlords and lenders are also typically the same issues that any lender will probably place at the top of its agenda. Most affect possible interruption or loss of income, the lender's primary concern. Others affect a range of lender concerns not necessarily tied to loss of income.

[41.14] A. Casualty and Condemnation

A lender will want to assure that if the building burns down or a government acquires it for public use (however defined), the lender understands how that loss will affect rental income and the continuation of the leases in the building. The lender does not necessarily expect tenants to continue paying rent if they can't occupy their spaces. A lease that imposes such a requirement may create more problems than it solves.¹⁶ Here is a short summary of the lender's agenda in this area, when considering a routine space lease:¹⁷

- *Rent Abatement.* Understand and summarize, very briefly, when and how the lease allows the tenant to abate rent after a casualty or condemnation. Typically, a lender will accept reasonable rights to abate rent in proportion to the tenant's inability to use its premises. A lender will even usually tolerate provisions that allow a tenant to terminate its lease if the unusable condition continues for a certain period. As a practical matter, lenders and landlords do typically have

15 Practicality of this type often deviates from the mindset of nonrecourse lending, which in many ways assumes – at least as a starting point – that the borrower is incompetent and will default immediately after the closing. Reliance on the borrower's management skills represents a different mindset. As a practical matter, though, it is both common and reasonable when lenders think about existing leases.

16 Such a lease forces each tenant to insure a risk that in most cases is more efficiently (i.e., cost effectively) insured once, at the landlord level, with part or all of the cost potentially passed through to tenants. If a tenant fails to maintain that particular insurance, the landlord cannot look to its own insurance to fill the gap, but must instead look to the tenant's credit and the landlord's remedies under the lease. If, on the other hand, the landlord agreed to abate rent, the landlord's insurance carrier would probably give the landlord a simpler and more reliable mechanism (than claims against the tenant) to make up for the lost rental income.

17 For a ground lease, synthetic lease, or bondable lease, the lender's expectations will vary quite substantially from those described here. Such leases fall outside the scope of this Chapter.

to live with the risk of lease termination upon casualty or condemnation, and they simply need to do what they can to address the risk. A lender's tolerance for abatement and termination rights will be greater in small leases than in large leases. The lender also wants to confirm that the provisions allowing the tenant to abate rent and terminate the lease make sense and dovetail with the borrower's actual insurance coverage and the insurance requirements in the loan documents. This may require coordination with the borrower's insurance broker and the lender's insurance advisers, plus tailoring of the insurance provisions for the loan. If lender's advisers identify a disconnect between tenants' abatement rights and borrower's insurance program, the lender will want the borrower to adjust its insurance program—both for the closing and in the loan document requirements for future insurance. Here, as so often happens, the due diligence process and what it uncovers can drive changes in the loan documents.

- *Where's the Cash?* If a loss occurs, the lender will not want the tenant to take any of the insurance or condemnation money that would otherwise go to the lender—which would make these funds unavailable to repay the loan or restore—or to require the borrower to apply those funds in a manner inconsistent with the loan documents. A lender will therefore want to understand exactly what the lease, particularly a large lease, requires along these lines, and identify any inconsistencies or issues. Strong tenants will often insist on resolving any inconsistencies between their lease and the loan documents in favor of the former, though it's rare for a space tenant to claim any significant amount from casualty or condemnation proceeds. A lender will want to know that the lease allows the landlord to use insurance or condemnation proceeds to restore, with any excess going to the landlord and its lender, all under reasonable and typical terms and conditions that the lender can accept. As long as those terms and conditions are generally reasonable, a lender will probably not want its counsel to spend the time to confirm that they match perfectly the requirements of the loan documents.
- *Restoration Procedures.* If the lease does require the landlord to restore, the lender will want to confirm that nothing in those restoration procedures will create risks or concerns for the lender. As an extreme example, if the lease requires the landlord to restore but provides that a noncreditworthy (or potentially noncreditworthy) tenant will hold the restoration funds while the process goes forward, a lender would regard such a provision as troublesome. A lender will

also want to satisfy itself that if the landlord actually does restore in a prompt manner, the tenant will remain in place under the lease, and the deadline to restore is not unrealistically short.

[41.15] B. Go Dark

If the lease covers retail space, particularly in a building with other retail tenancies or in a mixed-use project, the lender will want to confirm that, at a minimum, the lease requires the tenant to open for business by a certain date. The lender will then ideally want to ensure that the tenant must continue to operate after opening. This issue will matter particularly for large anchor stores, which typically pay a lower rent based on the assumption that by being open for business they will attract customers for the benefit of everyone else at the property.

If the lease allows one of these major tenants to close up its operations at whim, this undercuts the assumption that drove the economics of the lease and the property. Although the lease would require the anchor tenant to continue to pay rent after closing, major chain stores have been known to do exactly this (and gladly!) when they open a new location across the street and want to prevent a competitor from opening at their former location. Any such closure by an anchor tenant can imperil the viability of other tenants and hence, ultimately, viability of the entire property. Courts will occasionally infer an implied covenant of continuous operation, but no lender wants to rely on that possibility. Lenders and their counsel will, and should, therefore usually assume that unless a lease obligates the tenant to operate, the tenant can shut down at any time, a possibility that will and should raise concern for the lender.¹⁸

If a retail lease does not contain a covenant to operate, then counsel should flag that omission as an issue. But a lender will typically not be concerned about reasonable exclusions from the covenant to operate, such as temporary closures to take inventory, construct alterations, or the like, provided that the exceptions are not so broad that they consume the rule.

Although tenants will sometimes agree to remain open and continue operating without qualification, most tenants refuse to incur such open-

18 As an underwriting matter, the lender may worry less if the tenant achieves a high sales volume at the leased location. To perform that analysis, though, the lender will want sales information, and will want to know that the lease requires the tenant to provide it. Not all leases do, particularly if the tenant does not pay percentage rent. Ultimately, a tenant's sales volume in proportion to rent offers a great—probably the best possible—predictor of the tenant's future at the property.

ended obligations, arguing that if it no longer makes business sense to remain open they should not be obligated to do so.

As a common compromise, major tenants often agree that if they shut down for a certain period, the landlord can terminate the lease and take back the vacant space. The details and mechanics of these landlord termination rights will vary widely from project to project. A lender will care a lot about them, particularly for anchor tenants or if the lender considers termination likely. Here are some examples of agreements landlords might make with major tenants, if the tenant “goes dark” and the landlord terminates the lease:

- *Landlord’s Kickout Payment.* The landlord might agree to pay the tenant some amount when terminating the lease, such as reimbursement of the tenant’s fixturing costs. But just how much will the landlord need to pay? Usually the lease will set up a formula, often not entirely clear. At a minimum, the lender may want to try to analyze how much the landlord would actually need to pay. The lender may want to go a step further, and obtain specific comfort from the tenant about the measure of the payment. As an example, these payments often take into account the tenant’s unamortized balance of its leasehold improvements. The lender may want the tenant to confirm in an estoppel certificate just how much the tenant spent on leasehold improvements, and how the tenant is amortizing that investment. That calculus represents an example of how the lease review process may drive the closing requirements, in this case through an estoppel certificate.
- *Funding.* If the tenant goes dark and the landlord decides to terminate the lease and make a termination payment, how will the landlord fund that payment? The lender will realize that if the borrower ever needs to make that payment and then find a replacement tenant, the borrower will probably try to persuade the lender to advance the necessary funds, which the lender may or may not want to do. For that reason, if the lender cares about the issue and sees a reasonable likelihood that it might arise, based on its assessment of the anchor tenant’s future at this location, the lender might want to establish a reserve or an additional line item in the loan to assure a funding source.
- *Tenant’s Kickout Payment.* Conversely (and less likely for going dark terminations of anchor leases), if the tenant must pay the landlord for any such termination, where does that money go and what will the

landlord use it for? The landlord will probably incur costs to re-tenant the space. As a general question, whether or not the tenant must pay for the termination, how will the landlord cover its re-tenanting costs without coming to the lender looking for more money? And how will the landlord make up for lost rent while the borrower finds a replacement tenant? Usually a lender will agree to apply the termination payment to cover all these costs, provided they are bona fide and reasonable. But what if the costs exceed the termination payment? Who covers the shortfall?

- *Timing.* Does the timing of the termination right give the landlord a reasonable time to find a replacement tenant before the old tenant goes away?
- *Control Over Termination.* Look carefully at how the termination right actually works. Does the borrower control it to the exclusion of the lender? Would it survive a foreclosure? Could the borrower use its control over the termination right to create leverage against the lender? For example, if the termination right is a one-time-only event, the lender may fear that if the borrower and the lender are fighting when the termination right arises, the borrower might—simply to gain leverage in the dispute with the lender—refuse to exercise the termination right even though it makes economic sense for the building. The lender may prefer that the termination right remain in effect indefinitely, or at least arise periodically, so that once the borrower and the lender resolve their dispute and (hypothetically) the lender owns the building, the lender will still have some reasonable opportunity to terminate the lease if the anchor tenant stays closed.
- *Lender Consent Right.* Conversely, if the lender does not want to terminate the lease but the landlord does, does the lease (or a separate agreement) protect the lender by saying that the termination will not be effective without the lender's consent? Does that restriction bind the tenant? If the lender fears a termination without its consent, the lender may want to tailor the nondisturbance agreement with the tenant accordingly.
- *Required Activity Level.* What level of activity in the space must the tenant continue to show to protect itself from termination? Will that level of activity meet the lender's expectations for the space and the project? For example, operation of two subleased flea market booths in the back corner of the space should not suffice to protect a tenant from termination.

For any retail project, issues about the tenant's obligation to operate, and the possibility of closure, will often reside near the top of any lender's list. If lender's counsel does not remember to look for these issues, they are easy to miss because the concern arises more from what the lease doesn't say than from what it does.

[41.16] C. Abatement Rights

Does the lease allow the tenant to abate or offset rent? (Disregard casualty or condemnation abatements, which raise separate concerns, addressed above.) A tenant's rights to abate rent will often tie to the tenant's "self-help" rights—rights of the tenant to cure the landlord's defaults and offset the costs against rent. Major tenants will often negotiate these rights if the landlord fails to complete required construction or fails to deliver required services or utilities and the failure hurts tenant's business. In extreme (and rare) cases, the tenant may obtain these rights for any landlord default at all.

For a major tenant, a lender may simply have to live with abatement rights. But the lender should begin by understanding exactly what they are. At a certain point they become intolerable. At some earlier point, they may lead to tailored language and negotiations in the loan documents.

Ideally, the tenant will not be able to activate any self-help or abatement rights without giving the landlord and the lender plenty of notice and opportunity to correct the situation. Moreover, the tenant's self-help and abatement rights should apply to as few of the landlord's obligations as possible. For example, a lease that lets the tenant abate rent for delays in initial construction or for interference with the tenant's network control center is far more palatable than one that allows the tenant to self-help and abate whenever the landlord defaults in any way.

A practical lender may also recognize that a tenant rarely exercises any self-help or abatement rights, particularly if the landlord manages the property in a competent way. Over the whole universe of commercial leasing, the time and attorney fees spent negotiating these provisions probably far exceed their practical value.

[41.17] D. Assignment/Subletting

If a tenant is particularly desirable, the existence and continuation of that tenant may be a substantial element in the lender's approval of the loan, both because of the tenant's creditworthiness backing part of the rent

stream and (for a retail lease) because of the traffic and visibility the particular tenant can bring to the property.

In those cases, the lender may care a great deal about whether and under what circumstances the lease allows the tenant to assign or sublet. Typically, even if the lease allows assignment or subletting, a lender will live with it as long as the original tenant remains liable under the lease. On the other hand, a lender might take a harder line, saying that the possibility of an assignment or sublet creates the possibility of an unexpected change in the character and use of the property. It all depends on the circumstances. A lender will often conclude that the borrower's equity cushion provides adequate comfort so the lender doesn't have to worry too much about the risks of assignment and subletting.

Unless a lender has instructed its counsel that special circumstances exist, any lease review should probably answer at most these questions on assignment and subletting under any major lease:

- *Assignment/Subletting.* Does the lease let the tenant assign or sublet, and if so to what degree and within what constraints? To the extent the lease grants the tenant flexibility, can the lender tolerate that level of flexibility and whatever long-term uncertainty it creates for the landlord and lender?
- *Release of Liability?* Does the lease contain any language that would allow the original tenant or its guarantor to be released from liability upon an assignment? Any such release from liability amounts to a red flag that counsel should bring to the lender's attention promptly. This issue will be important if the initial lease obligor is creditworthy, and less important or not important at all if that initial obligor has no meaningful credit.¹⁹
- *Recapture Rights.* Does the landlord have the right to terminate the lease (recapture the space) if the tenant wants to initiate certain types of assignment or subletting? Does the timing work and does the lender want to be involved in these decisions and any related re-leas-

¹⁹ Lenders' and landlords' business personnel often seem to think that if the lease says nothing on these issues, then an assignment can terminate the original tenant's liability. As a matter of ordinary contract law, that proposition is just plain wrong. As a practical matter, of course, the original tenant (the assignor) will have no interest in staying in the space so may have little enthusiasm for covering any unpaid rent, and may seek every possible excuse for not doing so. Thus, the existence of an unreleased assignor will not entirely solve the problem for the lender. The lender will still be nervous even if counsel persuades them that a lease assignment, in and of itself, will not terminate anyone's liability.

ing decisions? (Many loan documents restrict new leases and any lease amendments. Fewer require lender approval for assignments and subleases that require the borrower's approval.)

- *Change of Use.* Does the lease offer any flexibility for a change of use if the tenant assigns or sublets? Does the flexibility create potential problems for the future economics and attractiveness of the property? Might the lender fear that a permitted change of use could create some intolerable situation from the lender's perspective?

[41.18] E. Termination/Cancellation Rights

If a lease allows the tenant to terminate under any circumstance beyond casualty and condemnation (as discussed above), this will probably create substantial concern for a lender. Here are some examples of termination rights that could concern a lender, or should at least be brought to the lender's attention:

- *Sales-Based.* Right to terminate for failure to achieve specified level of sales.
- *Co-Tenancy.* Right to terminate if some other tenant (or group of tenants) is no longer in occupancy, or never enters into occupancy.
- *Landlord Default.* Termination rights arising from a possible landlord default.²⁰
- *General.* Unilateral right of the tenant to terminate, even if the tenant must make a payment to the landlord.
- *Bad Timing.* Tenant right to terminate without giving enough notice for the landlord to find a replacement tenant.

In some types of projects, the lender may just need to live with these termination rights, as tenants typically obtain them. In those cases, the lender will need to assess the likelihood that any termination right will actually arise. If the project is somehow "on the edge," with a higher than normal risk that these rights might activate, the lender might insist on

²⁰ A Subordination and Nondisturbance Agreement may give lender a chance to cure landlord defaults, though typically with rather short cure periods. If a particular lease contains very tenant-friendly language on termination rights for landlord's default, the lender may want to insist that borrower obtain changes in that language. Problems with tenant termination rights should be identified early in the lease review process. They represent another example of how the leases—and due diligence discoveries—might drive closing documentation.

negotiating some backup mechanism to pay for retreating and repositioning should it become necessary. The lender might also mitigate these concerns based on the lender's comfort with the borrower's management skills, and ability to prevent problems. If the lender goes too far down that road, though, it stops being a traditional commercial real estate loan.

[41.19] F. Unreasonable Burdens

A lender will also worry about any lease that imposes unusual and atypical burdens on the landlord. In the short term, such burdens may produce unpredictable adverse effects on cash flow or increase the likelihood of mistakes, issues, or complexity. In the long term, the lender must see itself as a successor landlord, i.e., the most likely owner of the property after any hypothetical foreclosure. In that capacity, the lender will not want to bear obligations that vary dramatically from those of a typical passive landlord receiving a steady stream of real estate income. Any lender's counsel reviewing a lease should therefore look for unusual or burdensome obligations or restrictions affecting the landlord, such as:

- *Transfer Restrictions.* Beware of prohibitions on transfers by the landlord or by the ultimate owners of equity interests in the landlord. In assessing any such restriction, lender's counsel must ask whether it will significantly impair the lender's exit strategy (including, in the first instance, the lender's ability to conduct a foreclosure sale). In general, both lenders and landlords highly disfavor any restriction on transferability of the landlord's position. Rights of first refusal or first offer represent a particularly tedious and problem-prone variation on transfer restrictions. If possible, a lender would like to see them go away completely after any foreclosure.
- *Restrictions on Other Property or Activities.* Watch out for anything at all that restricts the landlord's operations, leasing, activities, construction, or use of—or anything else involving—the landlord's property outside the leased premises. Expansion options are the first and most traditional example of such provisions. Other examples would include restrictions on signage, exclusive rights for a particular tenant, restrictions on leasing to particular types of tenants, obligations to maintain particular parking, uses, standards, no-build areas, lines of visibility, circulation pathways, and the like. Strong tenants may even sometimes impose radius clauses on their landlords, prohibiting the landlords and their affiliates from leasing space to competitors in any other properties the landlord or its affiliate owns within the radius area. Any major retail lease will probably restrict at

least some landlord flexibility within the same property where the leased premises are located. Lender's counsel should identify these restrictions—know what to look for—and then bring them to the client's attention. The lender must then decide whether they create a problem, for example because they conflict with other leases. To the extent that they merely restate what any reasonable landlord would or would not do in any way to maintain an economically viable property, a lender often won't care. But it is ultimately a decision for the lender to make in the context of the transaction as a whole. And if the landlord obligations relate to real property outside the scope of the lender's collateral, even reasonable provisions can create serious problems. If the lender were to foreclose on this particular property, could it control what happened elsewhere?

- *Subtenant Recognition Traps.* A substantial lease may allow the tenant to enter into subleases. To facilitate those future subleases, the lease may obligate the landlord to enter into agreements with subtenants (“recognition agreements” or “nondisturbance agreements”) by which the landlord agrees that if the landlord-tenant lease ever terminates, then the landlord will recognize the subtenant as a direct tenant. A tenant's and a subtenant's desire to obtain recognition agreements from the landlord makes perfect sense. But a landlord—and hence a lender—must remember that these agreements could force the landlord to become a direct landlord under whatever sublease the tenant negotiates. Therefore, before a landlord agrees to enter into recognition agreements with any subtenant, the landlord must know that the terms of the sublease will be tolerable to the landlord. One can develop scores of criteria to define what would be tolerable, but ultimately the lender may insist on having the right to reasonably approve any sublease before the subtenant is entitled to any protection.
- *Unusual Obligations.* Does the lease impose on the landlord any obligations that are difficult to perform, not capable of being quantified, or outside the scope of typical landlord obligations under a lease? As an example, a lender may be concerned if a lease allows the tenant to require future upgrades to building systems without defining what those upgrades are. Obligations to provide building security may also create concern.

[41.20] G. Options and Preemptive Rights

Although expansion and renewal options in and of themselves do not typically cause great concern, they can create serious problems if they are: (1) significantly below market; (2) conflicting; (3) on uncertain terms; or (4) scheduled in a way that denies the landlord sufficient time to find a replacement tenant if the tenant does not exercise an option. Any landlord also should consider how the options interact with the possibility that landlord might recover possession of leased space before the scheduled expiration date of an existing lease.

For a substantial property, parsing out the options and how they might interact over time can be a very large and difficult project, which someone else can do or has probably done, but whose work will still require checking. If the leases suggest the need for such an exercise, lender's counsel should try to recognize the possible problem as early as possible, and determine how to proceed. Counsel will typically want to advise the lender to insist on a complete analysis of all the options, to confirm that none potentially conflict under any circumstance.

Any purchase option, or even a right of first refusal or first offer to purchase, should raise an immediate red flag. Such options are very atypical in space leases, even the largest space leases, and can and should create substantial concern for a mortgage lender and its counsel. At a minimum, a lender will insist that they not apply to a foreclosure (or substitute) transfer, and no longer apply to any post-foreclosure owner.

[41.21] H. Exculpation

Does the lease say that, no matter what, the landlord's liability will always be limited to its interest in the premises? Any landlord and any lender will always want to see such a provision, although a lender that really wants to make a particular loan can usually figure out a way to live without such language. The lender can, after all, probably send a suitable subsidiary to bid at the foreclosure sale and take title to the asset if the need arises. That way, the lender may be able to get comfortable with the lack of an exculpation clause, although a conservative lender may worry about the risk of forgetting about the problem and taking title in its own name. Substantial institutional lenders have been known to make mistakes like this, at great expense.

[41.22] I. Protection on Alterations and Contest

Many leases give a tenant some flexibility in two areas that can produce direct economic loss to the landlord: alterations and the tenant's right to challenge the validity of legal requirements that apply to the building.

In the case of alterations, if the tenant does not pay for any construction work, the unpaid contractors and other parties may have the right to file a mechanic's lien. In some states, that lien attaches to both the tenant's leasehold and sometimes even the landlord's fee estate. In the worst case, a mechanic's lien may sometimes even obtain priority over the lender's mortgage. The landlord and sometimes even the lender may therefore find it needs to pay the tenant's construction bills to protect itself from a foreclosure under the mechanic's lien.

Similarly, if the lease allows the tenant to contest the application of particular legal requirements, the landlord and lender may find themselves stuck with the adverse consequences if the tenant's contest fails and the tenant chooses not to, or cannot, comply with the legal requirements as finally determined.

A landlord may mitigate each of these risks by requiring the tenant to post a bond if the lien or amount at issue in a legal contest exceeds a certain level, depending on the size of the lease and the landlord's comfort with the tenant. A lender will have similar concerns, but often more strongly felt than the landlord's. A landlord may be willing to waive any requirement for bonds, in the interest of getting the deal done, but a lender may not want to be as flexible and accommodating.

Therefore, if a lease does not require the tenant to post bonds under the circumstances described here, counsel will probably want to bring the issue to the lender's attention, so the lender can decide whether it creates a serious problem.

[41.23] J. Concessions to Creditworthy Tenants

Leases with unusually creditworthy tenants—such as a chain store that has not yet filed bankruptcy or has completed its latest round through bankruptcy and has not yet started to consider the next one—will often contain concessions to the tenant premised on the assumption that the tenant is creditworthy. For example, tenants of this type will often not be required to post bonds of the type suggested in the preceding section,

because the landlord believes the tenant's credit is good enough to eliminate any need for bonds. The landlord may also dispense with a security deposit, loosen the "use" clause, agree to significant restrictions outside the leased premises, give the tenant extra flexibility on its activities in the space, and so on, all premised on the notion that the tenant is creditworthy and therefore these concessions make sense to "get the deal."

What happens though, if during the long life of the lease the premise for all these concessions turns out to be wrong? To the extent that the lease contains concessions to the tenant based on that tenant's credit quality, the landlord (and particularly the lender) may want those concessions to go away if the tenant's credit quality goes away. Any such concession clawback provisions are quite unusual, but recent history—particularly with chain retailers once regarded as having impeccable credit—demonstrates that such clawbacks may become quite important and relevant.

To the extent that (1) a lender is uncomfortable with any tenant-oriented concessions based on the assumption that the tenant is creditworthy; but (2) the lease does not provide for a "concession clawback" if the tenant becomes less creditworthy, a lender may regard that fact as a serious problem with the lease. It might also not care, or decide it can live with the risk. But this issue represents a business decision that cannot be made unless counsel identifies and raises it in the lease review process.

[41.24] VI. LENDER PROTECTION ISSUES

For most of the issues discussed so far in this chapter, the concerns of the borrower (landlord) and the lender (possible future landlord or seller to the next landlord) are quite similar. Both share each of these concerns, although a lender may care more than a borrower because of the lender's more conservative and downside orientation.

For another category of issues, though, a landlord or borrower will probably have no direct interest at all. Instead, the landlord or borrower will only have an indirect interest in making sure that a lender—today's or tomorrow's—will not object to the lease.

The issues in this latter category relate to the relationship between the tenant and the lender, and the effect of a loan default or other possible problems with the mortgaged property. Any lease review project may need to consider these issues, though their importance will vary depending primarily on the size and importance of the lease, as well as other circumstances.

[41.25] A. Estoppel Certificates

Does the lease require the tenant to provide estoppel certificates, i.e., certificates confirming the continued existence and status of the lease, that the tenant has no claims against the landlord, and similar matters? Does the lease establish any burdensome restrictions or limits on the landlord's right to obtain estoppel certificates? A lender will want the tenant to be unambiguously obligated to deliver an estoppel certificate for today's closing, as well as for any future closing. And the lender will be uncomfortable to the extent that anything in the estoppel certificate might limit the lender's (or a future lender's) ability to rely on it.

[41.26] B. Priorities

In a lender's perfect world, the lease will simply say that it is subordinate to all mortgages, with nothing more said. But leases with substantial tenants rarely contain such a provision. Instead, subordination will at a minimum be conditioned on the lender's entering into a nondisturbance agreement. These agreements and this relationship create a host of issues.²¹ For a typical lease review, lender's counsel just needs to make sure its client understands what the lease says about this issue. Specifically, the lender needs to know the answers to these questions:

- *Subordination.* Does the lease say it is subordinate to mortgages?
- *Nondisturbance.* If so, is subordination of the lease nevertheless conditioned on the lender's delivering a nondisturbance agreement?
- *Conditions.* What must that nondisturbance agreement say? Will this lender or a hypothetical future refinancing lender be willing and able to satisfy those requirements? Does the lease define the form of the nondisturbance agreement, and will a lender tolerate it? Can the landlord satisfy its nondisturbance obligations by providing whatever form of nondisturbance agreement a future lender might require?

A lender would prefer to see any subordination clause be as simple and straightforward as possible, with no need for the lender or landlord to remember to do anything at all. If the lease conditions subordination on the lender's entering into a nondisturbance agreement, then lender's counsel should note this fact, and the necessary agreement must then be

21 Other chapters of this book address nondisturbance issues and the issues they raise. Ordinarily, these issues and the related negotiations probably attract more attention than they merit, but once in a while nondisturbance really makes a difference.

entered into as part of the closing, another example of how the lease review process can drive closing requirements and why it helps to identify those requirements early in the process.

If the lease requires a nondisturbance agreement that the tenant gets to approve, a careful lender's counsel will assume that the tenant will never approve the agreement, and therefore the subordination will never become effective. When a lease contains such a requirement, lender's counsel should regard it as a red flag that requires immediate attention. For a major tenant, the lender will probably want to resolve any such uncertainty at the time of the closing, as a condition to making the loan. Whatever resolution the parties craft, it should apply not only to today's loan closing but also to any future loan closing.

A lender may decide that it wants to use its own form of nondisturbance agreement, rather than any form of nondisturbance agreement required by any particular lease. For a large building with many tenants, a lender may decide that it is just more efficient to use its own form rather than create a tailored document for each tenant based on its lease. Especially in the case of large tenants, the lender should be prepared to negotiate the required nondisturbance terms and conditions into the lender's form. Of course, a lender's willingness to tolerate these terms may depend on the tenant's size and remaining lease term, and how badly the lender wants to make the loan. Lenders with a very low tolerance for any negotiation of a nondisturbance agreement might be willing to close without entering into such an agreement with tenants it deems immaterial to the real estate's value. This is especially true where a building is primarily leased to a single marquee tenant and the lender doesn't much care about the rest of the tenant base.

[41.27] C. Attornment

Does the lease require the tenant to attorn to anyone who purchases the property at a foreclosure sale, i.e., accept that person as the tenant's new landlord? In most cases, one assumes this new landlord would be the lender or its designee. What conditions and limitations apply to that attornment? Does the lease negate any possibility that a foreclosure sale might terminate the lease and with it the tenant's obligations to the foreclosed-out landlord or any subsequent landlord?

[41.28] D. Cure Rights

If the landlord ever defaults under the lease, particularly in a way that might entitle the tenant to terminate, a lender might want the right to receive notice of the default and to try to correct the situation. For that purpose, a lender might want some additional time, beyond whatever time the lease gives the landlord. Provisions of this sort are particularly important for leases with major tenants. Even there, though, they will usually give the lender only a fairly limited additional cure period—far from the degree of additional protection that a lender would expect to see in, for example, the leasehold mortgagee protections in a ground lease. In the author's experience, leases will often give a lender at most 30 extra days to cure the landlord's default, and very rarely much more time beyond that. In negotiating a subordination and nondisturbance agreement the lender will probably seek a longer cure period than whatever the lease provides. Unlike the case in a ground lease, though, a possible termination of a space lease would not deprive lender of its entire collateral—just some part of the rental income.²² And it is not reasonable to expect the tenant to wait around for very long while the lender tries to cure the landlord's default. The tenant needs to be able to operate a business in the leased premises. So, although a lender will often want a right to cure the landlord's default, the cure right may ultimately not be all that extensive. Whatever it is, lender's counsel should note it as part of the lease review.²³

[41.29] E. Direct Rent Payment

If the loan goes into default, a lender may obtain the appointment of a receiver to collect rental income from the property. A lender may, however, seek an extra level of flexibility long before that, by having the right to require the tenants to pay rent directly to the lender after a loan default, even if the lender has not yet obtained a receiver. In a lender's perfect world, the lease would contain provisions to this effect, so that the lender (and the borrower) would not need to obtain a separate agreement with the tenant. More typically, however, separate agreements of this type are required. The issue remains one that counsel may want to look for and mention in any lease review, particularly for a major lease.

22 One could argue that the lender's exposure is even less, at least if the lease is at market and the borrower could readily replace the tenant. Still, there will be a cost and delay.

23 As a practical matter, notice and cure rights are rather overrated, as few lenders will actually have any interest in curing defaults. They serve more as an early warning and monitoring device.

[41.30] F. Conditions to Lender Protections

To the extent that the lease builds in protections for a lender of the types suggested in this section, lender's counsel will want to scrutinize those protections to understand what conditions the lender must meet in order for these protections to be activated. For example, if the lease requires the tenant to receive notice before the lender will qualify for a particular protection, the lender will not want to rely on the landlord to remember to give that notice. Instead, the lender's counsel should update the closing checklist to include the notice to the tenant, and the lender and its counsel should make sure the notice is given. It represents yet another example of how lease review can drive closing documentation.

[41.31] G. One Last Category of Issues

In addition to all the lease-related issues this chapter specifically covers, a lender and its counsel should watch for any provisions in the leases that seem unusual or weird—anything that might create out-of-the-ordinary issues or problems. These provisions might include unusual tenant rights, unusual conditions to the tenant's obligations, evidence of a past dispute that may still fester, uncertainty about either party's obligations, evidence of possible zoning problems or disputes, unusual limitations on the landlord's remedies, or anything else that could undercut what the lender wants to see in the lease, as summarized earlier in this chapter. To identify anything of this type, whoever reviews the lease needs to avoid wearing blinders; instead, they should generally pay attention and keep their eyes open for unusual provisions beyond those discussed in this chapter.

CHAPTER FORTY-TWO

MODEL LEASE REVIEW CHECKLIST

Joshua Stein, Esq.*

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MODEL LEASE REVIEW CHECKLIST

Description. This Model Document is a lease review checklist, written from a lender’s perspective. It seeks to distill the highlights and most common problems that might appear in any commercial space lease. Any lease review checklist can be as long or as short as one might wish. That’s because leases raise an endless array of issues—anything that could affect the leased space or the building over the next many years. This checklist draws a line toward the “shorter” end of the spectrum.

For thoughts on how to use this checklist, please see chapter 44 on how a lender reviews a lease. There is much more to a lease review than filling out a checklist.

This model lease review checklist starts with a blank form, followed by a sample form filled out for a hypothetical (but unlikely) sample lease.

MODEL LEASE REVIEW CHECKLIST

Item	Summary
Prepared By	
Date Prepared	
Current Landlord	
Current Tenant	
Title(s) and Date(s) of Document(s) Reviewed	
Missing Documents	
Premises	
Term and Extension Options	
Expansion Rights	
Commencement Date or Remaining Conditions	

Item	Summary
Premises Delivery; Remedies for Late Delivery	
Base Rent	
Percentage Rent	
Escalations/Pass- Throughs	
Rent Offsets and Abatement Rights	
Buildout Obligations of Landlord and Tenant	
Security Deposit	
Permitted Uses	
Exclusive Use: Remedy for Landlord's Breach	
Covenant to Open and Operate: "Go Dark"; Recapture	
Radius Clause	
Tenant Termination Rights	
Landlord's Termination Rights	
Premises Maintenance and Repair	

MODEL LEASE REVIEW CHECKLIST

Item	Summary
Landlord's Obligations Regarding Premises	
Landlord's Obligations and Restrictions Outside Premises	
Alterations	
Bonding for Alterations and Right of Contest	
Insurance and Self-Insurance Rights	
Casualty	
Condemnation	
Tenant Financial Reporting	
Assignment; Subletting; Recapture; Allocation of Profits	
Release of Liability Upon Transfer	
Miscellaneous	
SNDA Obligations and Form	

If you have any questions about this summary or the lease itself, please give us a call. Thank you and best regards.

[NOTE: The following is a sample of how one could fill out—and slightly modify—the issues grid for a specific anchor lease.]

The following is a brief summary of some major or noteworthy terms of the proposed Ultimate Electronics lease for Arcadia Crossing. Overall, this lease is within the normal range of “anchor tenant” leases, although it appears to be closer to the “tenant-oriented” side of the spectrum. It is not, however, as tenant-oriented as a typical Home Depot lease.

Item	Summary
Prepared By	
Date Prepared	
Premises	42,000 square feet
Term	15 years, 3 months. Two 5-year options. Whether or not Tenant exercises any 5-year option(s), Tenant also has a 6-month option.
Commencement Date or Remaining Conditions	Earliest of July 1, 2015 or 150 days after building permit or Tenant’s opening for business. Either party can terminate if Commencement Date has not occurred a year after signing. (Timing may not work, given the July 1, 2015, alternative in defining Commencement Date.)
Delivery of Premises	January 4, 2015. For every day delay thereafter, 2 days free rent. After 30 days, Tenant can terminate.

MODEL LEASE REVIEW CHECKLIST

Item	Summary
Base Rent	\$37,625/mo (\$10.75/ft) for first 5 years, increasing by 10% starting year 6 and year 11. If Tenant obtains a judgment against Landlord, may offset up to 50% of base rent. If Tenant extends, then Base Rent rises to \$50,955/mo. (\$14.57/ft) starting year 16, then \$61,180/mo. (\$17.48/ft) starting year 21. If Tenant exercises its six-month renewal option, Base Rent rises by 10%.
Percentage Rent	None in most cases, but Tenant must report Gross Sales.
Escalations/Pass-Throughs	Tenant contributes its share, based on floor area, toward CAM (plus 10% overhead fee), insurance, utilities, and real estate taxes (excluding future special assessments). Tenant does not contribute to merchants' association.
Buildout	Landlord contributes \$10/ft upon substantial completion.
Security Deposit	None
Use; CC&R Issues	Electronics, office equipment, computers, etc. Existing CC&Rs prohibit this use. Landlord has 60 days to obtain a CC&R amendment, or Tenant can terminate and recover up to \$100,000 of its costs. What happened?
Exclusive	Retail and wholesale sale, distribution, installation and repair of televisions, video, home audio, mobile electronic equipment. If Landlord violates, Tenant's rent shifts to 2% of sales, but no termination rights for either party.

Item	Summary
Covenant to Operate	Tenant must open and must then operate for at least 5 days. Thereafter, if Tenant closes for 60 days and does not reopen within 60 days after notice (at any time) from Landlord, Landlord can terminate.
Radius Clause	Tenant cannot compete with itself within 2.5 miles in first 5 years.
Tenant Termination Right	In year 5 , if Tenant's sales are less than 90% of comparable stores in the chain, Tenant can terminate by paying \$150,000.
Landlord Obligations	Landlord is responsible for latent defects for six months. Landlord must preserve specified access routes. Landlord must maintain and operate shopping center to a standard of similar properties. Abatement and termination rights if Landlord fails to perform, after cure periods.
Premises Maintenance and Repair	Landlord maintains shell and structure. Landlord warrants existing HVAC for 12 months from delivery of possession. Tenant maintains interior, tenant improvements, and building systems. If Tenant replaces any building systems during the last 3 years, Landlord must contribute based on relative useful life remaining after the term (but useful life is capped at 5 years).
Alterations	No requirement for Tenant to post a bond , even if Tenant's credit deteriorates.

MODEL LEASE REVIEW CHECKLIST

Item	Summary
Insurance	Tenant provides liability coverage of \$3,000,000. Landlord can require increase per reasonable and customary practices for similar property. Tenant covenants to maintain its own casualty insurance (but no certificates, etc., for Landlord).
Off-Premises Restrictions	Lease restricts Landlord's expansion. Cannot evaluate without site plan, but the restrictions would appear to be of a type generally consistent with similar leases.
Casualty	Landlord must restore structure, but can terminate if work would take more than 120 days. If Tenant does not restore within a year, Tenant can give notice. If Landlord still has not restored after 90 days, Tenant can terminate. Rent abates to the extent Tenant cannot use the space.
Condemnation	First, Landlord receives up to \$420,000 for unamortized contribution to buildout. Second, Tenant receives its unamortized buildout cost. Third, to Landlord.
Transfer of Lease	Landlord cannot unreasonably withhold, but may recapture. Tenant receives all net profit from sale of lease, but not from sale of business (a dispute waiting to happen). No release of Tenant upon assignment. Tenant may mortgage its lease and personalty (initially to XYZ).
Miscellaneous	Mutual obligation to reimburse attorney fees, if dispute arises.

Item	Summary
SNDA	Standard, with minimum tenant negotiations. Tenant can abate all rent until Landlord delivers initial SNDA. (Although such a clause is inadvisable from a Landlord's perspective, it does not cause great concern to a mortgagee, assuming (a) mortgagee can accomplish the SNDA without borrower help; or (b) only one mortgage.)

If you have any questions about this summary or the lease itself, please give us a call. In the meantime, assuming the Lease meets with your approval as a “business” matter, we see no reason to disapprove it as a legal matter, although it should be confirmed that the final lease tracks the draft.

Thank you and best regards.

CHAPTER FORTY-THREE

THE USE AND MISUSE OF ESTOPPEL CERTIFICATES

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- * Originally published by Andrew Herz, Esq., in the March 2000 newsletter of the American College of Real Estate Lawyers, who acknowledged the editorial comments of ACREL members Patrick A. Randolph, Mark A. Senn, and Joshua Stein, and the contributions of colleagues Kenneth L. Sankin and Suzanne Mikos.

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[43.0] I. INTRODUCTION

Estoppel certificates are unusual and misused instruments. They start out being considered unimportant lease boilerplate during lease negotiations, progress to being critical documents immediately before a sale or financing, yet thereafter are ignored completely. Most leases contain an obligation by the tenant (and frequently by the landlord) to deliver an estoppel certificate within a specified period of time, certifying to the other party as to certain matters relating to the lease. Only in the context of leases are estoppel certificates critical documents. Further, lenders and purchasers frequently try to use them for purposes for which they were not intended.

Almost all important encumbrances on title are disclosed by the public record. A lender or purchaser can easily learn the amount of judgments, the size of mortgages, and the amounts claimed by mechanic's lienors. This is not so with leases. In most jurisdictions, a tenant, by having possession of premises, puts the world on notice as to the existence of all of its rights, whatever those rights may be. Moreover, a tenant is generally not required, absent a contractual obligation to do so, to disclose to anyone the nature and extent of its rights and obligations and a variety of facts relating to the lease.

Thus, the importance of the estoppel certificate becomes apparent. The definition of what constitutes the "lease agreement" is in a state of constant flux. Because the terms of a lease are not generally reflected on the public record, leases are frequently amended, and the landlord/tenant relationship is constantly "under construction." This explains the critical need for a lender or purchaser to confirm the lease's status—particularly with respect to a claim or defense of the tenant that cannot be independently identified by looking at the lease. Despite all of this, landlords themselves rarely use estoppel certificates to confirm the status of their leases. The tenant should request an estoppel certificate from the landlord at the time of lease negotiations as it may be helpful and necessary if the tenant later wants to assign its lease, either in the context of a real estate transaction or in a corporate transaction affecting the tenant and its assets.

Although the goal of any estoppel certificate is to "estop" a tenant from asserting claims inconsistent with the certificate, the tenant's mere signing

of an estoppel certificate will not necessarily achieve that desired result.¹ The doctrine of estoppel is grounded in common-law principles of equity.² Before any party can claim an “estoppel” against another, that party (here the lender or purchaser) must be able to prove the following elements:³

- (i) lack of knowledge of the facts in question;
- (ii) lack of any means of obtaining such knowledge;
- (iii) reliance on the words or conduct of the party to be estopped;
- (iv) reasonableness and good faith in so relying; and
- (v) action, based on such reliance, resulting in a prejudicial change to the party’s position.

Estoppel is an equitable principle. Accordingly, the party seeking its benefit must be innocent and must act in good faith. A party cannot assert estoppel in good faith where it is charged with actual knowledge of the matters in the estoppel certificate.⁴ In some jurisdictions, ignorance of the truth of the matter in question is good enough to allow enforcement of an

1 *See, e.g., Bush Realty Assocs. v. A.M. Cosmetics, Inc.*, 2 A.D.3d 270, 770 N.Y.S.2d 19 (1st Dep’t 2003) (estoppel certificate not enforced where there was sufficient evidence to find that relying party had actual knowledge that representation was not accurate); *Robert T. Miner, M.D., Inc., v. Tustin Ave. Investors, LLC*, 116 Cal. App. 4th 264 (Cal. Ct. App. 2004) (estoppel certificate not enforced where ambiguity existed in estoppel certificate and certificate was contradicted by lease); *but see Plaza Freeway Ltd. P’ship v. First Mountain Bank*, 81 Cal. App. 4th 616 (Cal. Ct. App. 2000) (estoppel certificate that contradicted lease was enforced); *see also Santaro v. Jack of Hearts Carpet Co.*, 6 Misc. 3d 1024(A), 800 N.Y.S.2d 356 (Sup. Ct., Onondaga Co.) *aff’d*, 23 A.D.3d 1073, 803 N.Y.S.2d 501 (4th Dep’t 2005) (estoppel certificate certifying existence and terms of lease (but not rent) was not sufficient alone to establish a contract where landlord failed to produce lease documents); *Katz v. M.M.B. Co.*, 1986 Ohio App. LEXIS 6734 (even though tenant signed estoppel certificate it was not binding on the tenant because it had limited knowledge of the issues involved); *see also* Jeffrey B. Steiner and Zachary Samton, *Loan Due Diligence: Estoppel Certificates*, N.Y.L.J., May 19, 2010, p. 5, col. 2.

2 *See* Brent C. Shaffer, *Using Tenant Estoppel Letters to Cut to the Chase*, Prob. & Prop., Nov./Dec. 2001.

3 While the elements vary based on jurisdiction, this is a relatively representative amalgam. *See* cases cited *supra* note 1 for variations on the elements required.

4 *See, e.g., JRK Franklin, LLC v. 164 E. 87 St. LLC*, 27 A.D.3d 392, 393, 812 N.Y.S.2d 506 (1st Dep’t 2006) (“an estoppel certificate will be enforced unless the certifying party can show . . . that the assignee accepted the certificate with knowledge of the contrary, and true, state of the facts”); *see also Hammelburger v. Foursome Inn Corp.*, 54 N.Y.2d 580, 587, 446 N.Y.S.2d 917 (1981).

equitable estoppel.⁵ Other courts, though, will require the party relying on the estoppel certificate to exercise some degree of due diligence, reasonable care, and circumspection in ascertaining the underlying facts.⁶ Furthermore, a party that has been placed on “inquiry notice” as to the truth of the matter in question or who had the means and opportunity to discern the truth generally cannot assert an estoppel. Similarly, where both parties are equally informed of the matters at hand and have equal means of obtaining the necessary knowledge, an estoppel will not be given effect, and if the party seeking the estoppel has obtained knowledge that reveals information contrary to that stated in the estoppel certificate, reasonable reliance cannot be established.⁷

A party trying to claim estoppel also must experience a material and detrimental change in its position or status from that which it would otherwise have occupied and the alleged detriment or injury must arise from the denial of the estoppel.⁸ In other words, the court needs to conclude that an injury will result if the other party is not estopped from denying the truth of the statement previously made in the certificate.

This chapter will discuss the elements of, and the obligation to provide, an estoppel certificate; the effectiveness of estoppel certificates in achieving an actual estoppel; and some common problems and pitfalls practitioners encounter in negotiating, executing, and enforcing estoppel certificates in leasing transactions. It is important that the tenant understand that the request for execution and delivery of an estoppel certificate has potential legal and business implications and should be reviewed by in-house or outside counsel.

5 *JRK Franklin*, 27 A.D.3d 392 at 507.

6 *See, e.g., Resolution Trust Corp. v. D.C.*, 78 F.3d 606, 609 (D.C. Cir. 1996) (citing Restatement (Second) of Contracts § 172, note b: “if the recipient knows that the assertion is false or should have discovered its falsity by making a cursory examination, his reliance is clearly not justified and he is not entitled to relief”); *Bush*, *supra* note 1, at 20; *MS P’ship v. Wal-Mart Stores, Inc.*, 2 A.D.3d 1482, 1484, 770 N.Y.S.2d 514 (4th Dep’t 2003) (estoppel not enforced because relying party had opportunity to inspect).

7 *Cf. Miner*, *supra* note 1.

8 *See Health-Loom Corp. v. Soho Plaza Corp.*, 272 A.D.2d 179, 182, 709 N.Y.S.2d 165 (1st Dep’t 2000); *BWA Corp. v. Alltrans Express U.S.A., Inc.*, 112 A.D.2d 850, 853, 493 N.Y.S.2d 1 (1st Dep’t 1985); *JRK Franklin*, *supra* note 4, at 507.

[43.1] II. ELEMENTS OF AN ESTOPPEL CERTIFICATE

Estoppel certificates generally contain the following elements, some of which are more commonly encountered than others:

[43.2] A. Identification of the Lease and All Amendments and Related Documents

By identifying all documents that constitute the “lease agreement” package, the party receiving the estoppel certificate can satisfy itself that it has received and reviewed all relevant lease documents. Often a form of estoppel certificate will say that a true and correct copy of the lease is attached for purposes of identification. In other instances, parties do not attach such documents, partly because it can become unwieldy to do so.⁹ Nevertheless, attaching the full lease document is good practice, and could serve to raise any dormant disagreements that may exist between the parties regarding the status of the lease.¹⁰

The party delivering the certificate must be careful to confirm that all amendments and ancillary documents that could modify the lease are mentioned in the estoppel certificate. Documents that could potentially be included in defining the “lease agreement” include: commencement date agreements; alteration agreements and consents; the exercise (or waiver) of options; consents to prior assignments and sublettings; settlement agreements regarding disputes under the lease; subordination, nondisturbance, and attornment agreements; memoranda of lease; recognition agreements with ground lessors; change of address notices; material correspondence; and even prior estoppel certificates. Rarely, though, do the parties adequately consider such ancillary documents in defining the “lease package.”

In any sale transaction, purchaser’s counsel will want an estoppel certificate to cover as many issues and be as broad as possible. Seller’s counsel will want to keep things simple and will try to strictly construe the “lease package” to include only the lease and formal amendments. If all the potential lease documents described above are included in the “lease package,” a tenant may find it difficult to confirm documents it may have

9 See generally Earl L. Segal & Michael A. Segal, *Putting the “Stop” Back in Estoppels*, 12 Metro. Corporate Counsel 4 (April 2004).

10 See Santaro, *supra* note 1 (where estoppel certified as to existence of lease, but landlord failed to produce an executed lease agreement).

misplaced. When negotiating an obligation to deliver estoppel certificates from tenants, seller's counsel must be aware of the terms of the estoppel provisions in the existing leases. A tenant can only be required to give the information that its particular lease requires it to provide. Similarly, the seller can only agree to provide to the purchaser information that is set forth in the estoppel provisions of its existing leases with the tenants. It is therefore important when representing a landlord that the direct lease contemplate that a tenant be required to provide such further information as a lender or purchaser reasonably may request.

[43.3] B. Confirmation of Factual Matters Not Documented Within the Lease Itself

Once the lease document is defined, the next most important job the certificate performs is to require the party giving the estoppel to confirm (or in some cases, to establish) that certain elements of the landlord/tenant relationship that cannot be confirmed by reviewing the documents have occurred or, conversely, do not exist. These may include:

(A) setting forth key lease dates, such as the commencement date, the rent commencement date, and the expiration date, at least where these dates are not certain but depend upon the occurrence of certain events;

(B) determining that contingencies or conditions precedent referred to in the lease have been satisfied;

(C) confirming satisfactory performance by the landlord of any required work (or, if not, what loose ends remain), the payment of monies owed by the landlord to the tenant in connection with the initial construction or build-out of the premises, and the taking of occupancy of the premises by the tenant;¹¹

(D) confirming the current escalated rent where it cannot be determined within the four corners of the lease; and

(E) establishing whether any default exists. This can be worded in various ways relating to whether a present default exists and whether

¹¹ The request by landlord for its mortgagee or prospective purchaser to certify any amounts under a work allowance that are overdue, or whether other disputes exist that may cause unpaid amounts to be paid to tenant or disputes resolved so that landlord can obtain a clean estoppel certificate from the tenant. At a minimum, noting that a dispute exists when returning the estoppel certificate may preserve rights the tenant may want to litigate and arbitrate in the future, which rights might be prejudiced in the absence of some mention of the dispute.

notice has been given. Frequently this fact is confirmed only to the best of the knowledge of the signer, having made no specific inquiry. As a practical matter, such a qualification should be acceptable to the recipient as experienced counsel and its client know it is a true statement.

[43.4] C. Confirmation of Independent Facts Relating to the Tenant

Often a landlord (or purchaser or lender) may want to know about facts outside of the lease itself which affect the ability of the tenant to continue to perform its obligations under the lease. These could include:

(A) the financial condition of the tenant or guarantor delivering the certificate and its solvency;

(B) whether such party is involved in any litigation that could adversely affect its ability to perform;

(C) such party's net worth, especially where there is a net worth threshold for obligations under the lease such as posting security, delivering bonds for construction, or obtaining a release of liability upon an assignment; and

(D) composition of the ownership of such party, especially where the lease has been assigned or where the premises is sublet from a related party where there is an obligation that such relationship continue.

Frequently, the obligation of a party to certify as to any of the above matters may be outside the scope of the required certificate called for under the lease. Even if some of the information described above is contemplated by the lease, any tenant agreeing to provide sensitive or confidential information, should condition such obligation upon receiving a confidentiality agreement in form satisfactory to it. In such an instance, the tenant would be within its rights to refuse to provide any such information or confirmation.

[43.5] D. Confirmation of Matters Set Forth in the Lease

Many estoppel certificates repeat detailed information that is clearly set forth in the lease such as the rent, the premises, and key dates. For a lender or purchaser, it is often easier to verify lease information set forth in an offering memorandum, loan application, rent roll, or contract of sale by checking estoppel certificates rather than the leases themselves. To the

extent that the information in the estoppel certificate matches the lease, no one is prejudiced and, indeed, the review process may be made simpler. But what if there are major discrepancies?¹² What if the tenant certified that it did not have a renewal option when it did?¹³ Would not the lease, rather than the estoppel certificate, govern in the event of a conflict since the lease constitutes the best evidence? Could the party receiving the certificate truly say that it relied upon the facts in the estoppel certificate?

[43.6] E. Attempts to Modify the Lease by the Landlord or, More Often, Its Lender

A lender will often try to use estoppel certificates to impose upon the tenant new and independent duties to the lender.¹⁴ These either (a) obligate the tenant to attorn to a lender or recognize an exercise of an assignment of rents to the lender or (b) grant the lender additional rights and time to perform in the event of the landlord's failure to perform. The purpose of these changes is to give the lender the benefits of a subordination and attornment agreement without having to grant the tenant nondisturbance protections.

Usually these are rights that a landlord could have anticipated and provided for in the initial lease. Had they been included in the original lease, they probably would have been acceptable to the tenant. But they were not. If it arises only in the estoppel certificate, does the obligation of the tenant to the lender continue to have a life of its own? If the landlord and the tenant amend the lease and ratify it without referring to the estoppel certificate, do the obligations undertaken for the benefit of the lender go away? If the tenant forgets about the estoppel certificate, does it have liability to the lender (or might its purported termination even be ineffective) if the tenant later terminates the lease because of the landlord's default without giving notice and a cure right to the lender? The better practice in these cases would be to amend the lease to add these rights and provide that it may not be further amended without the lender's consent except for ministerial amendments or amendments required to reflect the exercise of rights under the lease. The lender should not be able to prohibit these

12 See *id.* (citing *Travelers Ins. Co. v. Liljeberg Enters., Inc.*, 799 F. Supp. 641, 645 (E.D. La. 1992) (lease termination date changed from 10 years to 7 years after commencement based on ambiguous estoppel certificate)).

13 See *Miner supra* note 1 (where tenant failed to fill in blank for renewal rights, ambiguity between the lease and the estoppel certificate should be construed against the drafter of the lease and estoppel, here, the landlord's, predecessor); but see *Plaza, supra* note 1.

14 See generally Segal & Segal, *supra* note 9.

types of amendments. To amend the lease, though, the tenant must be willing to do so and may demand some consideration. Another possibility would be to accept the lender's concept if it splits the request into one for a separate estoppel certificate and one for a subordination, non-disturbance and attornment agreement (given that the latter agreement would provide the non-disturbance protection that lender had been trying to avoid by its request only for an estoppel certificate).

[43.7] III. OBLIGATION TO DELIVER ESTOPPEL CERTIFICATE

Normally, a lease specifically sets forth what information may be required in the estoppel certificate. Some leases include a form of estoppel certificate as an exhibit to the original lease. Frequently there is an omnibus clause at the end of the lease provision covering estoppel certificates, which enables either the landlord or the lender to obtain such additional information as such party may reasonably request. This generally is intended to ensure that novel requirements of future lenders or purchasers can be satisfied.

Absent an express obligation to give an estoppel certificate, a tenant is not obligated to execute or deliver one.¹⁵ But a purchaser that acquires property accepts title subject to any and all rights that the tenant may have. For example, a tenant in occupancy might hold an unrecorded lease that includes an option to acquire the property. Such option will take priority over a subsequent lien, purchaser, or new lease with a new tenant. Therefore, absent delivery of an estoppel certificate, a purchaser of property has no assurance as to the rights of a tenant. Of course, a seller can represent as to the tenant's rights but such representations, if given, typically lapse after a stated survival period and might not be backed by meaningful credit.

Well-negotiated leases will also require the landlord to deliver its estoppel certificate upon the tenant's request. This is an especially useful tool which may be essential for the tenant in the event of an assignment or sublease or upon a sale of its assets.

¹⁵ In fact, some take the position that even if the tenant is contractually obligated to deliver an estoppel certificate, a landlord faced with a tenant's refusal to do so does not have an appropriate remedy. See John L. Opar, *Estoppel Certificates: Handle With Care*, N.Y.L.J., Sept. 19, 2005, p. 9, col. 4.

Attorneys representing purchasers not only negotiate what is included in the estoppel certificate, but they also negotiate the percentage of the tenants required to provide estoppel certificates, because generally it is very difficult to get all the tenants in a building to deliver estoppel certificates. The percentage can be based on a required aggregate square footage of the leases in the building, a specified percentage of tenants, or both. If less than all the tenants sign estoppel certificates, the seller/landlord may be required to give a seller's or landlord's estoppel certificate (more accurately, warranty certificate) upon which the purchaser can rely for a specified period to cover the leases for which estoppel certificates are not obtained, or until such estoppel certificates are obtained.

[43.8] IV. IS AN ESTOPPEL CERTIFICATE EFFECTIVE?

Despite the importance and potential value of an estoppel certificate, it is a document that landlords generally do not require to be delivered in the ordinary course of business. While sophisticated landlords will go to the trouble and expense of having annual financial statements prepared and lenders will require their borrowers to submit financial information regarding their properties on a recurring basis, landlords, for the most part, do not require tenants to deliver estoppel certificates on any regular basis. Why is this? Probably the main reason is that landlords do not want to invest the effort necessary to obtain estoppel certificates. Landlords inadvertently may be making a good business judgment given the certificate would not “estop” a tenant from asserting a claim different than as set forth in the estoppel certificate unless the landlord relied upon it. Even if the estoppel certificate purports to (and does) amend the terms of the lease for the benefit of a new landlord or a lender, it is rarely thereafter treated as a “lease document” in defining what constitutes the lease (even if the lease is subsequently amended).¹⁶

Perhaps a mutual estoppel certificate between the landlord and the tenant would constitute adequate consideration and obviate the need for reliance upon the principle of estoppel. But, alas, it is often much easier for a landlord to point to the provision in the lease that requires the tenant to provide an estoppel certificate than to concede anything to the tenant. Perhaps lease drafters can solve the “detrimental reliance” problem by adding language to the lease to eliminate the problem. And perhaps not.

¹⁶ But see *Miner*, *supra* note 1, at 179.

Thus, unless the tenant could in fact be estopped, it may be argued that estoppel certificates are of fleeting relevance or importance. Nevertheless, in those few instances where there is a major discrepancy between a matter asserted in the estoppel certificate and a subsequent claim by a tenant, the estoppel certificate can be of great importance. Issues raised in estoppel certificates appear, however, to be rarely litigated.¹⁷

[43.9] V. PROBLEMS AND PITFALLS

Each party to a leasing transaction, from the tenant to the landlord to the lender, encounters various pitfalls and concerns in creating the most favorable and effective estoppel certificate. As discussed above, reliance is an essential element for the effectiveness of an estoppel certificate. However, estoppel certificates are frequently treated as post-closing items and a party receiving the benefit of an estoppel certificate cannot say it relied upon the estoppel certificate in acquiring the property or making a loan if the estoppel certificate is delivered after the closing of the acquisition or the loan. Additionally, an estoppel certificate should state that it is made as of a specific date and exactly who may rely upon it, so if a party is not an intended beneficiary, it would have no right to so rely.¹⁸

To a tenant, estoppel certificates are fraught with peril. Tenants often sign them without advice of counsel, sometimes without careful (or even any) thought or review. Commonly, they also are utilized as a “back door amendment” of the lease to create duties and obligations to lenders and other strangers. Similarly, language in an estoppel stating the tenant is delivering an estoppel to induce a lender to make its loan should be deleted.

To a landlord, estoppel certificates can be troublesome. For a closing, a landlord must play “middleman” between a tenant and a new purchaser or a lender that requires the tenant to sign a particular form of estoppel certificate. Even when a landlord obtains an estoppel certificate for its own benefit, the landlord may not be able to derive benefit from the estoppel certificate because it cannot show reliance. Whenever a lease attaches consequences to possible future facts relating to the tenant, landlord’s counsel negotiating that lease should think about how the landlord—and its possible lender and possible purchaser—will be able to monitor and stay fully informed about those future facts. It is a concern that landlord’s

¹⁷ See Opar, *supra* note 15.

¹⁸ Cf. Santaro, *supra* note 1 (estoppel certificate not enforced in landlord’s favor, in part because certificate was addressed to a third party and not to landlord).

counsel should raise whenever the parties negotiate provisions of this type, and take into account when tailoring the estoppel certificate requirements in the lease.

It is typical that landlord's counsel will want the ability to obtain a tenant estoppel within a relatively short period of time. The lease may provide that if tenant does not respond in a timely manner, landlord may sign the estoppel as attorney-in-fact for tenant or tenant's failure to timely provide an estoppel is a default under the lease. This solution will likely be limited to any recourse the potential purchaser or lender can negotiate from the seller, as it is likely the tenant will be able to avoid being estopped with respect to such matters.¹⁹

[43.10] VI. CONCLUSION

Estoppel certificates are neglected progeny of leases.²⁰ Their enforceability relies upon basic principles of equity rather than principles of contract law that require the giving of consideration. As such, they are often misused because they seek to do more than they were intended to do and are often utilized in situations where reliance upon them is inappropriate. If practitioners better understood how, when, and to what extent estoppel certificates can effectively be relied upon, they would be easier to negotiate and might add more value for everyone involved.

19 See Shaffer, *supra* note 2 (citing *Hunt v. Rousmainier's Adm'rs*, 21 U.S. 174, 201-03 (1823)). Shaffer advises against lenders and purchasers relying on such estoppel certificates for these reasons.

20 See Jerald M. Goodman, Sharon D. Brown, and Stephen J. Messinger, Ten Lease Provisions That Get No Respect, 28 GP Solo 24 (March 2011).

CHAPTER FORTY-FOUR

**MODEL TENANT ESTOPPEL
CERTIFICATE**

Joshua Stein, Esq.

Whenever a commercial real estate Lender accepts a mortgage on income-producing real property, the Lender knows that the Leases of the property will deliver the cash flow that should enable the Borrower to pay the loan. The Leases really matter. Without the Leases, the Borrower may find itself unable to pay the loan, unless the Borrower's principals decide to dip into their pockets—something the Lender needs to assume will never happen. Therefore, every commercial mortgage lender will want to know that: (a) the Leases the Lender has reviewed accurately reflect “the deal” between the Borrower and its Tenants; (b) the Tenants are happily paying their rent without major issues; and (c) the Leases and the Tenants will not produce unpleasant surprises after the closing based on problems that existed when the closing occurred.¹ A Purchaser of the same type of real estate will have similar concerns.

For a typical commercial mortgage loan closing, whether for an acquisition loan or a refinancing, the Lender or Purchaser obtains the comfort it needs by insisting that the Borrower (or Seller, in the case of a purchase and sale) obtain estoppel certificates from Tenants. In these certificates, the Tenants confirm certain facts about their Leases that give comfort to the Lender or Purchaser to help close the loan or purchase.

In preparing to close any commercial mortgage loan, a Borrower and a Lender may negotiate (or play a game of “chicken”) regarding exactly how many estoppel certificates the Borrower must deliver, and from which Tenants. A Lender's requirements and expectations will vary, but a Lender will typically want estoppel certificates from all the “major” Tenants and enough other Tenants to cover some high percentage of the total square footage of the property. That percentage will typically be at least 5% to 10% above the loan-to-value ratio of the loan, although it is entirely a matter of the particular Lender's tastes and the circumstances of each particular loan.

The following model document consists of a tenant estoppel certificate, suitable for use in any commercial real estate financing transaction with existing tenancies (i.e., almost all such transactions). This document is prepared from the perspective of the Lender. It also includes provisions that accommodate a simultaneous purchase of the same real property, and considers the needs of the Purchaser (comparable to the needs of a

¹ Problems that first arise after closing are handled through different mechanisms, such as nondisturbance agreements. An estoppel certificate focuses on the condition of leases and tenancies only at the moment of closing. Sometimes Lender's counsel will try to expand an estoppel certificate to include post-closing obligations (for an example, see suggestions later in this Chapter). That approach may create issues and problems, hence is disfavored.

Lender). For a refinancing, Tenants may object to having the estoppel certificate benefit the Landlord, so it may make sense to delete the Landlord as a party entitled to rely on the certificate (as discussed more fully below).

When a Landlord prepares a Lease, this model estoppel certificate or its equivalent can be attached as an exhibit, to avoid subsequent issues about what the Tenant must sign.² It can also be used in the same way as a standard estoppel certificate in loan documents. A careful Borrower will, however, insist that if a Lease provides for a particular form of estoppel certificate, then the Borrower never needs to deliver anything more than the Lease contemplates.

1. Substantive Comments

The following substantive issues arise in this document.

1.1 *Trivial Leases.* For minor Leases, a Lender might limit the estoppel certificate to a confirmation that the Lease, as defined in the estoppel certificate (including all amendments, etc.), has not been amended and is in full force and effect. The Lender might also want to include the Tenant's acknowledgment that the Lease has been assigned and Tenant's agreement to pay rent to Lender (or its designee) if directed to do so. Whether these assurances are necessary or sufficient depends on the circumstances.

1.2 *Deal-Specific Assurances.* Consider whether to obtain any assurances from the Tenant that may be specific to this particular Lease or project, such as: (a) the Tenant's option to cancel has expired without exercise; (b) the same is true for any similar option the Landlord might have; (c) the Tenant has taken possession of and approved the premises; and (d) similar matters. If review of the Lease discloses imperfections or ambiguities, an estoppel certificate may offer an opportunity to correct them. On the other hand, estoppel certificates may not be as reliable as full-blown Lease amendments, because of concerns about their binding effect, particularly on successors and assigns. Any deal-specific estoppel provisions will require early and thorough due diligence review of the Leases.

2 For added comfort, though, Landlord will also want to include a provision in the Lease in which Tenant agrees to sign any other reasonable form of estoppel certificate that a Lender or Purchaser later decides to require.

1.3 *Scope.* This model estoppel certificate offers a “base case” first, followed by a range of optional provisions that might apply based on the Lender’s tastes or the circumstances of the particular transaction. For a “typical” transaction, few if any of these optional provisions will make sense.

1.4 *Effect on Lease.* A careful Tenant may insist that an estoppel certificate state that nothing in it modifies or waives anything in the Lease. Depending on the wording, such a qualification may limit the utility of the estoppel certificate. It is, however, not unreasonable for a Tenant to insist that the Lender read and understand the Lease, so that the estoppel certificate addresses only factual circumstances that cannot be understood or confirmed merely by reading the Lease. This model contains no such limiting language of the type a Tenant might request.

1.5 *Knowledge.* Some Tenant assurances in this model estoppel certificate are limited by actual knowledge. These limitations are “market standard,” but a Lender might choose to take a more aggressive position.

1.6 *SNDA Issues.* One can add a few paragraphs to an estoppel certificate to try to give the Lender many benefits that it might achieve from a nondisturbance agreement (an SNDA).³ Sample language to that effect appears in the optional provisions after this model estoppel certificate. The first part of that language covers only the SNDA issues that tend not to create controversy: (a) pure “subordination”; (b) continuation of the Lease after foreclosure; and (c) protecting the successor owner from “Landlord-Tenant Conspiracies.” The last paragraph of that language covers SNDA issues that do tend to create controversy, which the writer has described as “Lender-Tenant Risk Shifting.” To the extent that one can cover these issues in an estoppel certificate, rather than an SNDA, this can certainly speed up loan closing. The use of an estoppel certificate as a general problem-solving device will not always work perfectly, however, for at least these reasons:

- *Issues and Delays.* If the Lease does not already obligate the Tenant to sign this particular form of estoppel certificate, inclusion of SNDA-type provisions in an estoppel certificate may create issues and delays that otherwise would not occur.

3 The issue of pure “subordination” rarely matters much. For more on SNDA’s, see Joshua Stein, *Needless Disturbances: Do Nondisturbance Agreements Justify All the Time and Trouble?*, 37 American Bar Association Real Property, Probate and Trust Journal, Winter 2003, at 703.

- *Lender Obligations.* To the extent that SNDA-type provisions impose obligations on the Lender (and give protections to the Tenant), the Tenant will want the Lender to agree to them. This can certainly be done in a number of ways without fully negotiating a traditional SNDA between the Lender and the Tenant (for example, the Lender can sign a one-paragraph letter agreeing to the Lender obligations and Tenant protections). It adds another piece of paper to the transaction, as well as a deviation from ordinary closing procedures.
- *Understanding the File.* After the loan closing, anyone trying to understand the Lease terms or the relationship between the Lender and the Tenant will not necessarily look in an estoppel certificate to find it, and will instead look for an SNDA. The estoppel certificate might simply get lost (a fate less likely to befall a Lease amendment), unless it has been recorded, which is rarely done for estoppel certificates.
- *Future Refinancing.* An estoppel certificate (or SNDA) delivered to the present Lender might not help a future Lender. There's no reason why this should necessarily always be the case, but it's the typical situation.
- *Lease Modification.* The estoppel certificate might be considered a Lease modification. The Tenant might later raise issues about whether the estoppel certificate truly could achieve a modification of the Lease.
- *Tenant's Assignment.* If the Tenant assigns its Lease, the estoppel certificate may not bind the Tenant's assignees.
- *Successors and Assigns.* Can the Lender's assignee also rely on the estoppel certificate? Probably yes, especially if the estoppel certificate says so. But what if the estoppel certificate is silent on that point? Will the estoppel certificate bind the Landlord's suc-

cessors and assigns? Probably not, unless they knew about it.

- *Future Estoppel Certificates.* When the parties later amend the Lease (or issue a future estoppel certificate), they may not remember to list the estoppel certificate as one of the documents that constitute the Lease. If not, the future Lease amendment (or even some future estoppel certificate) may erase the lender-protection estoppel certificate from the record of Lease documents.
- *Nonstandard.* The entire arrangement is rather non-standard, hence may produce left-field objections and problems that one cannot envision in the abstract. The parties may prefer to use a full-blown SNDA just to be standard and customary, which is usually the preferred approach in any real estate transaction.

Despite all these limitations and issues, a Lender may still find that it makes sense to build limited SNDA provisions into an estoppel certificate. For those occasions, the sample language offered in this model estoppel certificate should do the job, allowing the Lender to easily dispose of all limitations and issues raised above. On the other hand, a Lender could also easily conclude that these limitations and issues represent serious obstacles to the way Lenders typically close loans. In that case, the Lender would decide to require a separate SNDA and not include the suggested language in the estoppel certificate.

1.7 *Why Bother?* Estoppel certificates assume the Seller or Borrower is lying to the Buyer or Lender. These documents require a significant amount of work to obtain. They give Tenants an opportunity to whine and try to exercise leverage. If a creditworthy guarantor is willing to give the Buyer or Lender assurances similar to those in an estoppel certificate, the parties might consider replacing the estoppel certificate with those creditworthy assurances.⁴ If the estoppel certificate arises in the context of a ground Lease (where an existing space lease will become a sublease), the

⁴ Such certificates, when given, are often referred to as “Seller Estoppel Certificates” or “Borrower Estoppel Certificates.” In fact, they are not estoppel certificates at all, but warranty certificates that often repeat ordinary representations and warranties from the loan documents. If they don’t come from someone creditworthy—or if they are subject to the nonrecourse clause in the loan documents—then they add no value at all.

ground lessor might provide representations and warranties and allow the ground lessee to offset against ground rent if those representations and warranties prove wrong.

1.8 *Assignment of Existing SNDA.* If a new Lender is refinancing a loan held by an existing Lender that previously entered into a satisfactory SNDA with this Tenant (very often the case), then the existing Lender could assign the SNDA to the new Lender (to avoid the need to negotiate and obtain Tenant signatures on a new SNDA). That approach makes particular sense in New York, where the existing Lender will typically assign the existing mortgage to the new Lender anyway. The assignment (or a separate assignment) just needs to extend to the SNDA that the existing Lender signed with the Tenant. If the parties do that, then this estoppel certificate could include language designed to give the new Lender comfort about the SNDA already in place and its assignment. Sample language to this effect appears within the optional provisions after the model estoppel certificate. A careful Tenant will ask the new Lender to confirm and agree to any Lender nondisturbance obligations in the SNDA being assigned. This could be achieved with an appropriate countersignature of the assignment, a one-paragraph letter from the new Lender or the addition of an appropriate statement to the loan documents.

2. Points Not Covered

An estoppel certificate could cover these points, but this one does not:

2.1 *Estoppel for Acquisition.* If this form of estoppel certificate is used for a simultaneous acquisition of the property, then the Purchaser/Borrower will want to confirm that the purchase and sale documents match up to the requirements for delivery of estoppel certificates in the loan commitment.

2.2 *Economic Terms.* Some Lenders like to restate the fundamental economic terms of the Lease in the estoppel certificate, reducing the more burdensome Lease review process to an estoppel certificate review process. Sophisticated Tenants typically reject that approach, as it shifts to them the risk of transcription errors. They will usually only confirm that the Lease has not been amended except as the estoppel certificate states, and then require the Lender to read the Lease. The form of estoppel certificate offered here requires Tenant to confirm the amount of Fixed Rent only if it has been subject to variable adjustments. It does not otherwise require Tenant to summarize or confirm financial terms of the Lease. If

the Lender prefers a more exhaustive form of estoppel certificate, this one will need to be changed.

3. Checklist

Consider these issues when using this estoppel certificate:

3.1 *Customization.* Like any other document, an estoppel certificate will always need to be customized for the particular context and circumstances. Brackets, footnotes, and comments in this model indicate provisions particularly likely to need adjustment.

3.2 *Fact Checking.* When a Borrower/Landlord prepares estoppel certificates for execution by Tenants, the Borrower/Landlord should rigorously check the Lease files to identify and list all possible documents that modify the Lease. These could include side letters, correspondence, confirmation letters (e.g., regarding exercise of an option) or even emails.

3.3 *Obtaining from Tenant.* Tenants use requests for estoppel certificates as an opportunity to complain and raise issues. Even if a Tenant does not do so, at a minimum, the Tenant will want to assure the estoppel certificate is correct. For those reasons, the process of obtaining estoppel certificates from Tenants is typically slow and difficult. Therefore allow plenty of lead time. The more information the estoppel certificate requests, and the longer and more “off market” it is, the more time Tenants will take to respond. As a matter of strategy, Lenders will usually want to make it clear they will tolerate exceptions in the estoppel certificate rather than let Tenants believe that an “unclean” estoppel certificate will give any Tenant holdup value for a transaction. Typically, a Lender or Purchaser would prefer to receive an estoppel certificate with minor exceptions and issues than to receive no estoppel certificate at all.

3.4 *Recordation.* Ordinarily, a Tenant estoppel certificate will only be recorded if a memorandum of Lease was recorded, and not necessarily even then. Ideally, the estoppel certificate should be recorded whenever it modifies the Lease. An even tidier approach is to relabel the document as a Lease amendment, since it is modifying the Lease, and then record it or not depending on whether a memorandum of Lease was recorded. If an estoppel certificate will be recorded, think about any forms, affidavits, and tax returns that may be required to do so. Note that this model estoppel certificate is not in recordable form.

3.5 *Execution.* Ensure that all necessary parties sign the estoppel, including guarantors. This form of estoppel provides for a guarantor confirmation.

3.6 *Exhibits.* Update the list of exhibits to reflect which possible exhibits, if any, are being attached. For user convenience, Lender may prefer to collect in an exhibit (probably Exhibit A) all Lease-specific exceptions and variable items. This way, the text of the estoppel certificate would not vary much for individual Leases. This approach may save some work and coordination, if one person prepares the text of the estoppel certificate and another person prepares the Lease-specific exhibit. On the other hand, it is not too hard to tailor the form of estoppel certificate for the details of each particular Lease.

3.7 *Signed Estoppel Certificates.* As Tenants sign and return estoppel certificates, track them and maintain them in an organized fashion. Sometimes estoppel certificates disclose problems or issues. If one simply receives estoppel certificates, checks them off a list, and drops them in folders, then those problems or issues will often fall between the cracks. Hence, as obvious as it may sound, whoever required the estoppel certificate(s) should remember to read the signed estoppel certificate(s) as they arrive and, if they raise any concerns, address them quickly.

Location: _____

Tenant: _____

TENANT ESTOPPEL CERTIFICATE⁵

THIS TENANT ESTOPPEL CERTIFICATE (the “*Certificate*”) is delivered as of _____ (the “*Effective Date*”), by _____, a _____ (“*Tenant*”), to _____, a _____ (“*Landlord*”),⁶ to benefit Landlord and _____, a _____ (“*Lender*”).

Tenant delivers this Certificate based on these facts:

A. Landlord has advised Tenant that Landlord owns or is simultaneously acquiring the real property known as _____ (the “*Building*”).

B. Landlord or its predecessor in interest has leased to Tenant [the part of] the Building [commonly known as _____] (the “*Premises*”), under only these documents and agreements (collectively, the “*Lease*”):⁷

1. Lease dated as of _____, 20__;
2. [First Amendment of Lease] dated _____;
3. [Letter Agreement on Commencement Date] dated _____; and
4. _____.

5 Ideally, the Lease should: (a) attach a form of Certificate to avoid discussions and deliberations suggested in this Certificate and its cover notes and footnotes; and (b) also require Tenant to provide other assurances as a future Lender or Purchaser reasonably requests.

6 A Tenant may reasonably ask why this Certificate should bestow any rights or benefits on the Landlord or in any way alter the landlord-tenant relationship. The Certificate is being requested in favor of a third party dealing with Landlord. Why should that fortuitously give Landlord any benefit? The Tenant’s position is reasonable, especially in the case of a refinancing. On the other hand, if the Landlord simultaneously acquiring the Property, then the Landlord is fully entitled to receive and rely upon an estoppel certificate.

7 List all documents that define the Tenant’s rights and obligations. Include, for example, letter agreements, option exercise notices, previous estoppel certificates that modified the Lease (although such certificates are inadvisable), written waivers, arbitration awards, judgments, and other substantive documents that define the landlord-tenant relationship.

C. Landlord has advised Tenant that Landlord intends to mortgage the Building, and collaterally assign the Lease, to Lender.

NOW, THEREFORE, Tenant certifies, acknowledges, and agrees, in each case as of the Effective Date only (for purposes of which, any blank space means “NO EXCEPTIONS”):

1. *Tenant Status.* Tenant: (a) is tenant under the Lease; (b) has not assigned, encumbered or hypothecated the Lease, Tenant’s estate under the Lease or any part of it; and (c) has not agreed to do any of the foregoing.

2. *Lease Status.* The Lease: (a) is in full force and effect; (b) has not been amended, canceled, modified, supplemented, surrendered, terminated or waived, in whole or part, orally or in writing, except as the definition of “Lease” states and (c) represents the entire agreement between Tenant and Landlord on Tenant’s rights regarding the Premises and all related matters. All conditions to effectiveness of the Lease have been met.

3. *No Offset.* [Subject only to adjustments of escalation and percentage rents in the ordinary course for the current year,]⁸ Tenant has no claim, counterclaim, defense, offset, right to receive any refund or recoupment (whether of any overpayment or otherwise), setoff or any other basis to reduce any payment the Lease requires, including any base rent, additional rent or other charges payable under the Lease (collectively, the “Rent”).

4. *Rent Commencement.* All conditions to commencement of Tenant’s obligation to pay Rent have been met, except _____.

5. *No Landlord Default.* To Tenant’s knowledge: (a) Landlord is not in default under the Lease and (b) nothing has occurred that, with passage of time or giving of notice, would constitute such a default. Tenant has

8 What about refunds Landlord may owe for previous years’ overpayments of escalation rents and percentage rents? The references later in this sentence to refunds and overpayments may cover such refunds, but one might want more comfort. If a Seller/Landlord owes substantial refunds for many years but has “forgotten” to pay them over, this could create a major surprise later. A Purchaser of the Building may want to perform extra due diligence on this point, and even obtain post-closing credit support, particularly for a noninstitutional Landlord.

MODEL TENANT ESTOPPEL CERTIFICATE

given Landlord no notice of any uncured default under the Lease. Tenant has commenced no legal proceeding against Landlord.⁹

6. *Tenant's Funds.* Landlord holds no security deposit, prepaid Rent or other funds of Tenant (or for which Tenant is entitled to credit) of any kind except _____. Tenant has paid no Rent more than 30 days before due except as the Lease expressly requires.

7. *No Other Interest.* Except under the Lease, Tenant has no right, title or interest (including any option to expand or renew) in or to the Building. Tenant has no option or right of first refusal to purchase the Building.

OPTIONAL PROVISIONS

For optional provisions to include in an estoppel certificate, see sample language after the signature blocks of this model estoppel certificate.

Tenant acknowledges that this Certificate will be relied upon, in accordance with its terms, as of the Effective Date only, by Landlord;¹⁰ Lender; any title insurance company insuring either; any future Lender to Landlord or a mezzanine Lender providing financing or preferred equity to Borrower's direct or indirect owners; any rating agency, issuer, trustee, or servicer in any securitization that includes any loan secured by a mortgage encumbering the Building; and the successors and assigns of (and counsel to) all the foregoing. This Certificate shall bind Tenant and its representatives, successors, and assigns.

[TENANT SIGNATURE BLOCK]

GUARANTOR'S CONFIRMATION

The undersigned, Guarantor under the [Guaranty] dated _____ for the Lease (the "*Guaranty*"), agrees, confirms and certifies for the benefit of all persons entitled to rely on the preceding Certificate that, as of the Effective Date only: (a) Guarantor shall be estopped by and shall not assert any facts inconsistent with the foregoing Certificate, but makes no representations or warranties beyond any in the Guaranty; (b) all representations and warranties in the Guaranty are true and correct; (c) the Guaranty is in full force and effect and has not been amended, modified,

9 It would be "off market" but conceivable to add: "Tenant does not presently contemplate doing so. All statements in this paragraph were correct at all times in the last 12 months."

10 As noted above, a Tenant may argue that the Certificate should not benefit the Landlord.

waived or terminated, in whole or in part; (d) Guarantor has no offset, claim, counterclaim or defense to its obligations under the Guaranty and (e) Exhibit ___ is a true and correct copy of the Guaranty.¹¹

[GUARANTOR SIGNATURE BLOCK]

11 Include clause "e" only if circumstances dictate.

**OPTIONAL PROVISIONS FOR AN ESTOPPEL
CERTIFICATE**

Factual Confirmations. The next few paragraphs relate to factual matters that may arise for particular Tenants. When these matters do arise, it is entirely appropriate for a Lender to seek comfort on these matters through an estoppel certificate. A Tenant should have no problem providing the comfort suggested here, assuming the statements are factually correct.

8. *Options.* Tenant has exercised only these option(s) under the Lease: (a) option to extend through _____, under Section ____; (b) option to expand the Premises to include _____ under Section ____; and (c) option to _____ under Section ____.

9. *Rent Adjustment.* The [Fixed Rent] under the Lease: (a) was last adjusted on _____; (b) after taking into account that adjustment, is \$_____ per month or \$_____ per year; and (c) will next be adjusted on _____.¹²

10. *Base Amounts.* “Base Real Estate Taxes” are \$_____. “Base Operating Expenses” are \$_____. These amounts are final and not subject to audit or adjustment.

11. *Dates.* The “Commencement Date” of the Lease was _____. The “Rent Commencement Date” of the Lease was _____. The “Expiration Date” of the Lease (taking into account only any options Tenant has already exercised) will be _____.¹³

12. *Notice Address.* Tenant’s current notice address is:

13. *Build-Out and Possession.* Tenant has approved the plans and specifications for construction of the Premises listed in Exhibit B. Except as Exhibit B states: (a) Landlord has [commenced / completed] Land-

12 Use this paragraph only if either: (a) Lender plans to rely on the Certificate in place of Lease review or (b) because of escalation formulas, the actual current rent cannot be determined from the face of the Lease. The reliance mentioned in item “a” may be “unreasonable” if the estoppel certificate doesn’t match the Lease. This approach often triggers objections from both the Landlord and the Tenant because of the extra work it creates and the risk it may impose on the Tenant. In general, if anyone can identify a date or a number by reading the Lease, the Tenant may reasonably object to confirming it in this Certificate.

13 Add only if uncertainty exists. Use this provision to tie down other significant but otherwise uncertain dates.

lord's obligations, if any, to construct the Premises in a timely manner in compliance with the Lease; and (b) Tenant has taken possession of the Premises.

Nondisturbance Agreement Provisions. The next few paragraphs give Lender some protections more typically found in a nondisturbance agreement. For comments, see the cover notes for the preceding Model Estoppel Certificate.

14. *Subordination.* Tenant acknowledges that the Lease and Tenant's claims under the Lease are subject and subordinate to Lender's mortgage on Landlord's Premises.

15. *Foreclosure Event.* If Lender forecloses under its mortgage, or exercises any right or remedy similar to such a foreclosure, or accepts an assignment or conveyance in lieu of such foreclosure (any of the foregoing, a "*Foreclosure Event*"), then, notwithstanding anything to the contrary in the Lease, from and after the Foreclosure Event: (a) the Lease shall not terminate; (b) Tenant shall have no right to terminate the Lease; (c) the new owner of Landlord's Premises (with its successors and assigns, "*Successor Landlord*") shall not be bound by any amendment, modification, waiver, termination, cancellation or surrender of the Lease made without Lender's consent; (d) Successor Landlord shall not be bound by any prepayment of Rent for more than 30 days except as the Lease required (or if paid to a lockbox under Lender's or Successor Landlord's control); (e) Successor Landlord shall have no liability or responsibility for Tenant's security deposit except to the extent Successor Landlord actually received it and (f) Successor Landlord's liability arising from or relating to the Lease shall never extend beyond its interest in Landlord's Premises. Nothing in this paragraph limits Tenant's exercise of any unilateral termination right under the Lease, provided that: (x) such right does not arise from a Foreclosure Event; and (y) if such right arises from Landlord's default, then Tenant has first given Lender a reasonable opportunity to cure such default.

16. *Successor Landlord's Liability.* Any Successor Landlord shall not be: (a) subject to any abatement, claim, counterclaim, credit, deduction or setoff against Tenant's obligations under this Lease (an "*Offset*") arising from acts or omissions of the prior Landlord (except to the extent of an Offset for any actual direct damages that both: (i) this Lease would allow Tenant to assert against Landlord; and (ii) accrue after Tenant has given Lender notice of the matters giving rise to the Offset); or (b) obligated to

pay or reimburse Tenant for any sum for which the Lease required the prior Landlord to pay or reimburse Tenant.¹⁴

NONSTANDARD PROVISIONS

The remaining numbered paragraphs contain more assurances that a Lender might want in an estoppel certificate. These assurances go beyond merely preventing the Tenant from asserting facts inconsistent with the Certificate. Instead, they ask the Tenant to provide affirmative assurances, and seem particularly likely to trigger objections. A Tenant would typically prefer not to cover any of these matters, characterizing them as unusual, noncustomary and overkill. Each of these provisions does, however, sometimes appear in estoppel certificates—as do a range of other provisions not included here, such as asking a Tenant to assume new environmental obligations to the Lender, a request that even the most aggressive Lender’s lawyer would probably consider inappropriate but nevertheless sometimes shows up in estoppel certificates. In some cases, however, these additional provisions may make sense.

17. *Loss Proceeds.* In the event of any inconsistency between Tenant’s and Lender’s rights regarding any condemnation award or insurance proceeds, that inconsistency shall be resolved in favor of Lender.

18. *Notice of Default.* If Tenant intends to terminate the Lease because of Landlord’s default, then Tenant shall first notify Lender of that default and give Lender a reasonable opportunity to cure it. This does not limit any other right or remedy of Tenant, except by deferring any right that Tenant may otherwise have to terminate the Lease for Landlord’s default.

19. *Rent Redirection.* If Lender gives Tenant written notice requiring Tenant to pay Rent to Lender (not Landlord) or any other party then, after Tenant receives that notice, Tenant shall pay to Lender (or as otherwise required) all Rent thereafter payable under the Lease, without regard to any contrary notice, instruction or direction from Landlord.¹⁵

14 This paragraph collects in one place the provisions in an SNDA that typically trigger Tenant objections. A Lender can certainly add more items to this list.

15 Tenant should insist that Landlord countersign this certificate, or otherwise approve and confirm the concept in this paragraph.

20. *Existing SNDA.* On _____, Tenant entered into a [Subordination, Nondisturbance, and Attornment Agreement] (the “*SNDA*”) with _____ (“*Previous Lender*”). Tenant has been advised that, on or about the Effective Date, Previous Lender is assigning the SNDA to Lender. [A copy of the SNDA (including all prior amendments, if any) is attached as Exhibit ____.] [The SNDA was recorded on _____ at Book _____, Page _____ in the Official Records of _____ County, _____.] The SNDA has not been amended or modified except as the definition of SNDA states. The SNDA is in full force and effect. Previous Lender is not in default under the SNDA. Tenant has received: (a) notice that Previous Lender has assigned the SNDA to Lender, and (b) no notice that Previous Lender has assigned the SNDA to anyone else. Wherever the SNDA refers to Previous Lender, it shall be deemed to refer instead to Lender.

21. *Copy of Lease.* Exhibit A is a true, correct and complete copy of the Lease.¹⁶

22. *Repairs.* Tenant knows of no condition in the Premises that the Lease requires Landlord to repair.¹⁷

23. *Negotiations.* Landlord and Tenant are not negotiating any Lease amendment.¹⁸

24. *Payments.* Tenant has received notice directing Tenant to make all payments under the Lease to _____. Tenant shall comply with that notice. Tenant acknowledges that Landlord may not revoke it without Lender’s consent.

25. *No Tenant Default.* To Tenant’s knowledge: (a) Tenant is not in default under the Lease and has received no notice of any such default that has not been cured; and (b) Landlord has not commenced any proceedings against Tenant and is not presently threatening to do so. [The statements in this paragraph were also correct at all times during the previous 12 months.]

16 Include this paragraph only if circumstances require, for example because the parties cannot locate a complete copy of the Lease and all amendments. This paragraph is particularly unlikely to be included if the parties plan to record the Certificate. If the parties need to use this paragraph, Landlord should also join in the Certificate to confirm Landlord concurs with Tenant’s identification of the entire Lease.

17 This and the next paragraph are unusual and rarely seen.

18 This sentence is nonstandard but seeks to ferret out pending Lease amendments, which could be material.

MODEL TENANT ESTOPPEL CERTIFICATE

26. *Loans to Pay Rent.* At no time [within the ___ months before the Effective Date] has Landlord, any predecessor in interest to Landlord or any person related to or affiliated with or otherwise acting for any of them directly or indirectly: (a) made any loan to Tenant or anyone related to Tenant; (b) waived, released or deferred any obligation of Tenant under the Lease, except scheduled rent abatements or (c) given or received any payment or other consideration as inducement to enter into the Lease or deliver this Certificate (including any so-called “key money” or “fixture fee” or any obligation to pay rent or modify or cancel any lease at any other location), except as the Lease discloses.¹⁹

27. *Tenant’s Equity Ownership.* All Equity Interests of Tenant are owned and held as follows: _____.

28. *Binding and Enforceable.* The Lease and this Certificate bind and are enforceable against Tenant in accordance with their terms.

29. *Optional Priority.* Lender may elect in writing at any time [by notice to Tenant] that all (or any part, as Lender designates) of Lender’s right, title and interest in Landlord’s Premises shall be subordinate to the Lease and Tenant’s rights and claims under the Lease.

30. *Tenant’s Property.* Exhibit ___ accurately identifies all personal property Tenant owns in or at the Premises.

¹⁹ This may be overkill, but the author knows of transactions where Sellers or Borrowers used strategic loans to tenants as a technique to mask chronic payment problems with tenants.

CHAPTER FORTY-FIVE

**MODEL NONDISTURBANCE
AGREEMENT AND REPORT**

Joshua Stein, Esq.

**REPORT OF
SUBCOMMITTEE
ON NONDISTURBANCE AGREEMENTS
COMMERCIAL LEASING COMMITTEE
REAL PROPERTY SECTION
NEW YORK STATE BAR ASSOCIATION**

NOTE: The following report was issued in 1993 and has not been updated, but remains relevant and timely. In the span of time since this report was issued, though, major tenants have become less accommodating of lenders, and minor tenants have tried to do the same though perhaps not as successfully. Against those trends, the model form of nondisturbance agreement offered here is probably more lender-oriented than the typical negotiated outcome. Indeed, critics have charged that this model is overly lender-oriented in any event, and does not meet its goal of providing a “reasonable” and “balanced” document. For that reason and others, the New York State Bar Association Commercial Leasing Committee is expected soon to revisit this report and model form and issue a Second Edition. That process has not yet started. Commercial leasing attorneys who would like to participate should communicate with the editor.

[45.0] I. INTRODUCTION

Most commercial leases provide that the tenant’s estate is “subordinate” to the landlord’s mortgage. This means that if the landlord’s mortgagee were to foreclose its mortgage and name the tenant as a party defendant in the foreclosure action, then the foreclosure would terminate the tenant’s lease and, with it, the tenant’s right to occupancy. Whoever purchased the collateral at the foreclosure sale would do so free and clear of the lease.

Most commercial tenants do not understand why, if their landlord defaults on its mortgage, the mortgagee or anyone else should have the right to terminate the tenant’s occupancy. As a result, any commercial tenant that leases a significant amount of space, intends to make a significant investment in tenant improvements, or otherwise has significant negotiating strength often will not allow its lease to simply be “subordinate” to the mortgage.

Instead, commercial tenants negotiating new leases commonly insist that the landlord obtain for them a “nondisturbance” agreement from the mortgagee. This agreement states that if the mortgagee forecloses, the mortgagee will honor and recognize the tenant’s lease and not disturb the

tenant's rights under the lease. Such an agreement is often called a "Subordination, Nondisturbance and Attornment Agreement" or some variation thereof (an SNDA agreement).

In the 1980s, mortgagees generally "granted" SNDA agreements to few tenants, often only nationally recognized tenants or other tenants with significant leverage and creditworthiness, and then only after careful review of the proposed lease. Moreover, those agreements would generally limit the tenant's rights and protect the mortgagee's interests in every possible way. Mortgagees would also sometimes try to use SNDA agreements as an occasion to renegotiate leases, adding such provisions as environmental indemnities from the tenant.

In the real estate world of the 1990s, in which rent-paying tenants constitute the only meaningful source of value for real estate, mortgagees are more willing to "grant" nondisturbance. A tenant that might not have been able to obtain an SNDA agreement in 1986 will routinely ask for one, and is more likely to get it, in 1993. Moreover, mortgagees have learned that some of the provisions in SNDA agreements can serve the mortgagee's interests as well.

SNDA agreements typically address issues about the relationship between the mortgagee and the tenant, usually resolving those issues within a predictable range of outcomes. In some cases, however, a "strong" or "unreasonable" (prospective) mortgagee or a "strong" or "unreasonable" (prospective) tenant will propose an SNDA agreement that deals with the standard issues in ways outside the normal range of outcomes or raises issues outside the normal range of issues. In those cases, SNDA negotiations can evolve into a renegotiation of the lease. These aberrational approaches can produce negotiations that are complicated, time-consuming and not completely satisfactory to anyone.

To simplify and streamline negotiations of SNDA agreements and to define a "reasonable" baseline, the Commercial Leasing Committee of the New York State Bar Association Real Property Section decided in 1992 to assign to a subcommittee the responsibility to develop a model SNDA agreement. That model is attached to this report, followed by brief instructions regarding its use.

The following comments are intended, among other things, to guide the user of this model SNDA agreement, explain some judgments and decisions the subcommittee made, and call the user's attention to other commonly negotiated outcomes for some of these issues.

[45.1] II. OVERALL APPROACH AND PURPOSE

The model SNDA agreement is a complete agreement intended for cases where the parties want to minimize or eliminate negotiations and get the job done in a reasonable way. It is suitable for transactions of any size. It may be especially appealing for relatively small loans and relatively small tenancies that will not support significant transaction costs and negotiations. This form is also designed to be a flexible starting point or reference point for use in transactions where the parties customize their own SNDA agreement.

The model SNDA agreement seeks to resolve each of the usual SNDA agreement issues in a standard and reasonable manner, reflecting industry concerns. Based on the subcommittee's review of dozens of specimen SNDA agreements, the model also includes a few provisions that have begun to appear in some SNDA agreements but are not yet part of the basic issues covered in nearly every SNDA agreement. Additional issues are mentioned in these cover notes.

The model SNDA agreement reflects the subcommittee's view of how a well-represented mortgagee and a well-represented tenant could resolve the typical SNDA agreement issues without material prejudice. Some provisions in the model SNDA agreement can be characterized as "pro-mortgagee," others as "pro-tenant." As a whole, however, this model form represents an appropriate accommodation of the competing interests consistent with normal marketplace outcomes of negotiations between reasonably well-represented parties. In the aggregate, the subcommittee believes it is a "fair" and even-handed document.

Although an SNDA agreement plays an important role by defining the relationship between a mortgagee and a tenant, it is ancillary to the basic contract between the mortgagee and the mortgagor, which is the mortgage, and the basic contract between the landlord and the tenant, which is the lease. The parties should make sure the mortgage and the lease do what they need to do and give each party the protections it needs, rather than rely on the SNDA agreement to repair problems and plug gaps in the landlord-tenant or mortgagor-mortgagee relationship. The starting point should always be the mortgage and the lease.

[45.2] III. USE OF THE MODEL SNDA AGREEMENT

In addition to the instructions that follow the model SNDA Agreement, the matters listed below should be considered in preparing an SNDA Agreement based on the attached model.

[45.3] A. Recordation

The subcommittee believes every SNDA agreement should be recorded whether or not the lease or a memorandum thereof has been. The subcommittee disapproves of the common practice of not recording SNDA agreements. Of course, if the lease prohibits recording, tenant's counsel should consider whether recording an SNDA agreement might violate that prohibition. In arranging execution of a SNDA agreement, tenant's counsel should also prepare any ancillary affidavits, tax returns, a copy of the tenant's lease, and similar documentation that the recording office may require.

[45.4] B. Use Outside New York

The model SNDA agreement should not be used outside New York State without consulting local counsel. It is, however, a generic document. The only provisions deliberately tailored to reflect New York law and practice are the cover page and choice of law. Part of the rationale for how the model SNDA agreement treats security deposits (§ 4.3) derives from New York law on treatment of security deposits in a sale of a building. If that law varies in other states, the variation may suggest a different result on security deposits. Similarly, if the model SNDA agreement is used in an "automatic cut-off" state (one where a foreclosure automatically terminates subordinate leases regardless of what the parties agree), then the mortgagee may desire to make leases be "prior" to the mortgage, on all the same terms and conditions set forth in the model SNDA agreement.

[45.5] C. Estoppel Certificate

The estoppel certificate in the model SNDA Agreement (§ 7) will often need to be tailored for the particular lease, including: (a) whether the landlord has finished construction work and the tenant has taken possession; (b) identification of any presently determinable important dates, such as the "Commencement Date" or the "Rent Commencement Date"; (c) the status of any tenant termination options that may no longer exist if certain time periods lapse or certain conditions are satisfied; and (d) the

extent of the tenant's obligations under the lease to deliver estoppel certificates.

[45.6] IV. NEGOTIABLE ISSUES

The following are some basic issues raised by any SNDA agreement, and a description of how those issues were resolved in the model SNDA agreement, and why. Most of these issues are of a nature such that one side will “win” on the issue and the other side will “lose”; both sides cannot be accommodated. Particularly for these “zero-sum” issues, it was necessary to draw reasonable lines in the belief that the package as a whole is reasonable and sensible. Every issue can be resolved in other ways.

[45.7] A. Basic Economic Terms of Lease

The subcommittee believes the tenant should be entitled to the basic economic and possessory benefits of the lease it negotiated with the landlord. The mortgagee should not be able to modify fundamental business terms or override extension options, expansion options, representations and warranties, or similar terms that the tenant was able to negotiate with the landlord. The favorable outcomes of these negotiations were presumably reflected in the rent the tenant agreed to pay, thereby creating the value to support the loan. Once the mortgagee approves the lease (or is required, under the loan documents, to live with the lease), the mortgagee should, as a starting point, honor the business terms the tenant negotiated with the landlord. This approach forces the mortgagee to carefully review the lease to identify specific objectionable provisions and try to renegotiate them with the tenant.

[45.8] B. Security Deposit

The model SNDA agreement places on the tenant the risk that the landlord will misapply the tenant's security deposit (§ 4.3). The mortgagee is not responsible for security deposits unless actually received by the mortgagee. It might be reasonable to require the mortgagee to be responsible for the security deposit—effectively forcing the mortgagee to hold all security deposits from the inception of the loan—but the subcommittee decided to place the risk on the tenant. This approach tracks the normal negotiated outcome in SNDA agreements and the New York statute requiring actual delivery of security deposits to a purchaser for the purchaser to incur liability for them (N.Y. Gen. Oblig. Law § 7-105(2)).

[45.9] C. Construction Work

Many SNDA agreements categorically excuse the mortgagee from any obligation to complete construction that the landlord failed to complete (including even initial fixturing), yet permit the mortgagee to collect rent after foreclosure premised on the space being delivered in the condition required by the lease. The subcommittee believes this position is unreasonable. It is, however, the standard treatment of this issue in mortgagees' standard form SNDA agreements. It sometimes survives tenant negotiations. The subcommittee tried to formulate a single "standard" reasonable solution to this problem, but found it impossible to do so because leases reflect different business deals regarding construction. Therefore the subcommittee left the matter for negotiation between the actual mortgagee and the actual tenant (to be memorialized in each case in a separate "schedule" to the model SNDA agreement). If the parties do not specifically address the issue and the mortgagee names the tenant as a defendant in the foreclosure action, then the mortgagee will, after foreclosure, have no obligation to complete or pay for the tenant's construction and the tenant will have no recourse against the mortgagee (§ 4.6). As one way to resolve this issue, the subcommittee considered but ultimately did not adopt the following provision, which is presented here only as a sample starting point for consideration:

If Former Landlord has failed to perform Landlord's Construction-Related Obligation(s) with respect to Tenant's initial occupancy of Tenant's Premises and Successor Landlord does not agree in writing within 30 days after Tenant's demand after the date of attornment to complete such Construction-Related Obligation(s) within a reasonable period, then Tenant, as its sole remedy, shall have the right to elect either to terminate the Lease by written notice to Successor Landlord, or to complete and pay for such Construction-Related Obligations and offset all reasonable costs thereby incurred (the "*Construction Cost*"), together with interest on the unrecovered balance of Construction Cost, against any Rent thereafter payable, until Tenant shall have so recovered the entire Construction Cost.

[45.10] D. Casualty and Condemnation Repairs

The model SNDA agreement requires the mortgagee to perform casualty and condemnation repairs to the same extent that such repairs would

be required of landlord (§§ 1.1, 3.2). The subcommittee considered limiting the mortgagee's obligation to the amount of insurance proceeds received, but concluded the mortgagee should not be entitled to a better deal than whatever the landlord and tenant negotiated. This approach prevents the mortgagee from seizing upon the building's misfortune as the basis for early prepayment, except to the extent expressly contemplated by corresponding provisions in the lease. The subcommittee believes that a mortgagee, by properly drafting and administering its mortgage, can control the level of insurance, the insurance adjustment process, and the application of insurance proceeds. If the mortgagee fails to do its job, this should not become the tenant's problem. A mortgagee may feel otherwise.

[45.11] E. Deed in Lieu of Foreclosure

Consistent with industry standards, the model SNDA agreement provides that its mortgagee protections are triggered not only by an actual foreclosure, but also by a deed in lieu of foreclosure (DILF) from the landlord to the mortgagee (or its designee or nominee) (§ 1.2). A tenant may argue that in accepting a DILF, a mortgagee should succeed to exactly the same rights and obligations as the landlord, and the landlord's delivery of a DILF should not be an occasion for any change in the landlord-tenant relationship. Regardless of any merits to the tenant's position, the industry normally accepts the mortgagee's position on this issue. Therefore, the model SNDA agreement does the same. The point is extremely negotiable.

[45.12] F. Options

Some SNDA agreements provide that the mortgagee takes free of options to purchase, expand, contract, renew, and so on. The subcommittee believes the tenant should be entitled to preserve any options expressly provided for in the lease, and the mortgagee should take free only of any options not set forth in the lease. This latter point can be fully addressed with general language stating that the lease is the entire agreement between landlord and tenant, and the only agreement by which the mortgagee will be bound (§§ D, 3.2, 7.1). No particular discussion of options is required. Tenant's counsel should make sure the SNDA agreement expressly recognizes (and defines as part of the "Lease") any side letters, option agreements, or other ancillary documentation giving the tenant valuable rights that should survive a foreclosure.

[45.13] G. Amendments and Modifications

The model SNDA agreement permits landlord and tenant to amend the lease as they wish, but states that the mortgagee will not be bound by any amendments made without the mortgagee's written consent (§ 4.4). The subcommittee believes this position is more reasonable than the mortgagee's common position prohibiting all amendments. As an intermediate position, the tenant might agree that any amendment reducing rent requires the mortgagee's consent, under the theory that such an amendment would impair cash flow and thus perhaps adversely affect the mortgagee even before foreclosure. (Likewise, the model SNDA does not prohibit rent prepayments but merely states that the mortgagee will take free of them [§ 4.2]. Some other issues receive similar treatment.)

[45.14] H. Offset Rights

The model SNDA agreement tracks normal practice by prohibiting offsets against the mortgagee based on events that occurred before the date of attornment (§§ 1.4, 4.1). This means that if a tenant negotiates an offset right in a lease, the tenant should assert that right promptly because it will not survive foreclosure as to offsets that accrued before foreclosure. After foreclosure, the model SNDA agreement requires the Successor Landlord to accept the lease according to its terms, including any express offset rights (but only as to matters occurring after foreclosure) (§§ 3.2, 4.1). A mortgagee reviewing a lease with express offset rights may want to insist that the tenant agree, in the SNDA agreement, that the tenant's offset rights will terminate after foreclosure, even as to post-foreclosure matters. The model SNDA agreement defines "Offset Right" broadly (§ 1.4). The parties may prefer to limit the term to any "offset, defense, or counterclaim."

[45.15] I. Estoppel Certificate

The model SNDA agreement includes a full estoppel certificate (§ 7). It may be slightly more customary to omit the estoppel provisions or put them in a separate document. Either way, tenant's counsel should carefully review with the tenant the accuracy of any "estoppel" provisions.

[45.16] J. Opportunity to Cure Landlord's Default

The model SNDA agreement gives the mortgagee a fairly generous cure period for landlord's defaults—longer than the norm in many SNDA agreements, and more like the mortgagee's cure period available under a

ground lease (§§ 6.2, 6.3). This cure period is tempered somewhat by language stating that once a receiver is appointed, the mortgagee has the burden of causing the receiver to cure the landlord's default within a reasonable time (§ 6.3). This will not necessarily be easy, particularly as to nonemergency matters. A tenant may regard the mortgagee's cure period in the model SNDA agreement as excessive and may, for example, ask for the right to suspend or offset rent or exercise self-help during the cure period.

[45.17] K. Nonrecourse

The model SNDA agreement provides that any "Successor Landlord" is automatically exculpated from personal liability under the lease (§ 5). This provision is common but not completely standard. The subcommittee believes that any well-represented mortgagee will ask for it. Most tenants will accept it because they are accustomed to seeing such a clause run to the benefit of the landlord. In addition, even if a lease did not contain such a clause a mortgagee could always achieve the same result by having a shell corporation bid at the foreclosure sale.

[45.18] L. Landlord's Payment Obligations

If the lease requires the landlord to make payments relating to matters beyond the premises, such as "takeover payments" on a tenant's existing lease, tenant's counsel should modify the SNDA agreement to make sure this obligation will survive foreclosure.

[45.19] M. Future Advances

A tenant may prefer to "subordinate" (even with nondisturbance rights) only to a mortgage securing a known loan amount, and not to any future advances of future loans that the same mortgage might later secure. In this case tenant's counsel should limit the definition of "Mortgage" (and the subordination clause) to exclude future loan increases (§§ C and 2). Absent such a limitation, the "Mortgage" to which tenant will subordinate will include future increases. This result reflects industry standards.

[45.20] V. ADDITIONAL ISSUES TO CONSIDER

The following issues are not addressed in most SNDA agreements and thus do not appear in the model SNDA agreement. They may, however, be appropriate to consider in particular transactions and are discussed here for convenient reference.

[45.21] A. Payment of Rent to Mortgagee

Based on recent experiences with assignments of rents, receiverships, bankruptcy, and “cash collateral,” a mortgagee may want the tenant to agree, in the SNDA agreement, to pay rent directly to the mortgagee on request. The subcommittee decided not to include such provisions in the model SNDA agreement because (a) they are not (yet) industry practice and (b) the landlord and tenant can reasonably tell the mortgagee to rely on its ordinary legal rights and remedies in this area (e.g., appointment of a receiver; New York Real Prop. Law § 291-f). The following provisions could be included where desired:

[45.22] 1. Tenant’s Covenant

Add the following covenant by Tenant (breach of which would cause Tenant to lose nondisturbance rights or trigger other remedies):

Rent Payment Notices. From and after Tenant’s receipt of written notice from Mortgagee (a “**Rent Payment Notice**”), Tenant shall pay all Rent to Mortgagee or as Mortgagee shall direct in writing, until such time as Mortgagee directs otherwise in writing. Tenant shall comply with any Rent Payment Notice notwithstanding any contrary instruction, direction or assertion from Landlord. Mortgagee’s delivery to Tenant of a Rent Payment Notice, or Tenant’s compliance therewith, shall not be deemed to: (a) cause Mortgagee to succeed to or to assume any obligations or responsibilities as Landlord under the Lease, all of which shall continue to be performed and discharged solely by Landlord unless and until any attornment has occurred pursuant to this Agreement; or (b) relieve Landlord of any obligations under the Lease.

[45.23] 2. Landlord’s Acknowledgment

Add the following to Landlord’s acknowledgment at the end of the model SNDA agreement:

Landlord irrevocably directs Tenant to comply with any Rent Payment Notice, notwithstanding any contrary direction, instruction, or assertion by Landlord. Tenant shall be entitled to rely on any Rent Payment Notice.

Tenant shall be under no duty to controvert or challenge any Rent Payment Notice. Tenant's compliance with a Rent Payment Notice shall not be deemed to violate the Lease. Landlord hereby releases Tenant from, and shall indemnify and hold Tenant harmless from and against, any and all loss, claim, damage, liability, cost or expense (including payment of reasonable attorneys' fees and disbursements) arising from any claim based upon Tenant's compliance with any Rent Payment Notice. Landlord shall look solely to Mortgagee with respect to any claims Landlord may have on account of an incorrect or wrongful Rent Payment Notice. Tenant shall be entitled to full credit under the Lease for any Rent paid to Mortgagee pursuant to a Rent Payment Notice to the same extent as if such Rent were paid directly to Landlord.

[45.24] B. Tenant Exculpation

If the lease includes a nonrecourse clause, the tenant may wish to include the same nonrecourse clause, verbatim, in the SNDA agreement.

[45.25] C. Bankruptcy of Mortgagee

An SNDA agreement probably constitutes an executory contract that the mortgagee could reject in its own bankruptcy proceeding or similar proceedings for failed financial institutions. As part of the solution to this problem—at least in cases where the lease is being entered into before the mortgage—the tenant may insist on deleting the standard “subordination” clause in the lease and instead require that “subordination” be addressed only in the SNDA agreement, with a proviso stating that the “subordination” is effective only so long as the SNDA is effective against the mortgagee. This way, even if the SNDA agreement were rejected, the lease itself and Bankruptcy Code § 365(h) would, it is hoped, provide some protection, although the subcommittee found no case law directly supporting this proposition. Other solutions to the problem are available. Some are cumbersome, complex, and nonstandard. That does not mean every tenant should overlook the issue, which is otherwise outside the scope of the subcommittee's assignment.

[45.26] D. Bankruptcy of Landlord

Many SNDA agreements provide that a tenant's nondisturbance rights terminate if the lease terminates, without carving out a lease termination that occurs because the tenant's lease is rejected in the landlord's bankruptcy under 11 U.S.C. § 365(h). Although the Bankruptcy Code allows the tenant to remain in possession under these facts, the tenant's lease has probably still been "terminated."¹ This "termination" of the tenant's lease may allow the mortgagee, during or after foreclosure, to deny the tenant nondisturbance rights (because the lease has "terminated") and simply remove the tenant under the subordination clause of the SNDA agreement. Thus a mortgagee may be able to get around a nondisturbance covenant by manipulating the landlord's bankruptcy. The model SNDA agreement solves this problem by providing that the tenant loses nondisturbance rights only if the lease terminated because of an Event of Default by tenant.

[45.27] E. Miscellaneous

A mortgagee might want to be able to require the tenant to give the mortgagee the same periodic deliveries the landlord can require under the lease, such as updated financial information or updated estoppel certificates. A mortgagee might want the right to participate in legal proceedings relating to the determination of rights of parties to the lease, including arbitration. If the transaction involves out-of-state parties it may be appropriate to include a consent to jurisdiction. To prevent a desirable lease from terminating if a junior mortgagee forecloses, a first mortgagee may want the tenant to agree not to subordinate its estate to the lien of any junior mortgagee. None of these provisions are common in SNDA agreements. None are included here.

¹ *In re Carlton Rest., Inc.*, 151 B.R. 353 (Bankr. E.D. Pa. 1993).

MODEL NONDISTURBANCE AGREEMENT AND REPORT

The Subcommittee on Nondisturbance Agreements hopes that the above comments, and the model SNDA agreement that follows, will help standardize and streamline practice in this area. Subcommittee members will welcome comments and suggestions based on experience using the model SNDA agreement. If warranted, a second edition will be prepared and released.

Respectfully Submitted,

SUBCOMMITTEE ON

NONDISTURBANCE AGREEMENTS

Joshua Stein, Chair

Sheldon M. Goldstein

Andrea Paretts Ascher

Andrew L. Herz

Hugh P. Finnegan

Barry C. Ross

Richard M. Frome

W. Stephen Tierney

November 19, 1993

New York, New York

MODEL NONDISTURBANCE AGREEMENT AND REPORT

_____ (“Mortgagee”)

and

_____ (“Tenant”)

SUBORDINATION, NONDISTURBANCE,
AND ATTORNMENT AGREEMENT²

_____, 20__

This instrument affects real property situated, lying and being in the County of _____, State of New York, known as follows:

Section: _____

Volume: _____

Block(s): _____

Lot(s): _____

Street Address:

[New York City Only] _____

2 Copyright (c) 1993 New York State Bar Association. Consent is granted to modify and adapt this model SNDA agreement for specific transactions. See instructions following model SNDA agreement.

RECORD AND RETURN TO: NO MORTGAGE RECORDING TAX IS

_____, New York _____
Att'n: _____
File No.: _____
Document No.: _____

PAYABLE WITH RESPECT TO THIS
AGREEMENT. NOTHING IN THIS
AGREEMENT IS INTENDED TO
EVIDENCE OR SECURE ANY
INDEBTEDNESS OR TO CREATE
ANY
LIEN.

**SUBORDINATION, NONDISTURBANCE AND
ATTORNMENMENT AGREEMENT**

This SUBORDINATION, NONDISTURBANCE, AND ATTORNMENMENT AGREEMENT (this “*Agreement*”) is entered into as of _____, 20__ (the “*Effective Date*”), between _____, a _____, whose address is _____ (“*Mortgagee*”), and _____, a _____, whose address is _____ (“*Tenant*”), with reference to the following facts:

A. _____, a _____, whose address is _____ (“*Landlord*”), owns the real property located at _____ (such real property, including all buildings, improvements, structures and fixtures located thereon, “*Landlord’s Premises*”), as more particularly described in **Schedule A**.

B. Mortgagee has made a loan to Landlord in the original principal amount of \$_____ (the “*Loan*”).

C. To secure the Loan, Landlord has encumbered Landlord’s Premises by entering into that certain *Mortgage, Consolidation and Modification Agreement* dated _____, 20__, in favor of Mortgagee (as amended, increased, renewed, extended, spread, consolidated, severed, restated, or otherwise changed from time to time, the “*Mortgage*”) [to be] recorded [on _____, at Book _____, Page _____,] in the Official Records of the County of _____, State of New York (the “*Land Records*”).

D. Pursuant to a *Lease* dated as of _____, 20__, as amended on _____, 20__, and _____, 20__ (the “*Lease*”), Landlord demised to Tenant [a portion of] Landlord’s Premises (“*Tenant’s Premises*”). Tenant’s Premises are commonly known as _____.

[E. A memorandum of the Lease [is to be recorded in the Land Records prior to the recording of this Agreement.] [was recorded in the Land Records on _____, at Book _____, Page _____.]

F. Tenant and Mortgagee desire to agree upon the relative priorities of their interests in Landlord’s Premises and their rights and obligations if certain events occur.

NOW, THEREFORE, for good and sufficient consideration, Tenant and Mortgagee agree:

1. Definitions

The following terms shall have the following meanings for purposes of this Agreement.

1.1 *Construction-Related Obligation.* A “**Construction-Related Obligation**” means any obligation of Landlord under the Lease to make, pay for, or reimburse Tenant for any alterations, demolition, or other improvements or work at Landlord’s Premises, including Tenant’s Premises. “Construction-Related Obligations” shall not include: (a) reconstruction or repair following fire, casualty or condemnation; or (b) day-to-day maintenance and repairs.

1.2 *Foreclosure Event.* A “**Foreclosure Event**” means: (a) foreclosure under the Mortgage; (b) any other exercise by Mortgagee of rights and remedies (whether under the Mortgage or under applicable law, including bankruptcy law) as holder of the Loan and/or the Mortgage, as a result of which Successor Landlord becomes owner of Landlord’s Premises; or (c) delivery by Landlord to Mortgagee (or its designee or nominee) of a deed or other conveyance of Landlord’s interest in Landlord’s Premises in lieu of any of the foregoing.

1.3 *Former Landlord.* A “**Former Landlord**” means Landlord and any other party that was landlord under the Lease at any time before the occurrence of any attornment under this Agreement.

1.4 *Offset Right.* An “**Offset Right**” means any right or alleged right of Tenant to any offset, defense (other than one arising from actual payment and performance, which payment and performance would bind a Successor Landlord pursuant to this Agreement), claim, counterclaim, reduction, deduction, or abatement against Tenant’s payment of Rent or performance of Tenant’s other obligations under the Lease, arising (whether under the Lease or under applicable law) from Landlord’s breach or default under the Lease.

1.5 *Rent.* The “**Rent**” means any fixed rent, base rent or additional rent under the Lease.

1.6 *Successor Landlord.* A “**Successor Landlord**” means any party that becomes owner of Landlord’s Premises as the result of a Foreclosure Event.

1.7 *Termination Right.* A “**Termination Right**” means any right of Tenant to cancel or terminate the Lease or to claim a partial or total eviction arising (whether under the Lease or under applicable law) from Landlord’s breach or default under the Lease.

2. Subordination

The Lease shall be, and shall at all times remain, subject and subordinate to the Mortgage, the lien imposed by the Mortgage, and all advances made under the Mortgage.

3. Nondisturbance, Recognition and Attornment

3.1 *No Exercise of Mortgage Remedies Against Tenant.* So long as the Lease has not been terminated on account of Tenant’s default that has continued beyond applicable cure periods (an “**Event of Default**”), Mortgagee shall not name or join Tenant as a defendant in any exercise of Mortgagee’s rights and remedies arising upon a default under the Mortgage unless applicable law requires Tenant to be made a party thereto as a condition to proceeding against Landlord or prosecuting such rights and remedies. In the latter case, Mortgagee may join Tenant as a defendant in such action only for such purpose and not to terminate the Lease or otherwise adversely affect Tenant’s rights under the Lease or this Agreement in such action.

3.2 *Nondisturbance and Attornment.* If the Lease has not been terminated on account of an Event of Default by Tenant, then, when Successor Landlord takes title to Landlord’s Premises: (a) Successor Landlord shall not terminate or disturb Tenant’s possession of Tenant’s Premises under the Lease, except in accordance with the terms of the Lease and this Agreement; (b) Successor Landlord shall be bound to Tenant under all the terms and conditions of the Lease (except as provided in this Agreement); (c) Tenant shall recognize and attorn to Successor Landlord as Tenant’s direct landlord under the Lease as affected by this Agreement; and (d) the Lease shall continue in full force and effect as a direct lease, in accordance with its terms (except as provided in this Agreement), between Successor Landlord and Tenant.

3.3 *Further Documentation.* The provisions of this Article shall be effective and self-operative without any need for Successor Landlord or Tenant to execute any further documents. Tenant and Successor Landlord shall, however, confirm the provisions of this Article in writing upon request by either of them.

4. *Protection of Successor Landlord*

Notwithstanding anything to the contrary in the Lease or the Mortgage, Successor Landlord shall not be liable for or bound by any of the following matters:

4.1 *Claims Against Former Landlord.* Any Offset Right that Tenant may have against any Former Landlord relating to any event or occurrence before the date of attornment, including any claim for damages of any kind whatsoever as the result of any breach by Former Landlord that occurred before the date of attornment. (The foregoing shall not limit either (a) Tenant's right to exercise against Successor Landlord any Offset Right otherwise available to Tenant because of events occurring after the date of attornment or (b) Successor Landlord's obligation to correct any conditions that existed as of the date of attornment and violate Successor Landlord's obligations as landlord under the Lease.)

4.2 *Prepayments.* Any payment of Rent that Tenant may have made to Former Landlord more than thirty days before the date such Rent was first due and payable under the Lease with respect to any period after the date of attornment other than, and only to the extent that, the Lease expressly required such a prepayment.

4.3 *Payment; Security Deposit.* Any obligation: (a) to pay Tenant any sum(s) that any Former Landlord owed to Tenant or (b) with respect to any security deposited with Former Landlord, unless such security was actually delivered to Mortgagee. This paragraph is not intended to apply to Landlord's obligation to make any payment that constitutes a "Construction-Related Obligation."

4.4 *Modification, Amendment, or Waiver.* Any modification or amendment of the Lease, or any waiver of any terms of the Lease, made without Mortgagee's written consent.

4.5 *Surrender, Etc.* Any consensual or negotiated surrender, cancellation, or termination of the Lease, in whole or in part, agreed upon between

Landlord and Tenant, unless effected unilaterally by Tenant pursuant to the express terms of the Lease.

4.6 *Construction-Related Obligations.* Any Construction-Related Obligation of Former Landlord, except as expressly provided for in **Schedule B** (if any) attached to this Agreement. [*Note: Please see Paragraph 3 of Instructions following model SNDA agreement.*]

5. *Exculpation of Successor Landlord*

Notwithstanding anything to the contrary in this Agreement or the Lease, upon any attornment pursuant to this Agreement the Lease shall be deemed to have been automatically amended to provide that Successor Landlord's obligations and liability under the Lease shall never extend beyond Successor Landlord's (or its successors' or assigns') interest, if any, in Landlord's Premises from time to time, including insurance and condemnation proceeds, Successor Landlord's interest in the Lease, and the proceeds from any sale or other disposition of Landlord's Premises by Successor Landlord (collectively, "***Successor Landlord's Interest***"). Tenant shall look exclusively to Successor Landlord's Interest (or that of its successors and assigns) for payment or discharge of any obligations of Successor Landlord under the Lease as affected by this Agreement. If Tenant obtains any money judgment against Successor Landlord with respect to the Lease or the relationship between Successor Landlord and Tenant, then Tenant shall look solely to Successor Landlord's Interest (or that of its successors and assigns) to collect such judgment. Tenant shall not collect or attempt to collect any such judgment out of any other assets of Successor Landlord.

6. *Mortgagee's Right to Cure*

6.1 *Notice to Mortgagee.* Notwithstanding anything to the contrary in the Lease or this Agreement, before exercising any Termination Right or Offset Right, Tenant shall provide Mortgagee with notice of the breach or default by Landlord giving rise to same (the "***Default Notice***") and, thereafter, the opportunity to cure such breach or default as provided for below.

6.2 *Mortgagee's Cure Period.* After Mortgagee receives a Default Notice, Mortgagee shall have a period of thirty days beyond the time available to Landlord under the Lease in which to cure the breach or default by Landlord. Mortgagee shall have no obligation to cure (and shall have no liability or obligation for not curing) any breach or default by

Landlord, except to the extent that Mortgagee agrees or undertakes otherwise in writing.

6.3 *Extended Cure Period.* In addition, as to any breach or default by Landlord the cure of which requires possession and control of Landlord's Premises, provided only that Mortgagee undertakes to Tenant by written notice to Tenant within thirty days after receipt of the Default Notice to exercise reasonable efforts to cure or cause to be cured by a receiver such breach or default within the period permitted by this paragraph, Mortgagee's cure period shall continue for such additional time (the "***Extended Cure Period***") as Mortgagee may reasonably require to either (a) obtain possession and control of Landlord's Premises and thereafter cure the breach or default with reasonable diligence and continuity or (b) obtain the appointment of a receiver and give such receiver a reasonable period of time in which to cure the default.

7. *Confirmation of Facts*

Tenant represents to Mortgagee and to any Successor Landlord, in each case as of the Effective Date:

7.1 *Effectiveness of Lease.* The Lease is in full force and effect, has not been modified, and constitutes the entire agreement between Landlord and Tenant relating to Tenant's Premises. Tenant has no interest in Landlord's Premises except pursuant to the Lease. No unfulfilled conditions exist to Tenant's obligations under the Lease.

7.2 *Rent.* Tenant has not paid any Rent that is first due and payable under the Lease after the Effective Date.

7.3 *No Landlord Default.* To the best of Tenant's knowledge, no breach or default by Landlord exists and no event has occurred that, with the giving of notice, the passage of time or both, would constitute such a breach or default.

7.4 *No Tenant Default.* Tenant is not in default under the Lease and has not received any uncured notice of any default by Tenant under the Lease.

7.5 *No Termination.* Tenant has not commenced any action nor sent or received any notice to terminate the Lease. Tenant has no presently exercisable Termination Right(s) or Offset Right(s).

7.6 *Commencement Date.* The “Commencement Date” of the Lease was _____, 20___. [*Note: Please see Paragraph 2 of Instructions following model SNDA agreement.*]

7.7 *Acceptance.* Except as set forth in **Schedule B** (if any) attached to this Agreement: (a) Tenant has accepted possession of Tenant’s Premises; and (b) Landlord has performed all Construction-Related Obligations related to Tenant’s initial occupancy of Tenant’s Premises and Tenant has accepted such performance by Landlord. [*Note: Please see Paragraph 3 of Instructions following model SNDA agreement.*]

7.8 *No Transfer.* Tenant has not transferred, encumbered, mortgaged, assigned, conveyed or otherwise disposed of the Lease or any interest therein, other than sublease(s) made in compliance with the Lease.

7.9 *Due Authorization.* Tenant has full authority to enter into this Agreement, which has been duly authorized by all necessary actions.

8. *Miscellaneous*

8.1 *Notices.* All notices or other communications required or permitted under this Agreement shall be in writing and given by certified mail (return receipt requested) or by nationally recognized overnight courier service that regularly maintains records of items delivered. Each party’s address is as set forth in the opening paragraph of this Agreement, subject to change by notice under this paragraph. Notices shall be effective the next business day after being sent by overnight courier service, and five business days after being sent by certified mail (return receipt requested).

8.2 *Successors and Assigns.* This Agreement shall bind and benefit the parties, their successors and assigns, any Successor Landlord, and its successors and assigns. If Mortgagee assigns the Mortgage, then upon delivery to Tenant of written notice thereof accompanied by the assignee’s written assumption of all obligations under this Agreement, all liability of the assignor shall terminate.

8.3 *Entire Agreement.* This Agreement constitutes the entire agreement between Mortgagee and Tenant regarding the subordination of the Lease to the Mortgage and the rights and obligations of Tenant and Mortgagee as to the subject matter of this Agreement.

8.4 *Interaction with Lease and with Mortgage.* If this Agreement conflicts with the Lease, then this Agreement shall govern as between the

parties and any Successor Landlord, including upon any attornment pursuant to this Agreement. This Agreement supersedes, and constitutes full compliance with, any provisions in the Lease that provide for subordination of the Lease to, or for delivery of nondisturbance agreements by the holder of, the Mortgage. Mortgagee confirms that Mortgagee has consented to Landlord's entering into the Lease.

8.5 *Mortgagee's Rights and Obligations.* Except as expressly provided for in this Agreement, Mortgagee shall have no obligations to Tenant with respect to the Lease. If an attornment occurs pursuant to this Agreement, then all rights and obligations of Mortgagee under this Agreement shall terminate, without thereby affecting in any way the rights and obligations of Successor Landlord provided for in this Agreement.

8.6 *Interpretation; Governing Law.* The interpretation, validity and enforcement of this Agreement shall be governed by and construed under the internal laws of the State of New York, excluding its principles of conflict of laws.

8.7 *Amendments.* This Agreement may be amended, discharged or terminated, or any of its provisions waived, only by a written instrument executed by the party to be charged.

8.8 *Execution.* This Agreement may be executed in any number of counterparts, each of which shall be deemed an original and all of which together shall constitute one and the same instrument.

8.9 *Mortgagee's Representation.* Mortgagee represents that Mortgagee has full authority to enter into this Agreement, and Mortgagee's entry into this Agreement has been duly authorized by all necessary actions.

IN WITNESS WHEREOF, this Agreement has been duly executed by Mortgagee and Tenant as of the Effective Date.

MORTGAGEE

TENANT

By: _____

By: _____

Name: _____

Name: _____

Title: _____

Title: _____

MODEL NONDISTURBANCE AGREEMENT AND REPORT

Landlord consents and agrees to the foregoing Agreement, which was entered into at Landlord’s request. The foregoing Agreement shall not alter, waive or diminish any of Landlord’s obligations under the Mortgage or the Lease. The above Agreement discharges any obligations of Mortgagee under the Mortgage and related loan documents to enter into a non-disturbance agreement with Tenant. Landlord is not a party to the above Agreement.

LANDLORD

By: _____

Name: _____

Title: _____

Dated: _____, 20__

Each of the undersigned, a guarantor of Tenant’s obligations under the Lease (a “**Guarantor**”), consents to Tenant’s execution, delivery and performance of the foregoing Agreement. From and after any attornment pursuant to the foregoing Agreement, that certain Guaranty dated _____, 20__ (the “**Guaranty**”) executed by Guarantor in favor of _____ shall automatically benefit and be enforceable by Successor Landlord with respect to Tenant’s obligations under the Lease as affected by the foregoing Agreement. Successor Landlord’s rights under the Guaranty shall not be subject to any defense, offset, claim, counterclaim, reduction or abatement of any kind resulting from any act, omission or waiver by any Former Landlord for which Successor Landlord would, pursuant to the foregoing Agreement, not be liable or answerable after an attornment. The foregoing does not limit any waivers or other provisions contained in the Guaranty. Guarantor confirms that the Guaranty is in full force and effect and Guarantor presently has no offset, defense (other than any arising from actual payment or performance by Tenant, which payment or performance would bind a Successor Landlord under the foregoing Agreement), claim, counterclaim, reduction, deduction or abatement against Guarantor’s obligations under the Guaranty.

GUARANTOR

By: _____

Its: _____

Dated: _____, 20__

Attachments:

Acknowledgments

Schedule A—Description of Landlord's Premises

Schedule B—Landlord's Construction-Related Obligations

Schedule A

Description of Landlord's Premises

ALL THAT CERTAIN REAL PROPERTY lying, being and situated in the City of _____, County of _____, and State of New York, more particularly described as follows:

Schedule B

Construction-Related Obligations

- A. Construction-Related Obligations Remaining to Be Performed as of Effective Date.

[Summarize and Describe]

- B. Successor Landlord's Construction-Related Obligations After Attornment.

[Negotiate and Describe]

INSTRUCTIONS FOR MODEL SNDA AGREEMENT

1. *Overall.* Modify as appropriate for the particular transaction. Fill in blanks. Consider deleting or editing bracketed language.

2. *Important Dates.* Modify or supplement Section 7.6 to tie down the Commencement Date and any other important dates referred to in the Lease, i.e., any dates that must be known in order to understand the lease term or calculation of rent.

3. *Construction-Related Obligations.* In Schedule B, summarize any “Construction-Related Obligations” of Landlord that remain unperformed as of the Effective Date, and describe the extent (if any) to which Successor Landlord has agreed to be obligated to perform such “Construction-Related Obligations” after any attornment. Edit Section 7.7 based on the status of construction.

4. *Acknowledgments.* Sample acknowledgments are provided at the end of the document. Duplicate and edit as necessary for all parties signing, including landlord and any guarantors.

5. *Subleases.* Although the subcommittee regards it as unnecessary, a mortgagee may desire a list of all subleases entered into by the tenant. This could be attached as another Schedule.

6. *Non-Fee Estates.* This SNDA agreement assumes Landlord holds a fee estate. If this is not the case, modify accordingly.

7. *Lease Review.* In preparing an SNDA agreement, mortgagee’s counsel should review the underlying lease; consider whether the mortgagee is willing to “nondisturb” the lease; and, if so, whether the mortgagee should insist on renegotiating any of the terms of the lease. The SNDA agreement can incorporate the outcome of such negotiations, in the form of an agreement between mortgagee and tenant that would come into effect only if and when landlord is out of the picture. It is beyond the scope of this report to list issues that mortgagee’s counsel should consider in reviewing a lease.

8. *Loan Documents.* Mortgagee’s counsel should consider the interaction between the SNDA agreement and the terms of the loan documents, so they work well together. Many provisions of the model SNDA agreement (or optional provisions discussed in this report) require conforming or implementing language in the loan documents. This area is outside the scope of the subcommittee’s responsibilities.

CHAPTER FORTY-SIX

JOURNEY THROUGH THE NINE CIRCLES OF HELL: A TENANT'S ODYSSEY IN NEGOTIATING NONDISTURBANCE AGREEMENTS

Joel R. Hall, Esq.*

- * The author wishes to acknowledge the generous help of (1) Joshua Stein, Esq., of Joshua Stein PLLC, New York, NY, whose excellent article, *Needless Disturbances? Do Nondisturbance Agreements Justify All The Time And Trouble?* was the inspiration for the updating of this chapter, (2) Thomas C. Homburger, Esq., of counsel with K&L Gates, Chicago, IL, whose article, co-authored with Lawrence A. Eiben, *Who's On First—Protecting the Commercial Mortgage Lender*, provided instructive guidance on the nuances of mortgage subordination, (3) Dale Ahearn, Esq. whose insightful article, co-authored with his late partner, Jude Clark, of Frost Brown Todd, Louisville, KY, *Between a Rock And A Hard Place—Representing Owners In SNDA Negotiations*, was heavily quoted in these materials, (4) the several practitioners and scholars whose works are cited in these materials, and (5) the New York State Bar Association for making this possible.

[46.0] I. INTRODUCTION

An integral part of a commercial lease negotiation and the closing of a commercial mortgage loan has been the deliberation between the landlord, the tenant, and the mortgage lender with regard to the interrelationship between the lender and the tenant during the pendency of a loan and in the circumstance of a mortgage default and consequent foreclosure. The end game of such deliberations is the subordination, nondisturbance and attornment agreement (SNDA).

It has been suggested by some attorneys practicing in the field that the endeavor to negotiate SNDAs in terms of the time, energy, thought, and cost expended may not be worth the effort. This view is predicated upon the belief that (1) the problems and risks an SNDA covers, although theoretically conceivable, do not arise all that often in the real world, and (2) some of the positions taken by all parties in SNDA negotiations may have questionable merit.

Indeed, this has frequently been the view of the client in this process. In their desire to close a deal, the question is asked, “How often does this happen, i.e., a default by the landlord on its loan and the termination of the lease of a AAA rent paying tenant by the foreclosing lender?” The very fact that the question is being asked demonstrates that the client’s support for this piece of the transaction may be wavering. It is the job of the attorney to instill the proper perspective and convince the client that it is important—stuff happens and it only needs to happen once.

As a practitioner who has represented numerous commercial tenants and has dealt with hundreds of SNDAs on their behalf in lease negotiations and interactions with lenders seeking to subordinate the tenant’s lease, these materials are intended as a response to that suggestion as seen from the tenant’s viewpoint. The rationale underlying the tenant’s position on the issues raised in SNDAs will be explained and suggestions for a middle ground will be offered in an effort to achieve balance.

[46.1] II. SUBORDINATION OF LEASE OR MORTGAGE

§1.1 *The Lender’s Objectives.* In making a loan secured by real property, a lender considers not only the appraised value of the land and buildings but will also carefully evaluate the existing leases which encumber that property and which will represent the primary income stream by which the loan will be repaid. As observed by two commentators:

In structuring and documenting a loan, a lender will want to ensure that favorable leases (whether existing at closing or later executed) remain in place and unmodified throughout the term of the loan and continue in effect following foreclosure. The lender will also want to ensure that below-market or unduly burdensome leases do not survive foreclosure and that the lender's right to control condemnation awards and insurance proceeds is not undercut by an inconsistent lease provision that is senior in priority to the lender's deed of trust. On the other hand, in entering into a lease transaction, a tenant will want to ensure that its lease remains intact throughout its term and that the landlord's obligations are performed, even if the identity of the landlord changes over time. The tenant will be particularly concerned (at least in the beginning) that its lease and any subsequent amendments survive a foreclosure by its landlord's mortgagee—an event over which the tenant has no control.¹

For the tenant, the consequences of a mortgage foreclosure could be disastrous. It faces the prospect of losing its lease or being permitted to remain in the premises only under terms and conditions dictated by the lender. The question of the survival of the lease upon a foreclosure will be determined by the relative priority of the mortgage lien and the lease. Absent an agreement to the contrary, those priorities will depend on the order in which the respective instruments were recorded or on whether a junior party otherwise had notice of the senior encumbrance.² If the lease is recorded prior to the mortgage or the tenant is in possession at the time of recordation, or if the lender otherwise is, or should be, aware of the existence of the lease, the lease will be senior to the mortgage lien. Conversely, a lien will be senior to a lease if the mortgage is recorded before the recordation of the lease and before the tenant takes possession, or if the tenant has actual or imputed knowledge of the existence of the lien when it executes the lease.³

1 Patricia J. Frobos and David S. Kitchen, *The Priority of Liens and Leases*, 15 Cal. Real Prop. J. 1 (Fall 1997) (hereinafter *Priority of Liens and Leases*).

2 In the absence of a subordination of positions by either the lender or the tenant, priority is determined by the established concept of "first in time, first in right." See Thomas C. Homburger & Lawrence A. Eiben, *Who's On First, Protecting the Commercial Mortgage Lender*, 36 Real Prop. Prob. & Tr. J. 412, 419 (2001) (hereinafter *Homburger*).

3 *Priority of Liens and Leases*, *supra* note 1, at p. 1.

In modern leasing practice, the question of the subordination of the lease is almost universally addressed in the landlord's form of lease by the "automatic subordination clause."

A comprehensive form of automatic subordination clause in a lease follows:

Figure 1

Subordination of Lease

This Lease and all rights of Tenant hereunder are and shall be subject and subordinate in all respects to all present and future:

(1) ground leases, operating leases, superior leases, overriding leases and underlying leases and grants of term of the land and buildings comprising the Shopping Center, or any portion thereof (collectively, the "Superior Lease"),

(2) mortgages, deeds of trust, deeds to secure debt and building loan agreements, including leasehold mortgages, and spreader and consolidation agreements, which may now or hereafter affect the land and buildings comprising the Shopping Center, or any portion thereof or the Superior Lease (collectively, the "Superior Mortgage"), and

(3) each advance made or to be made under the Superior Mortgage. All references in this Lease to the Superior Lease and Superior Mortgage shall be deemed, in each instance, to include all replacements thereof, and any renewals, modifications, substitutions, supplements and extensions thereof or of any such replacement.

"Superior Lessor" shall mean the lessor at the time of a Superior Lease. "Superior Mortgagee" shall mean the holder at the time of a Superior Mortgage.

The provisions of this Paragraph shall be self-operative and no further instrument of subordination shall be required. In confirmation of such subordination, Tenant shall promptly execute and deliver, at its own

cost and expense, an instrument, in recordable form if requested, that Landlord, the Superior Lessor or the Superior Mortgagee may reasonably request to evidence such subordination; and if Tenant fails to execute, acknowledge or deliver any such instrument within ten (10) days after request therefor, Tenant hereby irrevocably constitutes and appoints Landlord as Tenant's attorney-in-fact, coupled with an interest, to execute, acknowledge and deliver any such instruments for and on behalf of Tenant.

Any Superior Mortgagee may, by giving notice of the same to the Tenant, elect that this Lease shall have priority over such Superior Mortgage, whether this Lease is dated prior to or subsequent to the date of such Superior Mortgage.

Under the foregoing provision, the superiority of a *previously existing* mortgage lien is simply confirmed since, as a matter of law this is already the case. With respect to *future* mortgages placed on the property after the lease was executed and which would otherwise be subordinate to the lease, the subordination clause reverses the priority of the two encumbrances in favor of the mortgage lien. Because this process places the tenant in a very vulnerable position, it is essential for the tenant to secure its lease by reaching an agreement with the lender ensuring the survival of the lease upon foreclosure and the assumption by the foreclosing party (or the purchaser at a foreclosure sale) of the landlord's obligations.

The "subordination, nondisturbance, and attornment agreement" (or simply the "nondisturbance agreement" or "SNDA") achieves this result in return for which the tenant *confirms* (in the case of a previously existing mortgage) the subordinate status of the lease to that mortgage and *subordinates* (in the case of a future loan) the leasehold interest to the subsequent mortgage. The manner in which, from a tenant's viewpoint, the nondisturbance agreement should be negotiated and drafted is extensively discussed in these materials.

However, absent a tenant's ability to secure the promise of a nondisturbance agreement in its lease or to secure one upon direct request from the lender, it is important that, at the very least, the tenant understands the process by which lenders work their superior position to their greatest advantage.

The enforceability of automatic subordination clauses in leases in California was tacitly confirmed in the case of *Dover Mobile Estates v. Fiber Form Products*, extensively discussed below. The California appellate court enforced the automatic subordination clause of the tenant's lease without discussion or analysis, despite the existing concerns of some commentators that such provisions were not enforceable.⁴

§1.2 Subordinating The Mortgage Lien To The Lease. Elevating the lease to a position *superior* to the mortgage gives the tenant the result it presumably always wanted but was unable to secure from the lender by means of an SNDA. However, since such alteration of priorities is the optional and unilateral choice of the lender, the protection the tenant receives is only fortuitous.

In Figure 1, above, and Figure 2, following, the lender is given the option to elevate the lease at its election by giving notice to the tenant of such choice.⁵

Figure 2

Subordination of Mortgage to Lease

Any Superior Mortgagee may, by giving notice of the same to the Tenant, elect that this Lease shall have priority over such Superior Mortgage, whether this Lease is dated prior to or subsequent to the date of such Superior Mortgage.

While this may appear beneficent on the lender's part, it is actually a very wise strategic option, as will be seen from the following discussion of a 1990 case in California.

4 *Priority of Liens and Leases, supra* note 1, at p. 4. The doubt stems from cases in California which require that in order for a superior lienor to be subordinated in status to a subsequent lien, the subordination clause must contain sufficient details disclosing the scope of the financial or other burdens to which the lienor is being subordinated. Also, if there are other conditions precedent to such subordination, those conditions must be met; otherwise, the superior lien remains superior.

5 In order for the lender to unilaterally subordinate the lien of its mortgage and elevate the encumbrance of the lease, the lease must expressly permit it. Patricia J. Frobes and David S. Kitchen, *The Priority of Liens and Leases – An Update*, 17 Cal. Real Prop. J. 1, 38 (Winter 1999) (hereinafter, *Liens and Leases: An Update*).

In the case of *Dover Mobile Estates v. Fiber Form Products*,⁶ a foreclosure purchaser brought an action to recover rent from a tenant who had been the lessee under a lease with the defaulting landlord. The mortgage lien had been created subsequent to the lease and would otherwise have been subordinate to it. However, the lease contained an automatic subordination clause which rendered the lease “subordinate to any mortgages or deeds of trust . . . that may hereafter be placed upon the premises.”⁷ In addition, the lease provided that the mortgagee could elect to render the lease superior to the mortgage, whether the lease was dated or recorded before or after the mortgage. When the landlord defaulted under its mortgage loan, the mortgagee foreclosed and the property was sold in a trustee’s sale. The tenant continued paying monthly rent for approximately six months and then after giving 30 days’ notice, vacated the premises.

The trial court found that the foreclosure sale extinguished the lease and entered judgment in favor of the tenant. The appellate court affirmed under the long-standing principle in California that the foreclosure of a superior mortgage extinguishes a subordinate lease, with the result that following foreclosure, neither the subordinate tenant nor the new owner is bound to perform under the lease. This result is automatic and is not dependant upon an election to do so by the mortgagee made *after* the foreclosure.⁸

In fact, the Court rejected the lender’s argument that the extinguishment of the lease is optional on the foreclosing purchaser’s part *following foreclosure*, without any concurrence needed from the tenant.⁹ The Court found “no reason to question the continued validity of this rule [i.e., automatic termination]” and observed that if the lender’s position were adopted

6 220 Cal. App. 3d 1494 (1990).

7 *Id.* at 1499.

8 This principle, referred to as the “automatic cut-off” rule, obtains in many other states as well. Other jurisdictions, applying what is referred to as a “pick and choose” rule, permit the lender to take title subject to certain leases while terminating others. See Morton P. Fisher, Jr. and Richard H. Goldman, *The Ritual Dance Between Lessee and Lender—Subordination, Nondisturbance and Attornment*, 30 Real Property Probate and Trust Journal, 355 (Fall 1995), at p. 358 (hereinafter, *Fisher and Goldman*).

9 The key phrase here is “following foreclosure.” The lender had failed to subordinate the mortgage to the lease prior to foreclosure (as it had the right to do pursuant to the Lease) but argued for the proposition that an automatic extinguishment was inconsistent with modern-day real property transactions (i.e., a “pick-and-choose” mechanism).

then the purchaser could evict the tenant if rent values increased or hold the tenant to the lease if rent values decreased. In other words, the purchaser could do whatever was most profitable. We decline to allow the purchaser this option. To the contrary, we think it more equitable to follow the rule that the trustee's sale automatically terminates the lease.¹⁰

Although *Dover* confirmed long-standing law, it was greeted by tenants in the depressed commercial real estate climate of the early 1990s as an unexpected boon—a means by which they could escape out from under leases whose rents could not now be supported by business conditions. Indeed, it was felt by some tenants that they were better off not to be locked into their leases by a nondisturbance agreement with the lender. However, as observed in *Priority of Liens and Leases*:

The outcome in *Dover* clearly favors tenants who find themselves burdened by above-market leases. In other economic circumstances, the *Dover* rule will please lenders or foreclosure sale purchasers who want to free their property of below-market leases. At the outset of a lease transaction, however, neither the lender nor the tenant will be able to predict whether the lease will be above or below market when the lender seeks to foreclose. Accordingly, unless the lender and tenant want to gamble on the future, it is in the best interests of both to enter into a subordination, nondisturbance, and attornment agreement that will preserve the lease following foreclosure.¹¹

Therefore, the perceived “boon” to the tenant does not really exist. In an “automatic cut-off” state, such as California, a lender is able to circumvent this affect and avoid the loss of the tenant by electing to *subordinate the mortgage* to the lease *prior* to foreclosure, thereby preventing its extinguishment. Nothing in the *Dover* decision suggested that the lender could not do just that.

However, in a case decided subsequent to *Dover*, a California Appellate Court held that a lender cannot *unilaterally* subordinate its lien to a lease

10 *Dover*, 220 Cal. App.3d at 1500. See also *Priority of Liens and Leases*, *supra* note 1, at p. 3.

11 *Priority of Liens and Leases*, *supra* note 1, at p. 3.

where the lease contains no provision permitting such subordination.¹² The Restatement of Property supports this view.¹³ But even if the lease in an automatic cutoff state such as California lacked a mortgage subordination provision, the lender can achieve the same result by a refinance of the loan with a new (and now junior) mortgage.¹⁴ In a “pick and choose” jurisdiction such as New York, the lender can simply not name the tenant as a defendant its foreclosure action.¹⁵ Thus, it is the *lender*, and not the tenant, who can play the circumstances to its best advantage, based upon the market conditions at the time of (but prior to) foreclosure. However, this issue is almost universally rendered moot by the inclusion in the lease by the “election to subordinate” provisions noted above in Figure 2 and is part of the overall subordination provision of Figure 1. The lender’s failure to do so *prior to foreclosure* in *Dover* was its fatal error.

Thus, there is little a tenant can do to avoid being manipulated by the lender following a loan default unless the tenant was able to negotiate a nondisturbance agreement with the lender prior thereto.

§1.3 *The Lender’s Election to Subordinate Its Lien to The Lease.*

One large commercial lender in shopping center transactions had until recently ubiquitously employed the “Subordination of Mortgage” device at or near the time of execution of a subordinate lease to preserve that lease in the event foreclosure became necessary in the future.¹⁶ However, that lender’s form *carves out* from the operation of its subordination the damage and destruction, insurance, condemnation and condemnation award provisions of the mortgage. By doing so, the lender preserves the seniority of the casualty and condemnation provisions of the mortgage which will continue to remain superior to and prevail over corresponding provisions of the lease in the event of either occurrence.

This author has polled leasing experts in the field and they are split on whether partial subordination actually works, i.e., whether a lender who

12 *Principal Mut. Life Ins. Co. v. Vars, Pave, McCord & Freedman*, 65 Cal. App. 4th 1469 (1998) cert. denied. See also *Liens and Leases: An Update*, supra note 5, at 34–35.

13 See Restatement (Third) of Prop.: Mortgages § 7.7 (1996).

14 Joshua Stein, *Needless Disturbances? Do Nondisturbance Agreements Justify All The Time And Trouble?* 37 American Bar Association Real Property, Probate and Trust Journal, Winter 2003, at 701 (hereinafter *Stein*).

15 *Id.* at p. 730.

16 Teachers Ins. & Annuity Assoc. of America. This lender had decided as a matter of policy that it wanted all of the leases to survive foreclosure and preferred the use of this device rather than negotiating a lengthy (and potentially contentious) nondisturbance agreement.

subordinates its mortgage to the lease must subordinate the *whole* mortgage and may not selectively retain the priority of those provisions it likes (unless the tenant so agrees) lest the subordination be ineffective. If this were correct an attempted unilateral “partial” subordination would be invalid with the result that the lease would be extinguished by the foreclosure anyway, just the opposite of the lender’s intent. Depending on the market conditions at the time, this may be a welcome result for the tenant.¹⁷

The insurance and damage and destruction provisions of the lease are often extensively negotiated by the tenant¹⁸ and leases frequently grant rights to the tenant and impose obligations upon the landlord more favorable to the tenant than the provisions of the mortgage between the landlord and the lender. In a multi-tenanted property such as a shopping center, the lender can find himself burdened with wholly inconsistent provisions and varied obligations scattered throughout numerous leases governing damage and destruction and the disposition of insurance proceeds, all of which will be very troublesome in the face of the real hazards of fire, earthquake or hurricanes.

A lender not wishing to find itself in this position or to test the theory of “partial subordination” will always seek the joinder of the tenant in order to preserve the desired insurance, damage and destruction and condemnation provisions of the mortgage. The large commercial lender referred to above avoided this danger by requiring the tenant to execute the subordination of mortgage document, thereby consenting to the partial subordination.

An unanswered question remains as to whether a lender in a multi-tenanted property such as a shopping center and located in a automatic cut-off state like California can nevertheless “pick and choose” which leases to subordinate to (e.g., the credit leases) and which ones will remain inferior and terminated upon foreclosure (e.g., the non-credit leases). It is the opinion of this author that the lender can so selectively subordinate. If an individual lease permits the lender, at its option, to subordinate the mortgage to it (or partially subordinate it), then the result should be no different if the property contains multiple leases.

17 As it was for the tenant in the *Dover* case. In that case, however, the lender failed to subordinate the mortgage at all.

18 This is less true in the case of the eminent domain provisions unless the tenant is an out-parcel occupant or a large space user (in which case a nondisturbance agreement would be forthcoming anyway).

§1.4 Does Subordination Of The Mortgage Afford Sufficient Protection For The Lender or The Tenant? While the lender and the tenant may feel that each has achieved the functional equivalent of a nondisturbance agreement, this is not completely true. What is needed from the lender's viewpoint is an attornment (or agreement to attorn) of the now superior tenant to the lender. The basic concept of an attornment is that a tenant acknowledges its obligations under the lease owed to the new landlord. This establishes the privity of contract following the foreclosure before the parties can enforce the contractual undertakings which are contained in the lease (as opposed to enforcing those features of the leasehold relationship which automatically survive foreclosure, such as the right to possession and the obligation to pay rent). Following an attornment, the same privity of contract arises between the tenant and the new landlord by reason of the foreclosure as had existed under the original lease.¹⁹ Interestingly, in California, which is an automatic cut-off state, it has been held that an attornment clause in a subordinate lease which requires the tenant to attorn to a lender at the lender's request is enforceable notwithstanding that the lease itself (and presumably all of its terms) are extinguished by a foreclosure of the superior lien.²⁰

But this is only half of the story. From the tenant's viewpoint, what is needed is a reciprocal undertaking *by the lender* to perform all of the lease obligations of the landlord. Without a contractual agreement by which the new landlord following a foreclosure agrees to a continuation of the landlord's obligations under the original lease, the tenant under the surviving lease has the right to occupy its leasehold interest as long as it pays the agreed upon rent, but the tenant lacks the ability to enforce the specific terms of the lease which do not run with the land.²¹ A tenant with a leasehold which is prior in right to a mortgage should seek an attornment agreement with the lender to ensure the continuation landlord's obliga-

19 *Homburger, supra* note 2, at p. 424.

20 *Liens and Leases: An Update, supra*, note 5, discussing *California Commence Bank v. Prudential Insurance Company, et. al.*, California Court of Appeal, 2d App Dist, Div. 3, Case no. B104018, February 2, 1999.

21 The following is a list of covenants that are usually considered to run with the land: "(1) a covenant of quiet enjoyment (2) a covenant to restore (3) a covenant to repair, and (4) an option to renew." *Homburger, supra* note 2, at 428, citing Stephen Carr Anderson, It's Time to Foreclose: Do You Know Where Your Tenants Are? ACREL—Commercial Lending Perspectives for the 90's, April 3-4, 1992 at 1 (hereinafter *Anderson*); see also *Fisher and Goldman, supra* note 7, at p. 364.

tions under the lease beyond the prior tenant's mere right to retain possession.²²

§1.5 Plan B: Another Tenant Protection—Curing The Landlord's Default. If the instrument subordinating the mortgage lien to the lease does not have an express reciprocal undertaking by the lender to perform the landlord's obligations, there is another method available to the tenant who was unable to secure nondisturbance protection from an existing lender (or who obtains nondisturbance protection but without the reciprocal undertaking). The landlord can grant the tenant the right to cure the landlord's default under the mortgage with the companion right to recover reimbursement from the landlord (and if necessary, as a rent offset) for the amount expended to cure. However, in order for this remedy to be effective it will also be necessary to secure the lender's agreement to accept the cure tendered by the tenant (the lender is not otherwise obligated to do so). The lender should have little objection to this procedure as it would be more palatable than granting a nondisturbance agreement or being pressured into subordinating the mortgage lien prematurely or allowing the loan to go into default. The only situation in which the lender would resist this approach would be if it desired to get out of the loan altogether for a variety of reasons (such as rising interest rates). This process also works in the case of a subordinate lease where the tenant does not have the protection of an SNDA.

Section 2924.b of the California Civil Code provides a procedure whereby certain parties in interest may be entitled to receive copies of a notice of default filed by the lender. A party entitled to receive such notice is granted a statutory right to cure the landlord's default and acquires a right of reimbursement from the landlord for the sums so expended. This idea is also supported by *Priority of Liens and Leases*.²³

While the tenant may not be enthusiastic about the prospect of resurrecting defaulted mortgages, it is a way out of its dilemma. This procedure would be unduly burdensome to a shopping center tenant but in the case of a street deal where the cost or amount of the delinquent performance may not be very great in relation to the property, this may be a workable solution for the tenant.

²² *Homburger, supra* note 2, at p. 426.

²³ *Priority of Liens and Leases, supra* note 1, at p. 13.

§1.6 *The Tenant's Interest.* So far we have examined the mechanics of how a lender maintains or achieves a superior position vis-à-vis the tenant and to control the fate of the tenant's lease upon foreclosure. From the tenant's side of the table, however, it stands to lose its entire investment in the premises and the loss of its business upon a foreclosure, regardless of the mechanism employed by the lender or the landlord—a dramatic consequence. Subordination of the mortgage to the lease may afford limited protection to the tenant's occupancy but without all of the benefits it bargained for. The right to resurrect a defaulted mortgage in §1.5 will protect the status quo but at possibly considerable expense to the tenant. The best protection for the tenant of its occupancy and for the lender in the continuation of the rent stream upon a foreclosure is the nondisturbance agreement discussed in the following sections.

[46.2] III. NEGOTIATING THE SUBORDINATION CLAUSE OF THE LEASE

§2.1 *Conditional Subordination.* The above discussion explored the options available to a tenant who does *not* initially have the stature to condition the deal on getting an SNDA from an existing lender²⁴ or to require the landlord to require nondisturbance protection for the tenant from a future lender in return for the subordination of the lease to the future mortgage. In the sections that follow, we shall examine (1) the concept of *conditional subordination* on the assumption that the tenant has sufficient importance to demand it from the landlord, and (2) strategies for the tenant to follow in negotiating the SNDA with the lender. Although it's possible that a tenant with clout may still not be able to convince an *existing* lender to grant nondisturbance protection, the tenant's relationship to a *future* lender is quite different.

a. *The Present Mortgage.* If a lease is already subsequent in time to the mortgage, then subordination is not technically required but all subordination clauses in leases provide language of subordination of the lease to all mortgages, "*presently existing* or hereafter made." The effect of this language in the context of a presently existing mortgage is to merely confirm in writing what is already the case at law.

b. *Future Mortgages.* With respect to future mortgages, the tenant must demand that its obligation to subordinate be *expressly conditioned*

24 This is because the loan is already in place and funded. There is little incentive for the lender to cooperate. However, it will ultimately be in the lender's interest to grant an SNDA to a major tenant whose lease is a significant pillar supporting the security of its loan.

upon receiving written assurance of non-disturbance protection from the future lender should the landlord default under its mortgage (“conditional subordination”). Otherwise, to a tenant who has spent considerable sums for investment, is enjoying a profitable business and is faithfully performing its obligations under the lease would be dispossessed and lose everything. Any tenant, regardless of whether its lease is a credit lease, is entitled to enjoy the sanctity of continued possession and to attorn to the foreclosing lender as its new landlord. This is especially true where the mortgage was executed after the tenant signed its lease and where the tenant was relegated to a subordinate status by virtue of an automatic subordination clause.

For a *credit tenant*, it constitutes the crowning irony to have its lease counted as a credit lease on the one hand—entitling the landlord to derive the benefits of a loan and allowing the lender to enjoy the security of the tenant’s financial strength—and on the other hand to permit the tenant to be dispossessed and its huge investment forfeited at the whim of that lender whose own interest was created subsequent to that of the tenant.

Many landlords assert that the smaller, non-credit tenant is not entitled to this protection, reserving it only for the large national chains. This undervalues and belittles the small tenant, especially in the case of a shopping center. The landlord was anxious enough to have that tenant in the mall in the first instance to fill up those empty, less attractive spaces and to add synergy to the shopping center. In addition, it is far more burdensome for a smaller tenant to make the investment necessary to build out a store, stock it and assume inherently greater risks than it is for the large, wealthy chains. To lose all of that when it has been faithfully observing its lease covenant would be a financial disaster. It is the duty of both the landlord and the lender to respect every tenant and its lease, provided that such lease is in good standing.

c. *“Built-In” Nondisturbance Protection.* There are a minority of shopping center developers in this country who support this principle and build non-disturbance protection right into their lease form. All that is left is to negotiate the terms of that SNDA with the future lender. As will be seen hereafter, this is no easy task. By and large however, tenants, including the national chain credit tenants, must still endure the burden of negotiating this protection into the lease on every occasion. Resistance from landlords’ lawyers still exists.²⁵ The landlord’s lawyer, for his or her part, is trying to make it easy on the client when closing a loan in the future and

25 “The more things change, the more they stay the same.” *Jean-Batiste Alphonse Karr.*

will be arguing for a lender that does not then exist when, in many cases, a future lender will accept the existing tenant and its lease as a *fait accompli* and enter into a nondisturbance agreement.²⁶ Experience has shown that a lender will be far more reasonable when dealing with an existing tenant (with respect to whom the lender desires to acquire priority) than with respect to a tenant who is already subordinate by virtue of having signed a lease after the loan was recorded.

d. *Landlord's Arguments Against Conditional Subordination—Addition to the "SNDA Tapes."* Joshua Stein, in his masterful article, sets forth a list of excuses (the "SNDA Tapes") offered by lenders and landlords for why a tenant should not bother to ask for an SNDA from an existing lender or to condition its automatic subordination upon getting an SNDA from a future lender.²⁷ To those humorous but woeful excuses the following additional examples are offered:

1. *I'll Never Get a Loan!* Some landlord lawyers have argued that to impose this condition in the subordination clause will endanger the landlord's ability to get financing in the future. They then scare their clients with this advice which makes it that much more difficult to get over the issue given the backdrop of a landlord's traditional fear of bankers.²⁸ However, this is simply not borne out in the real world. Lenders are in the business of closing loans and no lender—certainly not one intending to loan out \$50, \$100 or \$200 million on a shopping center property—is going walk away from a deal because one of the satellite tenants, and perhaps a credit one at that, is insisting on nondisturbance protection in return for the subordination of the lease. If there are lenders out there with that disposition and the landlord's lender unfortunately turns out to be one of them, the risk, such as it is, will have to assumed by the landlord, not the tenant.

One approach in dealing with this "lender from Hell" argument in a lease negotiation with the landlord is the following.

26 Prudent leasing practice in this area suggests that the tenant attach a nondisturbance form that it is comfortable with that it will agree to sign with a future lender. See the discussion *infra* "Attaching a Form SNDA to the Lease" as an exhibit.

27 *Stein, supra* note 14, at p. 774.

28 One New York City landlord posed the question to its loan broker who replied that the landlord would never get a loan if the tenant required an SNDA. That was outstandingly bad advice (and didn't succeed).

- If the hypothetical lender grants an SNDA to *none* of the tenants in the complex, then none shall be required with respect to the tenant negotiating the subject lease. The automatic subordination will be effective only if, and so long as the lender does not enter into an SNDA with anyone else in the project.
- If the lender *does* grant an SNDA to any other tenant in the project, no matter how large that other tenant may be (either in terms of space occupied or financial net worth) and regardless of whether that SNDA is granted at the time of loan closing or thereafter, then in such case the subordination is nullified unless such lender enters into an acceptable SNDA with the tenant.

Such a suggested approach should be sufficient to silence any argument from landlord's counsel that the landlord will never be able to get an SNDA from a future lender.²⁹

2. *Don't Worry About It!* Other landlords or their lawyers argue with a different slant: **"A credit tenant like yourself shouldn't worry about and insist on a nondisturbance agreement because no lender in its right mind would ever terminate your lease upon foreclosure since in such a distress situation the lender will want good rent paying tenants in place."** Then the obvious answer here is that such lender will have no problem giving the tenant nondisturbance protection at the outset. In other words, the landlord's argument is true, until its not. If there is a foreclosure, there is simply no guarantee that lenders will act in this fashion. They may want to amend the lease to their liking, with termination as the ultimate threat. In the New York City market lenders are interested in vacant possession and will want to foreclose to the ground, regardless of who the tenant is, for no other reason than a rapidly rising rental market. Or, the purchaser at foreclosure may wish to install an even more desirable tenant in the space or it may have different development plans for the building. Without nondisturbance protection a tenant is in serious jeopardy.

3. *I'll Indemnify You!* The suggestion here is that if there is a foreclosure and the tenant's lease is terminated by the lender, the landlord will indemnify the tenant for its loss. To persons of ordinary intelligence one immediately realizes that if the landlord has defaulted under its loan and

²⁹ This approach was successfully used by this author in one lease where the landlord's counsel sincerely (but naively) felt that its client would not be able to secure future financing because the tenant was insisting on receiving an SNDA as a condition of its subordination.

has precipitated a foreclosure, its obligation of indemnity is of no value. Furthermore, most leases contain an “exculpation” clause or a “non-recourse” clause which limits the tenant’s recovery source for monetary claims to the landlord’s “interest in the Property.” Following a foreclosure, the landlord no longer has an interest in the real estate, so there is no one to pursue and no judgment recovery source to attach. Lastly, the potential indemnification obligations would be enormous for the landlord—economic loss to the tenant—well beyond the “interest in the Property.” For this scheme to work a landlord would have to guarantee a huge obligation *personally*, including loss of future sales and profits, the cost of leasehold improvements and put up significant assets to secure it; this will never happen. A tenant should dismiss such a proposal as non-credible.

4. *You’re Too Small.* The suggestion here is that the tenant’s space will fall below the size threshold of the future lender for granting nondisturbance protection. There is no way a landlord can know this, despite its counsel’s professed experience in real estate financing transactions. The lawyer is simply trying to make life easier for its client in its negotiations with a future lender. A future lender will not be deterred from approving a loan or a lease simply because an existing tenant requires the protection of a nondisturbance agreement. Such a dismissive argument is not an effective negotiating technique. If, however, a loan commitment is already made with known parameters, then it will be the landlord’s job to make it happen lest it lose a leasing prospect assuming the tenant doesn’t blink first.

5. *You Can Terminate The Lease!* Some landlords suggest that if, *at the time of closing the loan*, the future lender refuses to sign a nondisturbance agreement, the tenant will have the right to cancel the lease! The defect in this argument should be obvious. If nondisturbance protection and quiet possession, i.e., the ability *to remain* in the premises following a mortgage foreclosure, is what the tenant is looking for, then why would it want the right to *cancel* the lease, especially at the very moment of the loan closing, long before there is even an issue of a landlord default and mortgage foreclosure and indeed, which issue may never even arise? The tenant’s business may be doing very well at the time and the tenant would have no desire to terminate the lease. Such a clause would force the tenant to make a dramatic decision at the time of the closing of a future loan when vacating the premises may be the furthest thing from its mind. What the tenant is seeking is not a cancellation right, but rather, the reverse - quiet enjoyment of the premises and the preservation of its lease. Lastly, it seems unlikely that the future lender would favor such a clause.

During the initial negotiation of a lease, a tenant may seek the right to terminate the lease if the landlord doesn't produce an SNDA from an *existing* lender. This is a threat that may or may not be wise for the tenant to exercise, given its interest in the premises in the first place, but should it elect to do so, it has not (presumably) invested significant sums which it might otherwise forfeit. There are more effective incentives for a landlord and existing lender to agree to extend nondisturbance protection to the tenant, without forcing the tenant to make the drastic decision to cancel, such as conditioning the delivery of possession upon getting an SNDA or abating (or deferring) the rent until one is received.

As against a *future* lender who is seeking to achieve priority by virtue of an automatic subordination clause, this approach is a sorry substitute for the automatic subordination to be conditioned upon receiving nondisturbance protection.

Figure 3

Subordination to Future Encumbrance Conditioned Upon Nondisturbance Protection

This Lease shall not become subordinate to the lien of any mortgage, deed of trust, ground or master lease, sale-leaseback transaction or other security instrument (any one or more of the foregoing individually or collectively called an "Encumbrance") which shall hereafter be placed on the Premises, *unless and until* Landlord obtains from the holder of the Encumbrance placed against the Premises, a non-disturbance agreement in recordable form which provides that in the event of any foreclosure, sale under a power of sale, ground or master lease termination or transfer in lieu of any of the foregoing or the exercise of any other remedy pursuant to any such Encumbrance:

(a) Tenant's use, possession and enjoyment of the Premises shall not be disturbed and this Lease shall continue in full force and effect so long as Tenant is not in default hereunder, and

(b) this Lease shall *automatically and unconditionally* become a direct lease, upon its terms, between any suc-

cessor to Landlord's interest, as landlord, and Tenant as if such successor were the Landlord originally named hereunder. (Emphasis Added).

The provisions of subparagraph (b) are quite definite and fixed. To the extent a proposed SNDA from a future lender contains extraneous and burdensome provisions of the type hereinafter discussed, those provisions are beyond the scope of that language and the tenant is still in the driver's seat. If the tenant and lender cannot work it out, the tenant's lease will *not* be subordinate to the mortgage. And the landlord will *not* be in a position to claim that the tenant is in default by refusing to sign the lender's form SNDA.

DRAFTING POINT—*Conditional Subordination—Tenant's Subordination Must Be "Conditioned Upon" Nondisturbance Protection.* Some leases contain the provision that **"this Lease will continue notwithstanding a foreclosure of the mortgage."** This has no effect on a superior lender. The lender is not a party to the lease and by virtue of its superior lien, is not subject to the terms of the lease.³⁰ Furthermore, if the clause obligates the tenant to subordinate to a future lender in one sentence and in a separate sentence declares that the lease will continue notwithstanding foreclosure, it is highly doubtful that, without the interdependency of the two sentences, this language would be sufficient to protect the tenant. The lender, as a third party beneficiary, enjoys the benefit of the tenant's covenant in the lease to subordinate but arguably would not have the obligation to honor the nondisturbance provisions of the clause. In the words of one commentator:

A tenant should not accept the "wooden nickel" lease provision that purportedly obligates any purchaser at a foreclosure sale to recognize and not disturb the tenant. The provision probably would be binding on a junior lienholder (who would take subject to the lease anyway) but would not bind a senior lienholder. Under Dover, a foreclosure sale purchaser will not be bound by any provision of the [subordinated] lease, and that presumably includes a provision of the lease purportedly obligating the purchaser to recognize the lease.³¹

30 *Priority of Liens and Leases*, *supra* note 1, at p. 4.

31 *Id.* at p. 13.

Unless the tenant's obligation to subordinate is directly and expressly *conditioned upon* getting a non-disturbance agreement, the tenant is not really protected.

§2.2 *Attornment by Tenant.* Attornment clauses in leases operate in tandem with subordination provisions to ensure that the lease, *at the successor's option*, shall continue³². The printed attornment clauses appearing in leases are written on the assumption that the subordination clause is also unchanged, i.e., that the tenant is subordinate to present and future mortgages *without* non-disturbance protection. Thus, these attornment clauses provide that while the tenant is obligated to attorn to the foreclosing lender or purchaser at foreclosure sale, this will be only effected if such party accepts the tenant's attornment *at its option*. These clauses need only to be changed, deleting the italicized phrase above, to be consistent with the lender's obligation to recognize the lease, become the new landlord under it and assume all of the landlord's obligations.

Attornment clauses can be enforced by the lender as a third party beneficiary of the tenant's covenant to attorn.³³ This is fine so long as this result is not the unilateral choice on the lender's part only.

Figure 4 below is an extract from an actual lease. The portions relevant to this discussion have been underlined. Figure 5 denotes the necessary changes.

Figure 4

Attornment by Tenant (Original Version)

In the event any proceedings are brought for foreclosure, or in the event of the exercise of the power of sale under any mortgage, deed of trust or deed to secure debt made by Landlord covering the Premises, Tenant shall *at the option of such purchaser* attorn to the purchaser upon any such foreclosure or sale and recog-

32 Attornment is "the act of feudatory, by a vassal or tenant by which he consents upon alienation of an estate to receive a new lord as superior and transfers to him his homage and service." *Fisher and Goldman*, *supra* note 8, at p. 362, quoting Webster's Third New International Dictionary.

33 See *Priority of Liens and Leases*, *supra* note 1, at pp. 7-8. See also *Liens and Leases: An Update*, *supra* note 5, at p. 35, for a discussion of cases where, after a foreclosure, a subordinate lease was nevertheless preserved by virtue of the attornment clause of the lease because the lender was found to be the intended third party beneficiary of the covenant to attorn. See also *Principal Mut. Life Ins. Co. v. Vars, Pave, McCord & Freedman*, 65 Cal. App. 4th 1469 (1998) *cert. denied*.

nize such purchaser as the Landlord under this Lease. (Emphasis added).

Figure 5

Attornment by Tenant (Revised)

In the event any proceedings are brought for foreclosure, or in the event of the exercise of the power of sale under any mortgage, deed of trust or deed to secure debt made by Landlord covering the Premises, *such purchaser shall take subject to this Lease and shall automatically and unconditionally be deemed to be bound by the obligations of the Landlord under this Lease and Tenant shall at the option of such purchaser attorn to the purchaser upon any such foreclosure or sale and recognize such purchaser as the Landlord under this Lease.* (Emphasis Added).

§2.3 Tenant to Execute “All Necessary Documents”—The Blank Check

Most subordination clauses contain provisions such as the following:

Figure 6

Tenant to Sign All Necessary Documents

Tenant agrees to execute any and all documents reasonably required by any mortgagee to effectuate the foregoing provisions (i.e., automatic or conditional subordination, Ed.). If Tenant fails to execute any such document within ten (10) days after request therefor, the same shall be deemed a material default under the Lease. In the alternative, Tenant hereby irrevocably constitutes and appoints Landlord as Tenant’s attorney-in-fact, coupled with an interest, to execute and deliver such document for and on behalf of Tenant.

To agree to such broad language without any limiting provisions will yield totally unhappy results for the tenant and should be completely unacceptable. Given the imagination of lender’s counsel, a tenant cannot predict or minimize the possibilities of what may appear in such a docu-

ment in the future, regardless of the tenant's knowledge of present day financing practice. The potential magnitude of such unexpected issues is extensively discussed in Part III of this article. As an example of the kind of surprises a tenant might encounter, lenders have recently included the following provisions in such "reasonably required" documents (which were not otherwise contained in the lease):³⁴

- (a) a disclaimer of any obligation to pay a construction allowance;
- (b) a disclaimer of any obligation to perform any construction or restoration work at the Premises;
- (c) an exculpation clause whereby the tenant is limited to recovery against the real estate for the landlord's defaults (where the lease had no provision or one that was more equitable); and
- (d) an exculpation clause disclaiming all responsibility whatsoever with respect to hazardous materials.

The tenant must know exactly what these documents say before the tenant agrees in advance to sign them, or, if such documents are unavailable, then at least the content of the clause must be severely limited to ensure that the tenant has not agreed in advance to material modifications of the leases.³⁵ The following clause is a suggested solution:

Figure 7

Limitation Upon Tenant's Obligation to Sign Documents

... provided however that:

(1) such documents shall be strictly limited in its wording or tenor to a confirmation by the parties (a) of the subordination of this Lease to such mortgage, and (b)

34 Or were contained in the lease in a negotiated form different from that of the lender's document.

35 In *Hartwig Transit Inc. v. Menolascino*, 113 Ill. App.3d 165 (Ill. App. Ct. 1st Dist. 1983), the landlord asked the tenant to sign a "confirmation of subordination," which really turned to be a lease amendment, imposing additional obligations upon the tenant. When the tenant refused to sign it, the landlord tried to default the lease. The court held for the tenant, finding that the "confirmation" was much more—an amendment that the tenant was not obliged to sign. See also *Stein*, *supra* note 14, at p. 716.

of the mortgagee's covenant not to disturb Tenant's possession and to recognize this Lease and be unconditionally bound by the provisions hereunder, and

(2) no such documents may increase any of Tenant's obligations hereunder or decrease any of Tenant's rights or Landlord's obligations under this Lease (or that of a Successor Landlord should it succeed to Landlord's position hereunder. (Emphasis Added).

[46.3] IV. NEGOTIATING THE NONDISTURBANCE AGREEMENT

§3.1 *In General.* In the following sections it is assumed that the lender has agreed, in the case of a subordinate lease, to negotiate an SNDA with the tenant or, in the case of a superior lease, the tenant has a conditional subordination clause and is now confronting the subsequent lender. The manner in which the SNDA should be modified will be explored.

a. *The Present Lender.* In dealing with the present lender's SNDA form, the tenant has very little leverage. The loan is already funded and the lender is under no compulsion to even grant an SNDA, let alone negotiate its provisions. A case in which a lender may be motivated, however, is if it is persuaded by the landlord that signing a credit lease with a nationally known tenant will substantially benefit the property and enhance the value of the lender's security and that it is better to settle the matter now rather than to play the market at the time of foreclosure. The lender will certainly care if the tenant - presumably a credit tenant - has conditioned the lease upon obtaining an SNDA. In any case, the tenant must use its powers of persuasion to spell out the fairness of its comments to the lender's form. Many existing lenders will be open-minded and will discuss and negotiate their form to a degree because they want the present security of knowing that upon foreclosure they will have rent paying tenants ready to attorn to them and maintain the integrity of the income stream without the pitfalls of ensuring lease survival at the time of foreclosure.³⁶

b. *The Future Lender.* In dealing with future lenders and their SNDA forms, the situation is quite different. Here the tenant's lease is a

³⁶ That is, by reliance upon (1) the proper and timely subordination of the mortgage lien to the lease, or (2) the enforcement of the lease against the tenant under a third party beneficiary theory, which in turn depends upon a properly drafted attornment clause.

superior encumbrance and the tenant's obligation to subordinate is conditioned upon getting nondisturbance protection from the lender upon terms and conditions acceptable to the tenant. Such future lenders, with a few exceptions, will accept the tenant and its lease as a *fait accompli* and will accept the tenant's modifications to their SNDA form (so long as the tenant, on its part, is not overreaching). It is unlikely that such a lender would decline to loan funds because of the necessity of negotiating an SNDA. Not surprisingly, a future lender is eminently more reasonable to deal with.

§3.2 Use of The Lender's "Customary" Form. If the nondisturbance clause of the lease contains the language of Figure 3 *supra*, which describes the substance of the nondisturbance agreement, then attaching a pre-approved SNDA form is not strictly necessary:

To guard against the possibility of an impasse with the future lender, many landlords insist on a provision that the nondisturbance agreement described in the lease will be on "the lender's then customary form". This is should be unacceptable to the tenant as it is placed at the mercy of the future lender where the fairness or egregiousness of a particular form is purely a function of the creativity of lender's counsel.³⁷ Whatever happens to be fashionable in nondisturbance agreements at the time, no matter how inconsistent with the basic notion of nondisturbance protection as respecting the terms and conditions of the tenant's lease, would have to be accepted by the tenant. One example of such a clause follows:

Figure 8

Tenant to Execute "Customary" Form of SNDA

This Lease shall become subject and subordinate to all future mortgages provided that Landlord shall deliver to Tenant from the holder of any such mortgage or superior lease an agreement in recordable form (i) whereby any such holder shall agree that as long as Tenant is not in default under any obligations under this Lease beyond any applicable notice and

³⁷ Examples of just how far SNDAs have mutated from their origins will be seen in the discussion that follows.

grace period, such holder shall not disturb Tenant's possession if such mortgage is foreclosed or superior lease terminated and (ii) containing such additional provisions as are customarily included in a subordination, attornment and non-disturbance agreement ("SNDA") issued by such holder in form reasonably acceptable to the holder of such mortgage or superior lease and Tenant. (Emphasis added).

What is "customary" is a relevant term, depending a lender's or a tenant's respective experience. To a lender, landlord or counsel for either, their experience may be that tenants acquiesced when asked to sign the lender's SNDA without substantial modification on any of the significant issues such as responsibility for prior obligations or recognizing rent offsets in self-help provisions. This practice stems from earlier custom where tenants were preconditioned to low expectations while high expectations were baked into the mindset of lenders. Thus, a lot of precedent has been set for tenants to fail in this effort. However, this is not true of the credit tenants, whether leasing a lot of space or a little.

§3.3 Attaching a Form SNDA to the Lease. Other landlords (and tenants) attempt to resolve the issue by attaching a pre-negotiated SNDA form to the lease. There are conflicting opinions on the wisdom of using a pre-negotiated form as an exhibit to the lease. Strictly speaking from the tenant's viewpoint, using a form previously negotiated between the landlord and tenant would be the safest practice for the tenant to follow. Having negotiated an acceptable form at the time of lease execution, the tenant avoids having something unknown thrust upon it later. However, the landlord will be concerned that even a pre-approved form, including one that the landlord has aggressively negotiated with the tenant to make it as "lender friendly" as possible, will not be acceptable to the future lender. Although they follow a *general* conceptual format, each lender's SNDA is different from another's and the one attached to the lease may not address that future lender's needs. As two commentators have noted:

There is sometimes the temptation to try to pre-negotiate an SNDA and attach a form to the lease, which the tenant agrees to execute in connection with the landlord's loan transactions. Owner's counsel may seek the input of the lender the owner anticipates using at the time, or counsel may draw upon his or her own experience to draft what is believed will be a reasonable form. This approach can

lead to disaster if the lender at the next refinance proves to be unreasonable, inflexible or married to its own form.

It is virtually impossible to predict all of the issues that a future lender may see in a tenant's lease. A lender will seek to use a modified SNDA to address lease issues and tenant related issues with respect to declarations, easements, covenants or restrictions. If the Owner and tenant have agreed upon a particular form of SNDA which is attached to the lease, the Owner has denied any subsequent lender flexibility in having its own particular needs met in an SNDA. The tenant, who probably negotiated vigorously and feels that they [sic] compromised extensively, will not be willing to renegotiate an already agreed upon SNDA form. It is almost better to have basic subordination, non-disturbance and attornment language in the lease and to otherwise start from scratch with each lender in an attempt to have the lender and the tenant agree to an SNDA.³⁸

The same may be said of the tenant who may feel a prior form was negotiated very effectively in its favor and is not interested in re-visiting those issues with a new lender who thinks it can do better.

Attaching a Form Previously Negotiated with a Particular Lender. Although this may be helpful in a great number of cases, it is also dependent upon whether the previous SNDA was negotiated in a situation where the lease was prior to or junior to the mortgage. An SNDA negotiated with a lender under an existing loan may not be as favorable to the tenant as one negotiated where the tenant is dealing with a future lender. In the former case, the circumstances may have required some hard concessions from the tenant in order to secure the agreement in the first place. Thus, it will not be that helpful to the tenant in the latter case. From the lender's side, this author recently encountered the following provision in an SNDA from a loan servicer for a major lender:

38 Dale E. Ahearn, Esq. and L. Jude Clark Jr., Esq., *Between a Rock And A Hard Place—Representing Owners In SNDA Negotiations*, Crafting Lease Clauses, Vol. III. International Council of Shopping Centers (ICSC), Selections From ICSC U.S. Shopping Center Law Conferences, 1999–2001, p. 187, 192 et seq. (hereinafter *Ahearn and Clark*).

Figure 9

Prior Form Not a Precedent

Landlord and Tenant acknowledge that Bank enters into numerous agreements of this type on a regular basis, both in its own capacity and as a commercial mortgage servicer on behalf of other lenders, and that the specific provisions contained in any agreement of this type entered into by Bank will vary depending on numerous transaction-specific factors, including, without limitation, the borrowers, loan documents, tenants, leases, servicers, servicing agreements and property and market conditions involved in the transaction. Accordingly, Landlord and Tenant further acknowledge that the specific provisions contained in this Agreement will not necessarily be acceptable to Bank in connection with any other transaction.

To give the future lender some flexibility, landlords often propose that the tenant agree to sign a form “substantially similar” to the pre-approved form. Or they ask that the tenant sign the future lender’s form provided the same is “reasonably acceptable” to the tenant. A tenant’s response would be that the subsequent SNDA be the same in all *material* respects to the previously negotiated form.

Such language, while appearing quite reasonable on its face, opens the door to all manner of mischief by the lender’s counsel and the possibility of a wide area of disagreement. Experience has shown that lender’s counsel are disposed to create SNDA forms which seriously erode some of tenant’s fundamental rights under the lease. If the future lender feels that the tenant’s position with respect to a particular issue in the SNDA is not reasonable, a dilemma for the tenant is created. The landlord, faced with the possibility that its loan will be jeopardized, may be compelled to allege that the tenant is in default of the lease in refusing to sign the SNDA and send the tenant a default notice. The tenant will then be faced with defending the reasonableness of its position in an eviction proceeding. The tenant should not place itself in such jeopardy where in this case the landlord is worried about the sensitivity of a future (and as yet unknown) lender.

A tenant has little motivation in exacting unreasonable demands from the lender or from the landlord because all it really wants, in return for

subordinating its lease, is nondisturbance protection and recognition of the lease upon the terms and conditions that were negotiated, without dilution by the lender. If the tenant does harbor bad faith motives and attempts to better the lease deal, the lender and the landlord can waive the necessity of subordinating the lease to the mortgage and proceed to close the loan without the tenant's subordination. What the tenant will gain from this tactic is the eternal enmity of its landlord and will likely have to pay dearly for it later on when the tenant needs the landlord's cooperation.

One possible compromise may be where (1) the lease has basic subordination, non-disturbance and attornment language in it,³⁹ and (2) the tenant additionally is required to sign a future lender's form that is "reasonably acceptable" to the tenant provided that certain conditions and prerequisites to the tenant's obligation to be "reasonable" are clearly set forth. Such a suggested clause follows:

Figure 10

Limitations On Agreement to Use Lender's Form SNDA

. . . provided however that any such subordination shall be conditioned upon Landlord delivering to Tenant a nondisturbance agreement in the form then customarily used by such Mortgagee, which form shall be subject to Tenant's approval which shall not be unreasonably withheld or delayed upon condition that such form:

(a) provides that so long as Tenant is not in default under this Lease beyond any grace period:

- (i) Tenant shall not be joined in any action to foreclose the Mortgage in connection with the Mortgagee's enforcement of its rights under such Mortgage (unless as a purely procedural matter such joinder is required in the jurisdiction in which the Premises is located, so long as Mortgagee does not seek the termination of the Lease, Tenant's rights under such nondisturbance agreement are not altered or dimin-

39 *Id.* at p. 193.

ished), this Lease shall remain in full force and effect and Tenant's possession of the Premises and its rights under this Lease shall not be disturbed or terminated,

- (ii) that this Lease shall *automatically and unconditionally become a direct lease, upon its terms*, between such Mortgagee, as landlord, and Tenant herein as if such party was originally named as landlord hereunder.

(b)does not increase any of Tenant's obligations under this Lease (other than (i) a requirement to give notices of Landlord's defaults to such Mortgagee and affording such party an opportunity to cure, or (ii) to deliver rent to such party in accordance with a direction to do so),

(c)does not reduce any of Tenant's rights under this Lease or any of Landlord's obligations hereunder (or that of the Mortgagee should it succeed to the Landlord's interest under the Lease. (Emphasis Added).

Such a provision would allow the lender's counsel little latitude for roguishness in attempting to alter the tenant's deal.

The New York State Bar Association Model Form. To simplify and streamline negotiations of SNDA agreements and to define a "reasonable" baseline, the Commercial Leasing Committee of the New York State Bar Association Real Property Section decided in 1992 to assign to a subcommittee the responsibility to develop a model SNDA agreement.⁴⁰ While those from the lenders side may have criticized it as going too far, those from the tenant's viewpoint complained that it did not go far enough.

40 Report of Subcommittee on Nondisturbance Agreements, with Model Agreement, NYSBA Real Property Law Section Newsletter No. 2, Spring 1994, at p 2.

Nevertheless, it was some movement toward a balance.⁴¹ The Model SNDA is attached as Exhibit A at the end of this chapter.

§3.4 The Act of Subordination—What Interest is Being Subordinated? The initial component of the SNDA is the act by which the tenant subordinates its leasehold interest to the mortgage. In SNDAs, the interest made superior is described as “the mortgage,” the “lien of the mortgage,” or both.⁴² The safest practice for the tenant to follow is to agree to subordinate its lease to the *lien* of the mortgage, as a statement of its relative priority vis-à-vis the recording statutes. Use of the broader phrase where the lease is subordinate to *the* mortgage or the *terms thereof* may create a presumption that the terms of the mortgage with respect to issues such as damage and destruction and condemnation will prevail over corresponding provisions of the lease where the subject is not otherwise dealt with in the SNDA. Where the subject is (typically) covered in the SNDA, this initial “subordinating” language may introduce inconsistencies or ambiguities regarding many issues that are best avoided by restricting the subordination to the *mortgage lien* only.

The granting clauses of mortgages are all encompassing in the extent of property subject to the mortgage lien and often extends to “**all personal property appliances and goods of every nature whatsoever now or hereafter located in, or on, or used, or intended to be used in connection with the Mortgaged Property.**” To the extent the landlord has granted such a blanket lien on the real and personal property located on the mortgaged premises, it is advisable for the tenant in the SNDA to insulate any its personal property from the lien of the mortgage as well as any “brand specific” leasehold improvements which under the lease it is permitted to remove and to seek confirmation by the mortgagee. Following is a suggested clause:

41 In the words of Joshua Stein: “The model SNDA agreement reflects the subcommittee’s view of how a well-represented mortgagee and a well-represented tenant could resolve the typical SNDA agreement issues without material prejudice. Some provisions in the model SNDA agreement can be characterized as “pro-mortgagee,” others as “pro-tenant.” As a whole, however, this model form represents an appropriate accommodation of the competing interests consistent with normal marketplace outcomes of negotiations between reasonably well-represented parties. In the aggregate, the subcommittee believes it is a “fair” and even-handed document.” Report of Subcommittee on Nondisturbance Agreements, with Model Agreement, NYSBA Real Property Law Section Newsletter, Spring 1994, at 42.

42 See Exhibit A at the end of this chapter, § 2.

Figure 11

Mortgage Lien Does Not Apply to Tenant's Property Or Brand Specific Items

Subordination. The Lease, the leasehold estate created thereby, and all rights and privileges of Tenant thereunder shall be subject and subordinate to the lien of the Mortgage and to any renewals, modifications, consolidations, replacements and extensions of the Mortgage to the full extent of the obligations now or hereafter secured by the Mortgage.

The foregoing notwithstanding, in no event shall any of (i) Tenant's trade fixtures, inventory, equipment, furniture and furnishings, accounts, books or records or other assets ("Tenant's Property"), or (ii) any improvements or fixtures of Tenant which are Tenant's tradeness (i.e., floor covering or lighting fixtures) or which incorporate the trademarks or reproductions of copyrights by or licensed to Tenant or any of its affiliates (the "Brand Specific Improvements") be or become subject or subordinate to the lien in favor of Bank. Tenant or its lender, if applicable, shall have the right to remove Tenant's Property and Brand Specific Improvements at any reasonable time or times; provided that Tenant or its lender promptly repairs the Property to its condition prior to the removal at no expense to Bank.

§3.5 "Naked Nondisturbance" vs. Full Assumption. Although a lender may accept the concept of nondisturbance protection, there are many who are reluctant to assume the full array of landlord obligations under the lease. A practice still commonly encountered today in SNDA's is where lender lawyers continue to cling to the medieval notion that while the lender may have privity of estate and contract with the tenant and may have to suffer the presence of the tenant upon foreclosure, it doesn't have to assume any of the landlord's obligations under the lease other than those that run with the land.⁴³ For the privilege of occupying the land the tenant must attorn to the lender, pay the rents and perform the other obligations but get little back in the way of the performance of the

⁴³ See discussion at § 2.2, *supra*.

landlord's material obligations that the tenant bargained for. At common law, the question of which obligations a lender would be required to honor upon foreclosure where the lender merely agreed not to disturb the tenant's possession, without more, would depend upon whether the covenants of the landlord in the lease run with the land or were personal in nature. The foreclosing lender would have privity of estate but not privity of contract with the tenant remaining on the premises and would be bound only by covenants in the lease which run with the land and not by personal covenants. The covenant of quiet enjoyment and those of a well maintained premises are covenants running with the land. On the other hand maintenance and repairs clauses, utility provisions, exclusives, restrictive covenants and co-tenancy clauses may or may not be personal covenants. The answer will turn on factual determinations in each case that may not be predictable.⁴⁴ This philosophy is reflected in the following provision found in nondisturbance agreements:

Figure 12

"Naked" Nondisturbance

So long as Tenant is not in default under the Lease (beyond any period given Tenant to cure such default) as would entitle Landlord to terminate the Lease or would cause, without any further action of Landlord, the termination of the Lease or would entitle Landlord to dispossess Tenant thereunder, Mortgagee agrees with Tenant that Mortgagee *will not disturb the peaceful and quiet possession of the Premises by Tenant by reason of any Foreclosure (as hereinafter defined) or otherwise, nor join Tenant as a party in any action or proceeding brought pursuant to the Mortgage.* (Emphasis Added).

Additionally, attornment clauses work in tandem with subordination clauses to ensure that with respect to leases that the lender wants to preserve, that the lease obligations run mainly in one direction – from the tenant to the foreclosing lender. Following is an example.

⁴⁴ Ahearn and Clark, *supra*, at note 38, p. 189.

Figure 13**“Partial” Attornment (i.e., by Tenant Only)**

In the event of Foreclosure (as defined herein), *Tenant shall be bound to Mortgagee under all of the provisions of the Lease for the balance of the term thereof (including any extensions or renewals thereof which may be effected in accordance with any options contained in the Lease) with the same force and effect as if Mortgagee was the Landlord under the Lease, and Tenant hereby agrees to attorn to Mortgagee as its landlord, such attornment to be effective and self operative, without the execution of any further instruments on the part of either of the parties hereto, immediately upon the succession by Mortgagee to the interest of Landlord in the Premises.* (Emphasis added).

The tenant is not interested in merely having a partial landlord as its contracting party—the part that collects the rent—but rather, expects to have a party responsible for operating the property and performing the other landlord obligations the tenant originally bargained for. What is needed is to remedy Figure 13 is an *attornment clause* which is more expansive. The attornment clause must involve a full affirmation by the tenant to render performance of its obligations to the foreclosing lender and full assumption by the lender of the landlord’s obligations under the lease. The additional required language follows:

Figure 14**Lender Bound to Tenant Upon Foreclosure**

“ . . . and further, in such event, *Mortgagee shall be automatically and unconditionally bound to the Tenant under all of the provisions of the Lease, and Tenant shall, from and after such event, have the same remedies against Mortgagee for the breach of any agreement contained in the Lease that the Tenant might have had under the Lease against Landlord thereunder . . .*” (emphasis added).

The extent to which the lender will be bound to the tenant, particularly with respect to prior claims arising out of uncured defaults of the departed

landlord, is the subject of contentious negotiation between the lender and the tenant.

§3.6 *The Lender's "Carve-Outs."* Lenders are extremely uneasy about being held accountable for outstanding defaults of the landlord which arose prior to foreclosure nor do they wish to be held to actions taken by the landlord which may be prejudicial to their position. Lenders are only willing to assume lease obligations which arise during their watch, i.e., only after they have succeeded to the landlord's interest following foreclosure (despite the fact that landlord defaults may be mounting while a lender is attempting to gain possession and title). Even more disconcerting to the tenant is the fact that lenders often try to limit or avoid certain other material obligations altogether, even after their succession to the landlord's interest.⁴⁵

Accordingly, customary lender forms of nondisturbance agreements have evolved a list of limitations (called "carve-outs") from their assumption of lease obligations upon foreclosure. A sampling of the list of carve-outs is set forth below:

Figure 15

The Lender "Carve Outs"

. . . and further, in such event, Successor Landlord shall be bound to the tenant under all of the provisions of the Lease, and Tenant shall, from and after such Succession, have the same remedies against Successor Landlord for the breach of any agreement contained in the Lease that the Tenant might have had under the Lease against Landlord thereunder provided, however, that Successor Landlord shall not be:

- (a) liable for any act or omission of any prior landlord (including Landlord); [See § 3.7 *infra*]**

- (b) subject to any offsets or defenses which Tenant might have against any prior landlord (including Landlord); or [See § 3.8 *infra*]**

⁴⁵ Or what Joshua Stein calls "*Lender-Tenant Risk Shifting*" and "*Post-Foreclosure Lease Improvement*." Stein, *supra*, note 14, at p. 711-712, 714.

(c) bound by any rent or additional rent which Tenant might have paid to any prior landlord (including Landlord) more than one month in advance; [See § 3.9 *infra*]

(d) bound by any security deposit which Tenant may have paid to any prior landlord (including Landlord), unless such deposit is available to the party who was the holder of the Mortgage at the time of a Foreclosure; or

(e) bound by any amendment, modification or termination made without the Mortgagee's consent." [See § 3.10 *infra*]

(f) bound by any termination of the Lease or surrender of the Premises made without the Mortgagee's consent;" [See § 3.11 *infra*]

(g) bound by assignments or subleases made without the lender's consent [See § 3.12 *infra*]

(h) liable for the performance of any construction work at or restoration of the Premises or liable for the payment of any construction allowance or contribution towards the cost of work performed by Tenant in the Premises; [See § 3.13 *infra*]

(i) liable for "representations and warranties" of the Landlord; [See §3.14 *infra*]

(j) liable for the cleanup of or damages resulting from hazardous materials in the Premises or Shopping Center; [See §3.15 *infra*]

(k) liable beyond the Successor Landlord's interest in the Premises [Shopping Center] for the performance of any obligation of the Landlord under the Lease. [See § 3.16 *infra*]

In response, the tenant will endeavor to modify the SNDA "carve-outs" in the manner discussed in the following sections. Often, when negotiating the lease it is the *landlord's* lawyer, and not the lender, who is insisting on the carve-out language within the lease itself. The landlord is

simply trying to make it easier on itself at some future time, to the tenant's detriment, when it is seeking to re-finance the property by giving the future lender a form it will be readily happy with. This is an unwise idea for the tenant; the landlord should allow the future lender fend for itself, a task for which it is entirely capable.

§3.7 Acts or Omissions. This, together with its companion carve-out, Offsets and Defenses (see § 3.8 *infra*) are the *most contentious* of the lender carve-outs. The tenant would modify the clause as follows:

Figure 16

**Lender Not Exempt From Prior Acts, Omissions,
Offsets or Defenses**

(Modified By Tenant)

. . . and further, in such event, Successor Landlord shall be bound to the Tenant under all of the provisions of the Lease . . . provided, however, that Successor Landlord shall not be:

- (a) liable for any act or omission of any prior landlord (including Landlord) *unless* Tenant shall have given notice (pursuant to Paragraph 2 hereof) of such act or omission to the party who was the then holder of the Mortgage (whether or not such holder elected to cure or remedy such act or omission); or
- (b) subject to any offsets (except those expressly permitted under the Lease) or defenses which Tenant might have against any prior landlord (including Landlord) *unless* Tenant shall have given notice (pursuant to Paragraph 2 hereof) of the state of facts or circumstances under which such offset or defense arose to the party who was the then holder of the Mortgage (whether or not such holder elected to cure or remedy such condition).⁴⁶

While some lenders hold to the traditional practice, others agree to a middle ground. In the words of two commentators:

⁴⁶ See Exhibit A at the end of this chapter, § 4.1.

State law varies greatly regarding a successor landlord's liability for acts and omissions, of its predecessor. In some states, a foreclosing lender is not liable for the acts or omissions of prior landlords unless they *continue* after foreclosure. In other states, the determination depends upon whether liability for such acts or omissions runs with the land or is personal in nature. Such determinations are often fact specific.⁴⁷

a. *The Tenant's Dilemma.* Most leases contain an "exculpation clause" or "non-recourse" provision which restricts all claims of the tenant for monetary damages to the landlord's "interest in the property."⁴⁸ However, following a foreclosure, the defaulting landlord no longer has an interest in the real estate. The party who *does* have the interest is the lender, the one who did not commit the defaults. Therefore, there is no one nor any real estate interest remaining against which the tenant might pursue its claim—a claim which has now been left behind. Further, while injunctive relief is exempt from the exculpation and might still have been an option against the new owner-lender, the new owner's position is that in any event it doesn't inherit past defaults of its predecessor and has no liability to the tenant with respect to them, whether in the nature of injunctive relief or otherwise. The tenant is left in a quandary.

This problem is further exacerbated by another clause in the lease. Many leases provide that upon a sale, the landlord is relieved of any lease obligations which arise *thereafter*, it being intended that each "landlord" is responsible only for those obligations that arise during its period of ownership. Tenants often modify this clause to provide that the new owner is *deemed* to have assumed all of such obligations and that the lease is burdened accordingly. While this may help preserve those claims for the tenant as against a future landlord who purchases the center in a *bargain and sale* purchase, it is of no value against a foreclosing lender or its successors who purchase the property in or following *foreclosure* because by virtue of the carve-out in the nondisturbance agreement; neither it nor subsequent owners will be subject to prior claims.⁴⁹

47 *Ahearn and Clark, supra* note 38, at p. 190.

48 This limitation would not apply to claims for injunctive relief.

49 Pursuant to the nondisturbance agreement, all "Successor Landlords" are exempt from prior claims, whether that party is the original lender or a subsequent purchaser.

Further, the lender's position is not one of complete helplessness in the matter. Although the lender did not commit the default, it was in a position to do something about it. Under the SNDA the tenant is required to notify the lender of any defaults of the landlord. The lender then has the right, but not the obligation, to cure those defaults. Since the lender has been made aware of the landlord's defaults, the lender is not without notice of the situation nor responsibility in the matter. It may take steps to force the borrower to cure the default. Barring that, such inaction result in the tenant being without a remedy upon a foreclosure when the lender has been on notice of a problem.

b. *The Lender's Position.* Lenders will view the tenant as having taken the risk that the original landlord might not perform its lease obligations. Accordingly, the foreclosing lender should not be looked upon as a guarantor of the prior landlord's performance, something the tenant did not have before.⁵⁰ Further, despite the myriad of covenants in the loan documents, the lender has no real effective or expeditious control over the borrower, let alone the awareness of the borrower's defaults.⁵¹

In the tenant's view, however, it had available at one time, a party or a resource (the real estate) to pursue for those claims, even if that party's solvency or the adequacy of the real estate interest was not guaranteed. Because of the non-recourse provision and the fact that the interest in the real estate has passed to the lender, the tenant loses both its right *and* its remedy.

Ahearn and Clark suggest that the tenant can still pursue its claim against the landlord unless the tenant "has unwisely agreed to overly restrictive exculpation language." This underestimates the difficulty encountered by tenants, including national chain credit tenants, when attempting to negotiate *any* changes to the non-recourse provision, let alone preserving any *personal* recourse against the landlord. It also overlooks the point that even with a moderate non-recourse provision, the real estate is no longer answerable for the prior claim since the lender, as the new owner of the real estate, denies liability for the very claim itself.⁵²

c. "*Continuing Defaults.*" In an attempt to resolve the issue some lenders will propose that "continuing" defaults in the nature of *mainte-*

50 *Ahearn and Clark, supra* note 38, at p. 190.

51 *Id.* at p. 190.

52 *Id.* at p. 198.

nance and repairs will survive foreclosure and the lender will respond to them. To a tenant, this provision, while helpful, may be viewed as still too limiting. The category of “continuing” defaults should not be limited to repair and maintenance obligations although this is the area in which most of the problems arise. An example of another continuing default would be one where the landlord defaults in its obligation to pay the taxes on the property and the tenant, in order to prevent a tax sale and protect its position, pays them on the landlord’s behalf and has a legitimate claim for reimbursement. It is no less accurate to state that other claims for reimbursement which flow from other landlord defaults “continue” as well. The answer should not turn on the distinction between judicial concepts of covenants which run with the land and those which are “personal,” a distinction that would not exist if the lease were viewed in a contractual context.

Additionally, even in the case of a repair obligation it is not always clear what is a continuing default and what is not. If the tenant’s roof is leaking and it has not been fixed, clearly that is a continuing default and the lender is responsible for not only the repair of the roof but also for damages suffered by the tenant (assuming the landlord was similarly liable under the lease). But what if the tenant exercises self-help (assuming the lease permits it) and fixes the roof at great expense in order to mitigate further damage to its property and loss of its business. The landlord’s failure to perform would be said to have been “cured” by the tenant who has now converted that failure into a claim for reimbursement in a liquidated amount. Does the “default”—the failure to repair—continue? Does its transformation into a liquidated claim for a sum certain destroy its character as a “continuing” default? A tenant should not be put in a worse position when it attempted to mitigate its losses than if it sat back and did nothing.

*Ahearn and Clark*⁵³ propose that the foreclosing lender assume liability for *continuing* acts or omissions of a prior landlord with respect to the *use and enjoyment* of the premises. This would mean that the successor landlord would be responsible for repair, maintenance, quiet enjoyment and lease renewal obligations. However, the foreclosing lender or foreclosure purchaser would not be liable for common area maintenance overpayments or unpaid construction allowances (except to the extent tenant’s construction constituted reusable capital improvements to the property) or other monetary obligations. They suggest that the Restatement of Prop-

53 *Ahearn and Clark, supra* note 38, at p. 197.

erty⁵⁴ also supports this view in that monetary obligations that arose from past breaches of covenants under a lease cannot be asserted against successor landlords.⁵⁵ The authors concede, however, that the extent to which the lender would have liability to the tenant for monetary amounts that flowed from an obligation that runs with the land (e.g. a repair obligation) is unclear. This is the very problem discussed in the preceding paragraph.

Other lenders offer the “continuing default” exception without expressly limiting its application to the repairs category; however, one still is left with the uncertainty of identifying which defaults are “continuing.” In one sense, all prior uncured defaults are continuing. The extent to which a tenant is willing to entertain this language is a judgment call in the context of its negotiation with the lender.

d. *A Better Solution—Lender or Tenant May Cure.* A satisfactory resolution for both parties is a procedure whereby the lender, upon taking possession, has a choice. It can elect to respond to the prior claim itself. Or, it can permit the tenant to effect the cure (if feasible) and to recover its costs out of the rent. The procedure would work as follows:

1. The lender must have received notice of all such claims pursuant to the notice provisions of the SNDA at the time notice thereof was sent to the landlord, with the right, but not the obligation to cure;
2. Upon foreclosure, the lender has the following choices:
 - a. cure the default itself, or
 - b. permit the tenant to cure the default and recover its costs out of the rent by way of offset. Under this option, the lender does not have to perform the obligation nor pay any money to the tenant.
3. Rights of rent offset which had accrued prior to foreclosure (assuming they were permitted in the lease in the first place) would be continued;

54 Restatement of Property (Second) § 16.1(3) (1977).

55 *Ahearn and Clark*, *supra* note 38, at p. 197.

4. Any rights of the tenant which have accrued by reason of a material breach by the landlord which is incapable of being cured are not lost upon a foreclosure. For example, if the landlord had constructively evicted the tenant by an unreasonable and permanent denial of access and/or visibility, giving rise to a termination right on the tenant's part, that right is not lost upon a foreclosure. Also, any damages the tenant has experienced are collectible as a rent offset;
5. The lender would have no liability for (nor would offset rights would extend to) *consequential* damages, the tenant waiving all claims for such damages as against the lender (whether or not it had the right to pursue such damages against the landlord in the first place).

While lenders do not like rent offsets, they dislike *doing* things even more. They would prefer to let the tenant cure the default and recover its expenses and damages out of the rent; in this way lenders do not have to lay out any money nor supervise the action. Where the tenant has already negotiated a "cure and deduct" remedy in the lease for landlord defaults, the lender will be less inclined to protest. But even where a tenant has no offset right in the lease, offering the lender this option is more palatable than requiring it to address the default directly. Lenders still may object that the tenant has now given itself, by virtue of this provision, an offset right it did not have previously against the landlord. However, as noted above, because of the non-recourse provision in the lease and the fact that the interest in the real estate has passed to the lender, the tenant would otherwise loses both its right *and* its remedy. Therefore, an offset right is appropriate to compensate the tenant for the loss of its traditional remedy.

Present Lender. While an existing lender has no incentive to make any concessions at all, let alone those that are perceived as an unreasonable risk, many of such lenders, recognizing the tenant's dilemma and the value of protecting their security with an SNDA with a desirable tenant, have willingly accepted this compromise solution.

Future Lenders. The tenant is in a stronger position with respect to a future lender because its lease and its subordination/nondisturbance clause is already in place and. Lenders are interested in closing loans and they are more willing to deal with an existing credit lease as a *fait accompli*; consequently they tend to be more accommodating on this point. Even

where the lease requires that a future lender assume the lease *automatically and unconditionally*, it is reasonable for the tenant to agree to this solution in an attempt to add more balance to the SNDA. As the solution is fundamentally a fair one, the response among future lenders has been one of cooperation. In some cases a monetary limit on the lender's exposure to insulate it from catastrophic damage claims may be appropriate. Following is a clause that embodies this solution:

Figure 17

Prior Claims Preserved

. . . and further, in such event, Successor Landlord shall . . . be bound to the Tenant under all of the provisions of the Lease . . . subject, however, to the following:

a.in the case of any act or omission of any prior landlord, including Landlord, or a failure of such prior landlord, including Landlord, to observe or perform its obligations under the Lease, which arose or occurred prior to the Succession or a claim of offset arising out of any of the foregoing (such prior acts, omissions or failure to observe or perform an obligation or offsets arising therefrom being collectively referred to as "Prior Claim(s)") and provided Tenant shall have given notice of and an opportunity to cure (pursuant to Paragraph 2 hereof) such Prior Claim to the party who was the then holder of the Mortgage or to any successor thereto prior to the Succession:

1. To the extent the Prior Claim is still unperformed, Successor Landlord, by notice to Tenant within ten (10) days after Tenant's demand for performance, shall either (A) complete performance of the Prior Claim and reimburse Tenant for any Direct Damages (as defined herein) suffered by Tenant by reason of such Prior Claim, or (B) permit Tenant to perform or complete such Prior Claim and Tenant shall be granted a right of offset against Rent due or to become due hereunder in the amount of the sums so expended by or owed to Tenant and to recover Direct

Damages (as defined herein) suffered by Tenant by reason of such Prior Claim.

2. With respect to Prior Claims in the nature of a right of offset against Rent which Tenant had, pursuant to the Lease, perfected prior to the Succession, Tenant shall continue to have the right to execute such offset until fully reimbursed, notwithstanding the Succession.

3. With respect to Prior Claims which materially interfere with Tenant's use and enjoyment of the Premises, Tenant shall have the right to assert such Prior Claim against Successor Landlord notwithstanding the Succession and, in addition, Tenant shall be granted a right of offset against Rent due or to become due hereunder to recover any Direct Damages suffered by Tenant by reason of the Prior Claim.

4. "Direct Damages" shall be those damages which Tenant has suffered by reason of the Prior Claim and which are reasonably foreseeable and a direct result of the Prior Claim (including, without limitation, physical damage to the Premises, leasehold improvements and Tenant's personal property), as distinguished from indirect or consequential damages (by way of example, but without limitation, lost sales or lost profits). Successor Landlord shall in no manner be liable for indirect or consequential damages which allegedly result from such Prior Claim.

b. Successor Landlord shall not be subject to any defenses except a defense (i) expressly permitted under the Lease, (ii) susceptible of application pursuant to subparagraph (a), and (iii) to the payment of a monetary obligation, and provided that, where applicable, the Mortgagee or its successor has prior to Succession been given notice of and accorded an opportunity to cure or address the circumstances giving rise to the defense pursuant to Paragraph 2 hereof.

§3.8 *Offsets and Defenses.* This carve-out is usually stated separately from “acts and omissions” (see §3.7 above) although both are similar in determining whether the lender is immune from them. See subparagraph (b) of Figure 17 above. This carve-out in its primordial form completely sheltered the lender from prior defenses of the tenant, resulting in a fundamental inequity.

- a. *Monetary Obligations.* In a situation where a Landlord-Tenant Conspiracy is not present, a claim by the landlord that the tenant underpaid an item of rent where the tenant claims that it overpaid it or it was not due,⁵⁶ presents an affirmative defense to which the tenant would otherwise be entitled. It would be an indisputable unfairness to deny the tenant this defense and require it to pay an amount twice or to pay it when it was not owed;⁵⁷
- b. *Defenses Permitted Under The Lease.* In cases where a condition to an obligation (although not technically a “defense” in the litigation sense) is expressly set forth in the Lease, the tenant should be permitted to assert it against the succeeding lender provided that notice of the circumstances and claim were given to the lender prior to foreclosure;
- c. *Lender Self-Help Provisions of SNDA.* Where the circumstances of the defense or claim were capable of being addressed under the lender’s opportunity to cure under subparagraph (a) of Figure 17 but the lender failed or elected not to do so.

§3.9 *Payment of Rent in Advance.* In Joshua Stein’s article, the author discusses a form of the Landlord-Tenant Conspiracy⁵⁸ in which the tenant pays a substantial amount of rent in advance, often at a discount, with the result that a significant portion of the rental value has been advanced to the landlord to the detriment of the later foreclosing lender. The tenant doesn’t want to pay this amount twice and the lender doesn’t want to be

56 For example, a dispute with respect to the calculation of percentage rent or a failure of a co-tenancy condition, a pre-payment of additional rent as required by the Lease (installments of real estate tax reimbursements on a calendar year basis when taxes are assessed of a fiscal year basis).

57 The Model SNDA takes a similar view. See Exhibit A at the end of this chapter, § 4.1.

58 For an explanation of this concept, see *Stein, supra* note 14, at p. 711.

bound by a possibly fraudulent transaction.⁵⁹ However, in many leases reimbursements for common area maintenance or real estate taxes are structured in monthly installments, frequently on the basis of estimates either in advance of the actual accounting period to which they relate (real estate tax reimbursements billed on a calendar year basis for taxes applicable for an ensuing tax fiscal year on a fiscal, July 1–June 30 basis) or until the actual amount of a cost is determined. The simple solution is to revise the carve-out in the SNDA to provide that the tenant will not pay rental in advance *of its due date under the Lease*. The lender will have reviewed and approved the lease on the basis of the customary practice of installment payments based upon estimates; a Landlord-Tenant Conspiracy effected after the lease was signed would thus be thwarted.

§3.10 Amendments and Modifications. A standard carve-out in SNDA forms is the one in which the lender is not bound by modifications or amendments of the lease to which it did not consent. Generally, there is no disagreement as to the fairness of this principle, but there are exceptions and limitations to this concept. To the extent that modifications and amendments are contemplated by and provided for in the lease, the lender should be bound by them. Examples would be (a) a provision in the lease for the readjustment of the rent to fair market value upon the exercise of an extension option (or at some other predetermined time), (b) a recalculation of rent due to consumer price increases, or (c) a readjustment of the rent and construction allowance by reason of a remeasurement clause.

Figure 18

Lender or Successor Landlord Bound By Amendments, Provision For Which Is Contained In Lease

Successor Landlord shall not be bound by any amendment, modification or extension of the Lease made without the consent of the party who was the holder of the Mortgage at the time of such amendment or modification, *except for those amendments, modifications or extensions, provision for which is expressly contained in the Lease*) or unless such amendment or modification was subsequently affirmed by an intervening holder. (Emphasis Added).

⁵⁹ Stein, *supra*, note 14 at p. 712.

As a stylistic point, the italicized language is inserted to make it clear that subsequent successors in the chain of title did not literally have to consent to the amendment themselves so long as the *then* holder of the mortgage at the time of the amendment did so (or in the absence thereof, so long as an intervening holder affirmed or ratified the prior amendment).

Some SNDAs go further to describe what type of amendments would be specifically proscribed.

Figure 19

Lender Not Bound By Material Amendments

Lender shall not be bound by any Material Amendment of the Lease or any waiver of any term of the Lease made without Lender's written consent (which consent shall not be unreasonably withheld or delayed). The term "*Material Amendment*" shall mean any modification or amendment to the Lease, other than one expressly provided for in the Lease which (i) reduces or postpones the rental amount or any other amounts payable under the Lease by Tenant, (ii) increases or decreases the term of the Lease, (iii) increases or decreases the size of the Premises (as defined in the Lease), (iii) imposes new financial obligations upon Landlord in excess of \$10,000.00, (iv) grants Tenant a termination option not expressly provided by the Lease as of the date hereof, or (v) grants Tenant a purchase option or right of first refusal to acquire all or any portion of the Property not expressly provided by the Lease as of the date hereof. (Emphasis Added).⁶⁰

See also the discussion under § 3.11, *infra*, on the rights of landlords and tenants in New York to effect amendments and terminations of the lease.

60 The underlined phrase is intended to also capture (i) *abatements*, i.e., actual reductions in rent, e.g., due to damage and destruction, condemnation, utility interruptions, co-tenancy failures (including the payment of alternate rent in lieu of regular rent), violations of exclusives, and (ii) *postponements* or *deferral* of rent, e.g., postponement of the rent commencement date under various circumstances, pending delivery of an SNDA. In some cases a lender may request that each possible occasion of an abatement or postponement be specifically listed in the SNDA.

a. *Affirmative Obligation of Tenant to Consult Lender In Advance?* Virtually all loan documents provide that the landlord-borrower may not do certain things with respect to the tenant leases without the lender's consent—such as effecting amendments, terminations, permitting assignments, releasing the tenant from liability, to name a few. Many lenders seek to enforce those provisions against the landlord by conscripting the tenant into the lender's service. Thus, nondisturbance agreements (and estoppel certificates) are often framed as an express undertaking on the tenant's part not to engage in such agreements.

Figure 20

Tenant May Not Amend, Etc. The Lease

... the *Tenant* may not, without the Mortgagee's consent:

- (a) **modify, alter or amend the lease.**
- (b) **terminate the lease, surrender the premises or accept a cancellation of the lease by the landlord;**
- (c) **assign the lease or sublet the Premises without the Mortgagee's consent; (Emphasis Added)**
- (d) **prepay any rent more than thirty (30) days in advance.**

Amendments or cancellations of the lease by the landlord are restricted by the terms of loan documents. If the tenant and the landlord enter into an amendment or the landlord cancels the lease pursuant to a right to do so in the lease, it is the landlord's duty, not the tenant's, to notify the lender and get its consent. Accordingly, it should not be the tenant's duty to insist that the lender be a signatory to every amendment or indicate its consent thereto in writing. While neither the landlord nor the tenant want to bring a third party into their deal with the power to veto it,⁶¹ it was the landlord that made the covenant and it the landlord's duty to honor it.

Also, if the tenant agrees to consult with the lender and then forgets to do so when amending the lease with the landlord, then the tenant has breached the nondisturbance agreement and the lender is not bound to

61 If there never occurs a loan default and foreclosure, the lender will be none the wiser nor the worse for it.

recognize the lease—everything that the tenant bargained for has been voided by this simple oversight.

To protect the tenant from losing the nondisturbance protection completely while at the same time protecting the lender from being held to amendments it never knew about, the language of Figure 20 above must be rewritten into a format whereby the lender *shall not be bound* by certain actions of the tenant which are done without the lender's consent. In this way, although the tenant may fail to consult the lender, if there is never a loan default, the lender will never know about it and the landlord and the tenant have the benefit of their bargain. However, if there is a foreclosure, the lender isn't bound if it had never approved the transaction.

§3.11 *Termination or Surrender.* Leases contain numerous instances where one party or the other may cancel the lease. Both parties may have a termination right in the case of casualty or eminent domain. The tenant may have a termination right based on insufficient sales or the failure of a co-tenancy requirement. The landlord may have a termination right if the tenant goes dark. Both parties have such right if the other is in material default.

The tenant must be able to exercise the termination rights it enjoys under the lease which it negotiated. Further, if the landlord terminates the lease pursuant to some right to do so, it is wholly inappropriate for the tenant to have to check with the lender to ensure that it's also OK with it. The tenant must be able to rely upon the validity of the landlord's exercise of that right—and to change its position in that reliance—with the presumption that the landlord is empowered to do so under its loan documents or has secured the necessary permission to do so. However, see the discussion *infra* involving leases and mortgages in New York.

If the lease is terminated pursuant to some existing right to do so and the lender's consent was not sought or obtained, it is impractical and burdensome if, following a foreclosure years after the termination, the lender requires the tenant to return or pay the rent for the interim period. Therefore, termination rights expressly provided for in the lease must be exempted from the lender's carve-outs. However, the lender should not be bound by *voluntary* terminations made outside of the provisions of the lease. Some lenders require to set out the express termination rights provided by the Lease.

a. *Voluntary Surrender Agreements.* The tenant can agree that it will not enter into *voluntary* termination agreements with the landlord, which

are not otherwise expressly provided for in the lease, without the lender's consent.

b. *New York Real Property Law, § 291(f)*. In New York State, protection for the lender is achieved by virtue of a statutory provision. New York Real Property Law, Section 291 (f) provides as follows:

Figure 21

New York Real Property Law, § 291(f)

An agreement, referring to this section, contained in a recorded mortgage of real property, or in a recorded instrument relating to such mortgage, restricting the right or power, as against the holder of the mortgage without his [sic] consent, of the owner of the mortgaged real property to cancel, abridge or otherwise modify tenancies, subtenancies, leases or subleases of the mortgaged real property in existence at the time of the agreement, or to accept prepayments of instalments of rent to become due thereunder, shall become binding on a tenant or subtenant after written notice of such agreement, accompanied by a copy of the text thereof; and any such cancellation, abridgement, modification or prepayment made by such tenant or subtenant, after such written notice, without the consent of the holder of such mortgage, shall be voidable as against the holder, at his [sic] option. The recording on or after July first, nineteen hundred sixty, of any such mortgage or instrument relating thereto shall for the purposes of this section be in itself a sufficient notice of the restrictive agreement to any tenant or subtenant who, after such recording, acquires by assignment, whether the assignment is by instrument or by operation of law, a leasehold estate in existence at the time of the restrictive agreement. This section shall not apply (1) to any tenancy, subtenancy, lease or sublease primarily for the residential purposes of the owner of the leasehold estate, or (2) to any tenancy, subtenancy, lease or sublease having at the time of the restrictive

agreement an unexpired term of less than five years.
(Emphasis Added).⁶²

The lender must furnish the tenant copies of the actual restrictions; in practice, such notice is almost always accompanied by a copy of § 291(f) itself. For example, what if the landlord terminates a tenant's lease pursuant to a provision which was contained in the lease prior to the existence of the mortgage? Where a tenant under a prior lease may not have constructive notice of the existence of subsequent mortgage, the statute requires the lender to give the tenant actual notice before the tenant is bound by it.⁶³

Section 291-f does not address leases entered into *after* the mortgage. Sending the tenant a 291-f notice will provide the certainty that the tenant has actual notice in addition to the constructive notice afforded by the prior recorded mortgage (where the terms of that mortgage restrict these activities). Also, with respect to states outside New York which do not have a statutory equivalent to Section 291-f, lenders have attempted to mimic the procedure by including in an estoppel certificate or other form of notice a copy of the actual restrictions that the landlord has agreed to in the mortgage in the hope that the tenant will be estopped from entering into lease amendments or taking any other adverse action without the lender's consent. However, absent privity of contract with the lender, it is doubtful that this procedure will be effective.⁶⁴ Prudence would also dictate that the tenant notify the lender or insist on the joinder of the lender in the termination notice. Thus, the lender's goal in policing the behavior of its borrower (the landlord) is achieved, albeit at some inconvenience to the tenant.

62 N.Y. Real Prop. Law § 291-f. For a full discussion of the effect of Section 291-f, see *Stein, supra* note 14, at p. 763 *et seq.*

63 *Stein, supra* note 14, at p. 763 *et seq.*

64 *See Priority of Liens and Leases, supra* note 1, at p. 9:

In the author's view, however, these steps are not adequate for a mortgagee relying on credit leases. The notion that a tenant is "estopped" from accepting a waiver or surrendering its lease without the mortgagee's consent simply because it knows consent is required provides a slim foundation on which to build a successful argument. What if the mortgagor represents it has obtained the mortgagee's consent; how much due diligence must the tenant perform, if any, to verify the mortgagor's representation? Because there is no privity of contract between the mortgagee and the tenant, it is far from clear that the tenant owes the mortgagee a duty to verify independently that the mortgagee's consent has, in fact, been obtained. The only adequate protection is to enter into a nondisturbance agreement that creates a binding contract between the tenant and mortgagee.

§3.12 *Assignments and Subleases.*

Figure 22

Lender Not Bound By Assignments or Subleases

Successor Landlord shall not be bound by an assignment of the Lease or sublease of the Premises which was made without its consent.

A provision such as this may be totally inconsistent with the lease terms. Assignments and subleases effected in accordance with the lease must be binding upon the lender. In the case of an assignment or sublease which requires the landlord's consent, it must be conclusively presumed in the tenant's favor that the landlord's consent is being given with the prior knowledge and acquiescence of the lender. Otherwise, the tenant is put into the position of having to police the landlord and the loan on the lender's behalf.

If the lease required the landlord's consent and the tenant secured it, it certainly does not want to have to convince the lender as well. If the landlord's consent to the assignment was not required at all, then this would present a serious degradation of the tenant's rights under the lease. Further, if the tenant was entitled to be released from liability upon an assignment pursuant to the terms of the assignment clause, the lender could still bind the tenant as an assignor-guarantor of the lease—an equally unacceptable result.

Assignments or subleases which can be effected *without* the landlord's consent must be equally binding upon the lender. All lenders will agree to this. Therefore, everything depends upon how extensively the tenant negotiated the assignment clause of the lease. Further, if the landlord is bound by a reasonable consent standard, the lender should be similarly bound. What if the landlord is ready to approve the assignment or sublease but the lender objects on reasonable grounds, e.g., a certain net worth requirement was not met? The only alternative for the tenant would be to complete the assignment but it could not guarantee the assignee or subtenant nondisturbance protection if the landlord defaults under its mortgage because the tenant's completion of the transfer would also void the SNDA (if the tenant has affirmatively agreed to secure the lender's consent first), or the lender would not be bound to recognize the assignment. This could expose the assignee-tenant to substantial losses.

Many assignment clauses grant the landlord a right of recapture when requested to consent to an assignment. If the landlord's choice is to terminate the lease or permit the assignment to proceed without any further right of consent on its part, then are we dealing with (1) a "termination" question, which may or may not require the lender's consent if the landlord is inclined to terminate, or (2) an "assignment" question (which, under these facts do not require landlord's consent) if the landlord does not elect to terminate?

Similarly, an offer to surrender procedure is a provision in an assignment clause of a lease which allows the landlord to elect to accept an offer of the surrender from the tenant and terminate the lease before the tenant ever finds an assignee or subtenant in the first place. The acceptance of the tenant's offer to surrender may be one of those already "expressly provided for in the lease," for which no lender consent is required. If the landlord declines to accept a surrender and the tenant is thereafter free to find an assignee or subtenant and effect a transfer *without* the landlord's consent, does the lender have to be consulted?

§3.13 *Obligation For Construction.* The following carve-out appears almost universally in SNDAs:

Figure 23

Lender Not Required to Perform Construction

Successor Landlord shall not be obligated to undertake or complete construction nor to reimburse Tenant for any construction allowance or contribution provided for in the Lease nor to undertake or complete reconstruction of the Premises or the Shopping Center following damage or destruction thereof.

This is problematic to a tenant. It is particularly surprising when it is a *construction* lender that is raising this issue. Construction lenders are in the business of funding construction and are experienced in completing projects following a foreclosure. Since their security is of greater value as a completed project than as a partially completed one, there is little compelling reason for the lender to be excused from this obligation.

Further, this provision is additionally burdensome where the landlord has agreed to pay the tenant a cash construction allowance (or grant a rent

abatement) in consideration for the performance by the tenant of certain leasehold improvements at the tenant's expense.

A solution would be a provision in which the lender: (i) elects not to proceed with construction so long it has made a decision to abandon the project and demonstrates that by agreeing not to proceed with construction anywhere on the project or for anyone else; (ii) upon lender's election not to proceed, Tenant may elect to cancel the lease or proceed with the landlord's work and the tenant's work at the tenant's cost; (iii) notwithstanding such election to withdraw, it has proceeded with construction anywhere else in the project, then it is required to proceed with construction at the premises; and (iv) agrees to pay the construction allowance (if earned by the tenant) whether or not the lender proceeds with construction.

§3.14 Representations and Warranties. Another carve-out is the one that proclaims that the lender is not liable for any "representations and warranties" of the landlord under the lease that do not run with the land. Among the bundle of landlord obligations under the lease are affirmative performance obligations, obligations to refrain from doing things, obligations of indemnity, etc. Many of the aforementioned obligations are couched in terms of "representations and warranties". Others may be representations and warranties in the narrow, classic sense: "Landlord warrants and represents that there are no structural defects or hazardous materials in the building."

But if there *are* structural defects or hazardous materials in the building, should the lender refuse to cure the problem? Or, will the lender fix the problem but disclaim liability for the "breach of the warranty," i.e., liability to the tenant for the *damages* that result from the breach of the representation?

What about the representation of title which is usually framed in the following language?

Landlord represents and warrants that it is the fee simple owner of said Premises, that it has full right, power and authority to make, execute and deliver this Lease and that there are no agreements, restrictions, covenants, encumbrances or easements which will increase any of Tenant's obligations under this Lease or diminish any of Tenant's rights hereunder. (Emphasis Added).

If the landlord had failed to inform the tenant that another party had an exclusive as to some of the tenant's goods, does this mean that the lender has no responsibility? Then what happens if the protected party has secured an injunction against the tenant? If the landlord failed to inform the tenant of an unrecorded easement running over a portion of the premises, what happens then?

A lender wants the assurance that when it succeeds to landlord's position, it should have no liability for a past or future breach of the original landlord's personal covenants which the successor landlord has no power to perform.⁶⁵

Ahearn and Clark acknowledge that the repair and quiet enjoyment obligations *are* covenants that run with the land;⁶⁶ therefore they should be binding upon the lender. Most lenders will expressly acknowledge, at a minimum, that repair and maintenance obligations survive foreclosure. And the SNDA itself is the tenant's covenant of quiet enjoyment. However, covenants such as exclusives, restrictive covenants and co-tenancy clauses may or may not be personal covenants.⁶⁷ Aside from questions of whether an obligation is a personal covenant or one that runs with the land, the liability of the lender should not turn on whether these covenants are couched in language of "representations or warranties" as distinguished from "covenants or agreements"; rather, it should stand or fall depending upon whether it is impossible (not just inconvenient) for the lender to honor them. The adverse impact on the tenant is equally severe.

The disclaimer language may so materially affect fundamental rights of the tenant under the lease that should be modified accordingly.

§3.15 *Hazardous Materials Indemnities and Cleanup.* Lenders are particularly sensitive about this problem. Because of the liability federal and state environmental statutes impose upon the landowner as an *ownership risk*, lenders aggressively avoid this liability. However, it must also be remembered that the lender obtained a Phase I and Phase II survey before the loan was closed and it should rely on its own due diligence. Landlord itself was aware of the contents of those surveys (and usually the tenant also) and the risks will be allocated in the lease negotiation process. If the landlord had undertaken some of the risk of contamination (or

65 *Homburger, supra* note 2, at p. 428.

66 *Ahearn and Clark, supra* note 38, at pp. 189, 197 & 198.

67 *Id.* at p. 189.

if the lease was silent on the matter altogether), the lender should not lessen that responsibility (or require the tenant to absolve the lender if the lease was silent) when it succeeds to the landlord's position through foreclosure.

§3.16 *Exculpation ("Non-Recourse") Provision.* Although most leases already provide for one, many SNDA forms add one of their own. The one appearing in the SNDA must be made consistent with the lease. The way to accomplish this is as follows:

Figure 24

Lender's Liability For (Its Own) Defaults

In the event of a default by Mortgagee or Successor Landlord of the obligations of Landlord under the Lease, the scope of Mortgagee's or Successor Landlord's liability will not exceed that as set forth in Section __ [Exculpation Provision] of the Lease.

OR

Tenant's recourse shall be limited to the Successor Landlord's interest (as that term is defined in the Lease) in the Property (Emphasis Added).

§3.17 *Priority of Mortgage Provisions Re Damage and Destruction and Eminent Domain.*

a. *Priority of Mortgage Provisions.* A tenant will have bargained for provisions in the lease obligating the landlord to reconstruct the premises in the event of a casualty or condemnation except when particular circumstances have occurred that will justify a landlord's cancellation of the lease. Unless the landlord had negotiated reasonable provisions in its loan documents providing for the release of insurance proceeds in the event of a casualty, there will be an inconsistency between the mortgage document and the lease provisions.

Lenders want the loan provisions to prevail in the event of a casualty or condemnation, regardless of whether the casualty or condemnation occurs pre-foreclosure or post-foreclosure and so provide in their form SNDA or subordination of mortgage instrument. A tenant will argue that following a foreclosure, the lender, as the successor landlord who has recognized the lease, should be obligated to perform all of the landlord's obligations,

including those the tenant has negotiated under the casualty and condemnation clauses of the lease. The lender should not be able to pick-and-choose which clauses it likes better in an exercise of Post-Foreclosure Lease Improvement.⁶⁸ In addition, the lease will provide that the landlord's obligation to restore will be dependent upon the proceeds it receives, undiminished by their appropriation by the lender to pay down the loan.

b. *Fire Insurance Proceeds.* All form mortgages initially permit the lender, at its option, to either appropriate the landlord's insurance proceeds to pay off or to reduce the loan or to release the funds for restoration of the damage. While many landlords successfully negotiate an agreement from the lender to release the proceeds upon a destruction,⁶⁹ others do not. Unfortunately, this is a negotiation in which the tenant is rarely invited to participate.

Many leases require that the tenant pays for the cost of the landlord's insurance covering the building shell in addition to the cost of the tenant's own insurance covering the leasehold improvements installed by the tenant. Landlords often retain great flexibility in the types and amount of insurance they will be required to carry. They often do not undertake to carry 100% replacement cost coverage (80% to 90% of replacement cost being more common) and retain wide discretion as to amount of the deductible (or self-insurance) they will maintain. Some landlords still do not even undertake to carry insurance at all. Although the lender will always require that the landlord-borrower carry sufficient insurance to protect the lender's security, the landlord seldom mirrors that obligation in the lease.⁷⁰

Upon a destruction, those leases allow the landlord to appropriate all or any part of such proceeds whether or not the lease is terminated. If the lender has exercised *its* rights under the mortgage to confiscate the proceeds, the tenant finds itself in the unhappy position of having paid the premium for a fund which is simply used to pay off the landlord's loan while the tenant's lease (1) may be terminated with no opportunity to

68 *Stein, supra* note 14, at p. 711.

69 Often through an escrow mechanism of an "insurance depository."

70 This should always be unacceptable to the tenant. A specific provision requiring the landlord to carry insurance of the same type and scope of coverage as that required of the tenant should be included in the lease.

recover its costs, or (2) is continued but without funds to pay for restoration.⁷¹

Following a foreclosure, in which the lender is bound to recognize the lease, it is unseemly to appropriate the proceeds of available insurance, especially the tenant's insurance and still expect the lease to otherwise continue. For a casualty or condemnation which occurs prior to foreclosure, the result is the same since the parties will be denied the funds with which to restore. To abrogate these often heavily negotiated casualty and condemnation provisions altogether and to render the insurance proceeds as a convenient fund with which to pay down the loan while the lease nevertheless continues would not be acceptable to a tenant. In response, a powerful tenant should insist upon (and will usually obtain) a provision in the SNDA that in the event of an occurrence, the damage and destruction, insurance and condemnation clauses of the lease will govern and prevail over the corresponding provisions of the mortgage, whether or not there has been a default under the mortgage and whether the occurrence took place before or after foreclosure.

Figure 25

Lease Provisions Re Casualty and Condemnation Prevail Release of Interest in Insurance Proceeds and Condemnation Awards

Notwithstanding the provisions of anything in the Lease or the Mortgage to the contrary, Mortgagee agrees:

(i) to the damage and destruction and insurance provisions of Article _____ of the Lease, and

(ii) that provided the Lease is not terminated by reason of a Casualty (as defined in the Lease) and that notwithstanding that Mortgagee may be named under the Tenant's insurance policies as loss payee thereunder, Mortgagee shall:

71 The situation can be even worse where the lease was still in effect because the tenant had no right to terminate and the landlord had limited its own obligation to restore to the amount of the insurance proceeds available to it.

- (x) release its interest in the proceeds payable under Tenant's AllRisk insurance policies ("Tenant's Proceeds"), and
- (y) if Landlord is also carrying All-Risk Insurance covering the Premises, shall release its interest in the proceeds payable under Landlord's All-Risk insurance policies ("Landlord's Proceeds"), all in accordance with the provisions of Article ___ of the Lease.

Tenant's Proceeds (and Landlord's Proceeds, if any) shall be used for the restoration of any Casualty damage to the Premises to the extent required by the provisions of Article ___ of the Lease. If the Lease is terminated pursuant to Section ___ thereof, Mortgagee shall nevertheless release to Tenant that portion of Tenant's Proceeds to which Tenant may be entitled pursuant to Section ___ of the Lease.

Further, and notwithstanding the provisions of anything in the Lease or the Mortgage to the contrary, Mortgagee agrees (a) to the eminent domain provisions of Section ___ of the Lease, and (b) the disposition of the condemnation award pursuant to the provisions of Section ___.

c. *Enclosed Mall Leases.* As a practical matter, however, this point will be difficult to achieve in shopping center leases simply because the tenant is but one satellite store out of many pushing up against the lender's position on the disposition of insurance proceeds already negotiated into the shopping center's mortgage.

d. *Strip or Street Deals.* However, in street or strip center deals the tenant is able to more effectively convince the lender to release its grip on those proceeds. Often, the landlord itself has negotiated for the release of the proceeds. The tenant only requires the lender to acknowledge that obligation as well as the restoration obligations of the landlord and the tenant under the damage and destruction clause.

Barring any success in obtaining such as provision, the tenant might secure some protection in the lease to obligate the landlord to restore,

regardless of lender appropriation, if the restoration cost is below a certain threshold amount. See Figure 26 below.

e. *Landlord to Undertake a Limited Obligation When Lender Appropriates Proceeds.* In the absence of securing a provision like Figure 25, a possible approach to this problem would be as follows. If the lender appropriates the proceeds to the extent that the landlord would be forced to spend out-of-pocket in excess of a certain threshold amount, the landlord would be relieved of its obligation to restore unless the tenant elected to supply the excess. This approach is similar to the way in which the parties deal with uninsurable casualties—a certain level of risk is assumed with the obligation to spend monies out-of-pocket so long as it is below a certain threshold level of required expenditure. It is critical however for the lender to agree to this in the SNDA for it to be effective. Following is a suggested clause:

Figure 26

**Appropriation of Insurance Proceeds by
Landlord's Lender**

Notwithstanding the foregoing, in the event of an insured casualty and in the further event that Landlord's lender appropriates all or any portion of the Landlord's insurance proceeds and as a result thereof, the cost to Landlord would be less than twenty-five percent (25%) of the replacement cost that Landlord would incur in discharging its restoration obligations in the event there was a total destruction of the Premises (the "Landlord's Threshold Amount"), then Landlord shall nevertheless be obligated to restore the damage. If such after such appropriation by the lender the cost to Landlord would be more than the Landlord's Threshold Amount, then Landlord may, within forty-five (45) days after such damage or destruction, notify Tenant of its intention not to repair its portion and terminate this Lease. If Landlord has given Tenant such notice of intention not to repair or restore, this Lease shall terminate upon the expiration of thirty (30) days after receipt by Tenant of such notice unless Tenant shall elect, by notice to Landlord within such 30-day period, to repair or restore the Landlord's portion of

such damage or destruction at Tenant's cost and expense. If the Tenant so elects, this Lease shall continue in full force and effect and the Tenant shall proceed to make such repairs and restoration as soon as reasonably possible. Upon completion of the Tenant's repair or restoration work, the Landlord shall reimburse Tenant an amount equal to the Landlord's Threshold Amount.

f. *Loan Disbursement Procedures—Waiver of Certain Requirements.* Mortgages will contain a number of procedural requirements or preconditions for the release of proceeds, including the placement of all funds into an “insurance depository.” Some mortgages simply state that proceeds will be disbursed “pursuant to the lender’s loan disbursement procedures which are then applicable.”

If feasible, the tenant should ask to review what those procedures are to determine if there are any unduly burdensome impediments to the release of the proceeds. Usually (but not always) the tenant can do little about them; on some occasions the lender can be convinced to release the proceeds under circumstances that the landlord was unable to obtain for itself. Generally, however, the tenant should only seek to get the lender’s agreement to waive certain nuisance provisions, such as the posting of a performance bond or the furnishing of lien waivers as a precondition to payment in the case of a credit tenant. If a lender agrees to these, such provisions could be made personal to the specific tenant. The SNDA would provide that the insurance proceeds, when being disbursed by the lender, depository or holder of the funds (“Holder”) would not be conditioned upon the following:

- (i) Approval by the landlord, or the Holder of any of the tenant’s contractors or subcontractors;
- (ii) Delivery to the Holder of lien waivers in advance of any restoration work performed at the premises;
- (iii) Previous payment by the tenant for the work or any portion thereof when the tenant requests a full or partial payment, so long as evidence of obligations actually incurred are presented;
- (iv) Delivery to the Holder of lien waivers after completion of the work or partial lien waivers at any inter-

mediate stage of the work from any contractor or subcontractor other than the tenant's general contractor retained for the performance of such work provided that the tenant reaffirms its obligation to cause to be discharged any lien against the property filed by any contractor or materialman and to indemnify the landlord and the Holder with respect thereto;

- (v) The furnishing of a payment or performance bond in connection with such restoration work.

§3.18 *Eminent Domain.* The situation is even more problematic for the tenant in the case of a condemnation. Most leases contain fairly liberal provisions for the landlord and rather limited protection for the tenant with respect to the cancellation of the lease following a partial condemnation.⁷² Just about every lease permits the landlord to appropriate all of the damages for a taking including those relating to all leasehold improvements on the real estate regardless of whether the tenant paid for them, as well as damages applicable to the value of the leasehold estate, i.e., the bonus value of the rent under the lease (which would otherwise be a tenant damage item). What is left for the tenant are only those special damages specifically awarded to it such as relocation costs, trade fixtures etc., provided such tenant damages do not reduce the landlord's award.⁷³

Larger tenants can obtain an agreement from the landlord that if the lease is terminated, the tenant can recover from the award the remaining unamortized portion of its leasehold improvement costs (exclusive of any construction allowance paid to the tenant) even though those sums would normally be included in the landlord's award for the taking of the bricks and mortar. If the lease is *not* terminated, those tenants will negotiate for the release from the award sufficient to cover the cost of restoring the leasehold improvements if they have been affected by the taking and are not part of the landlord's obligation to restore.

72 In the case of a total condemnation of the premises, the lease automatically terminates and the only residual question is the apportionment of damages.

73 It's difficult to understand how such damages could reduce the landlord's award if they are truly specifically awarded to the tenant. Even if a court makes one award for the total amount of all property interests taken and the damage suffered by both landlord and tenant, does the answer turn on (a) whether each element of damage is identifiable as a "landlord damage item" or a "tenant damage item," or (b) whether the award is embodied in a one party check (i.e., where the landlord is the sole payee) or a two-party check?

Unlike a casualty however, once the taking has occurred the property taken is gone forever and the damages stand in place of the improvements. The lender is worried that there will not be enough to go around in a total taking or that in a partial taking it will not receive a sufficient share reflective of the security taken. However, if the arithmetic is correct and compensation is awarded for the whole bundle of rights taken,⁷⁴ there should be sufficient funds for everyone. Provision should be made in the SNDA, as in Figure 25 above, for the lender to honor the negotiated eminent domain provisions of the lease.

Nevertheless, most tenants accept a clause which is unfavorable to them simply because the risk of a condemnation (especially one affecting an interior premises in a shopping center) is extremely rare and the sensitivity of the lender is extremely high. Regardless of the outcome of the eminent domain clause in a lease negotiation, a lender who is willing to sign a nondisturbance agreement should respect the rights and obligations of the parties. Again, this point is not pursued by many tenants, for reasons of practicality.

§3.19 Opportunity of Lender to Cure. Most SNDAs (as well as leases and estoppels) contain a “mortgagee protection clause,” i.e., a provision which extends to the lender an opportunity to cure the landlord’s failure of performance before the tenant can declare a default and/or claim a forfeiture. A typical clause is as follows:

Figure 27

Right of Lender to Cure

Landlord’s Default. Tenant agrees with Mortgagee that, from and after the date Tenant receives a fully executed copy of this Agreement, Tenant will not seek to terminate the Lease by reason of any act or omission of the Landlord until Tenant shall have given written notice of such act or omission to the holder of the Mortgage (at such holder’s last address furnished to Tenant) and following the expiration of the period accorded to the Landlord in the Lease to cure such default the holder shall have an additional reasonable period of time (but not less than thirty (30) days after

74 That is, the bricks and mortar, the rent stream, the value of the reversion, the value of the leasehold estate as well as the special tenant damages.

the expiration of the Landlord's cure period for such default) during which period such holder shall have the right, but not the obligation, to remedy such act or omission.

This is less than optimum protection for the tenant. A lender will have to have a receiver appointed or foreclose on the property to even put itself in a position to cure the default (and the landlord defaults may be mounting while a lender is attempting to get possession and title). Such proceedings could take an unacceptably long period of time. How long the tenant will have to wait for a cure while this is going on is an issue, especially if the lender's cure period does not even begin until the landlord's has expired. If the landlord has an open-ended period to cure non-monetary defaults, then it unclear when the lender's duty arises. The *nature* of the default should determine the period in which the lender must cure. The lender should (i) give the tenant prompt notice after receipt of tenant's default notice [10 days?] of its intention to cure the default, failing which the tenant may proceed with its remedies, (ii) have 10 days to cure monetary defaults and 30 days for non-monetary defaults (or longer if reasonably necessary), which periods run *concurrently* with the landlord's cure period.

§3.20 *Tenant to Honor Lender's Notice of Landlord Default.* When the landlord defaults under its mortgage, the most immediate summary remedy available to the lender is to invoke its rights as an assignee under the collateral assignment of rents and leases which the landlord gave to the lender as additional security for the loan.⁷⁵ Consequently, it will send a notice to the tenant and demand that future rent payments be sent directly to the lender. All nondisturbance agreements require the tenant to honor this demand.

However, the tenant does not want to be caught in the middle between the lender and the landlord, especially where the landlord denies that it is in default under the mortgage and is disputing the lender's demand as inappropriate and premature. It is essential, therefore, that the landlord be made a party to the SNDA and release the tenant from the duty to inquire as to the appropriateness of the lender's notice and from liability for any rents paid to the lender at the lender's direction.

⁷⁵ When the lender takes a collateral assignment of rents and leases as additional security, the assignment is conditional or contingent in nature. The landlord is permitted to collect the rents under the leases so long as the landlord is free of default under the mortgage. If the landlord does default, the lender perfects its status as the "assignee" and is immediately entitled to collect and retain the rents payable under the tenant's lease.

[46.4] V. CONCLUSION

To those who suggest that negotiating an SNDA is a “needless disturbance” in pursuit of protection against improbable events, it was the goal of this article to serve as a counterpoint to that assertion, stressing the importance to a tenant in obtaining one from a lender against the possibility of a landlord default. While SNDAs are still resisted by lenders and landlords with a stubbornness grounded in a tradition of presumed submission on the part of tenants, its value to a tenant (and the lender) justifies setting about on this odyssey to protect its investment and a thriving business. The article expressed the legitimate concerns of the tenant in this process and suggested areas of compromise in which the lender can be engaged in a constructive dialog to a reasonable solution, satisfactory to both parties. The more these compromises are forcefully pursued by a greater number of tenants, the greater the likelihood that the existing practices throughout the leasing industry will begin to shift to a more balanced state of shared risk.

EXHIBIT A

_____ (“Mortgagee”)

and

_____ (“Tenant”)

SUBORDINATION, NONDISTURBANCE

AND ATTORNMENT AGREEMENT

_____, 201__

This instrument affects real property situated, lying and being in the County of _____, State of New York, known as follows:

Section: _____

Volume: _____

Block(s): _____

Lot(s): _____

Street Address: _____

[New York City Only] _____

RECORD AND RETURN TO:

NO MORTGAGE RECORDING TAX IS PAYABLE WITH RESPECT TO THIS AGREEMENT. NOTHING IN THIS AGREEMENT IS INTENDED TO EVIDENCE OR SECURE ANY INDEBTEDNESS OR TO CREATE ANY LIEN.

File No.: _____

Document No.: _____

SUBORDINATION, NONDISTURBANCE AND ATTORNMENT AGREEMENT

This SUBORDINATION, NONDISTURBANCE, AND ATTORNMENT AGREEMENT (this "Agreement") is entered into as of _____, 201__ (the "Effective Date"), between _____, a _____, whose address is _____ ("Mortgagee"), and _____, a _____, whose address is _____ ("Tenant"), with reference to the following facts:

A. _____, a _____, whose address is _____ ("Landlord"), owns the real property located at _____ (such real property, including all buildings, improvements, structures and fixtures located thereon, "Landlord's Premises"), as more particularly described in **Schedule A**.

B. Mortgagee has made a loan to Landlord in the original principal amount of \$_____ (the "Loan").

C. To secure the Loan, Landlord has encumbered Landlord's Premises by entering into that certain _____ Mortgage, Consolidation and Modification Agreement dated _____, 200__, in favor of Mortgagee (as amended, increased, renewed, extended, spread, consolidated, severed, restated, or otherwise changed from time to time, the "Mortgage") to be recorded in the Official Records of the County of _____, State of New York (the "Land Records").

D. Pursuant to a _____ Lease dated as of _____, _____, as amended on _____, _____, and _____, _____ (the "Lease"), Landlord demised to Tenant [part of] Landlord's Premises ("Tenant's Premises"). Tenant's Premises are commonly known as _____.

E. Tenant and Mortgagee desire to agree upon the relative priorities of their interests in Landlord's Premises and their rights and obligations if certain events occur.

NOW, THEREFORE, for good and sufficient consideration, Tenant and Mortgagee agree:

1. Definitions.

The following terms shall have the following meanings for purposes of this Agreement.

1.1 *Construction-Related Obligation.* A “Construction-Related Obligation” means any obligation of Landlord under the Lease to make, pay for, or reimburse Tenant for any alterations, demolition, or other improvements or work at Landlord’s Premises, including Tenant’s Premises. “Construction-Related Obligations” shall not include: (a) reconstruction or repair following fire, casualty or condemnation; or (b) day-to-day maintenance and repairs.

1.2 *Foreclosure Event.* A “Foreclosure Event” means: (a) foreclosure under the Mortgage; (b) any other exercise by Mortgagee of rights and remedies (whether under the Mortgage or under applicable law, including bankruptcy law) as holder of the Loan and/or the Mortgage, as a result of which Successor Landlord becomes owner of Landlord’s Premises; or (c) delivery by Landlord to Mortgagee (or its designee or nominee) of a deed or other conveyance of Landlord’s interest in Landlord’s Premises in lieu of any of the foregoing.

1.3 *Former Landlord.* A “Former Landlord” means Landlord and any other party that was landlord under the Lease at any time before the occurrence of any attornment under this Agreement.

1.4 *Offset Right.* An “Offset Right” means any right or alleged right of Tenant to any offset, defense (other than one arising from actual payment and performance, which payment and performance would bind a Successor Landlord pursuant to this Agreement), claim, counterclaim, reduction, deduction, or abatement against Tenant’s payment of Rent or performance of Tenant’s other obligations under the Lease, arising (whether under the Lease or under applicable law) from Landlord’s breach or default under the Lease.

1.5 *Rent.* The “Rent” means any fixed rent, base rent or additional rent under the Lease.

1.6 *Successor Landlord.* A “Successor Landlord” means any party that becomes owner of Landlord’s Premises as the result of a Foreclosure Event.

1.7 *Termination Right.* A “Termination Right” means any right of Tenant to cancel or terminate the Lease or to claim a partial or total eviction arising (whether under the Lease or under applicable law) from Landlord’s breach or default under the Lease.

2. Subordination.

The Lease shall be, and shall at all times remain, subject and subordinate to the Mortgage, the lien imposed by the Mortgage, and all advances made under the Mortgage.

3. Nondisturbance, Recognition and Attornment.

3.1 *No Exercise of Mortgage Remedies Against Tenant.* So long as the Lease has not been terminated on account of Tenant's default that has continued beyond applicable cure periods (an "Event of Default"), Mortgagee shall not name or join Tenant as a defendant in any exercise of Mortgagee's rights and remedies arising upon a default under the Mortgage unless applicable law requires Tenant to be made a party thereto as a condition to proceeding against Landlord or prosecuting such rights and remedies. In the latter case, Mortgagee may join Tenant as a defendant in such action only for such purpose and not to terminate the Lease or otherwise adversely affect Tenant's rights under the Lease or this Agreement in such action.

3.2 *Nondisturbance and Attornment.* If the Lease has not been terminated on account of an Event of Default by Tenant, then, when Successor Landlord takes title to Landlord's Premises: (a) Successor Landlord shall not terminate or disturb Tenant's possession of Tenant's Premises under the Lease, except in accordance with the terms of the Lease and this Agreement; (b) Successor Landlord shall be bound to Tenant under all the terms and conditions of the Lease (except as provided in this Agreement); (c) Tenant shall recognize and attorn to Successor Landlord as Tenant's direct landlord under the Lease as affected by this Agreement; and (d) the Lease shall continue in full force and effect as a direct lease, in accordance with its terms (except as provided in this Agreement), between Successor Landlord and Tenant.

3.3 *Further Documentation.* The provisions of this Article shall be effective and self-operative without any need for Successor Landlord or Tenant to execute any further documents. Tenant and Successor Landlord shall, however, confirm the provisions of this Article in writing upon request by either of them.

4. Protection of Successor Landlord.

Notwithstanding anything to the contrary in the Lease or the Mortgage, Successor Landlord shall not be liable for or bound by any of the following matters:

4.1 *Claims Against Former Landlord.* Any Offset Right that Tenant may have against any Former Landlord relating to any event or occurrence before the date of attornment, including any claim for damages of any kind whatsoever as the result of any breach by Former Landlord that occurred before the date of attornment. (The foregoing shall not limit either (a) Tenant's right to exercise against Successor Landlord any Offset Right otherwise available to Tenant because of events occurring after the date of attornment or (b) Successor Landlord's obligation to correct any conditions that existed as of the date of attornment and violate Successor Landlord's obligations as landlord under the Lease.)

4.2 *Prepayments.* Any payment of Rent that Tenant may have made to Former Landlord more than thirty days before the date such Rent was first due and payable under the Lease with respect to any period after the date of attornment other than, and only to the extent that, the Lease expressly required such a prepayment.

4.3 *Payment; Security Deposit.* Any obligation: (a) to pay Tenant any sum(s) that any Former Landlord owed to Tenant or (b) with respect to any security deposited with Former Landlord, unless such security was actually delivered to Mortgagee.

4.4 *Modification, Amendment, or Waiver.* Any modification or amendment of the Lease, or any waiver of any terms of the Lease, made without Mortgagee's written consent.

4.5 *Surrender, Etc.* Any consensual or negotiated surrender, cancellation, or termination of the Lease, in whole or in part, agreed upon between Landlord and Tenant, unless effected unilaterally by Tenant pursuant to the express terms of the Lease.

4.6 *Construction-Related Obligations.* Any Construction-Related Obligation of Former Landlord.

5. Exculpation of Successor Landlord.

Notwithstanding anything to the contrary in this Agreement or the Lease, upon any attornment pursuant to this Agreement the Lease shall be deemed to have been automatically amended to provide that Successor Landlord's obligations and liability under the Lease shall never extend beyond Successor Landlord's (or its successors' or assigns') interest, if any, in Landlord's Premises from time to time, including insurance and condemnation proceeds, Successor Landlord's interest in the Lease, and

the proceeds from any sale or other disposition of Landlord's Premises by Successor Landlord (collectively, "Successor Landlord's Interest"). Tenant shall look exclusively to Successor Landlord's Interest (or that of its successors and assigns) for payment or discharge of any obligations of Successor Landlord under the Lease as affected by this Agreement. If Tenant obtains any money judgment against Successor Landlord with respect to the Lease or the relationship between Successor Landlord and Tenant, then Tenant shall look solely to Successor Landlord's Interest (or that of its successors and assigns) to collect such judgment. Tenant shall not collect or attempt to collect any such judgment out of any other assets of Successor Landlord.

6. Mortgagee's Right to Cure.

6.1 *Notice to Mortgagee.* Notwithstanding anything to the contrary in the Lease or this Agreement, before exercising any Termination Right or Offset Right, Tenant shall provide Mortgagee with notice of the breach or default by Landlord giving rise to same (the "Default Notice") and, thereafter, the opportunity to cure such breach or default as provided for below.

6.2 *Mortgagee's Cure Period.* After Mortgagee receives a Default Notice, Mortgagee shall have a period of thirty days beyond the time available to Landlord under the Lease in which to cure the breach or default by Landlord. Mortgagee shall have no obligation to cure (and shall have no liability or obligation for not curing) any breach or default by Landlord, except to the extent that Mortgagee agrees or undertakes otherwise in writing.

6.3 *Extended Cure Period.* In addition, as to any breach or default by Landlord the cure of which requires possession and control of Landlord's Premises, provided only that Mortgagee undertakes to Tenant by written notice to Tenant within thirty days after receipt of the Default Notice to exercise reasonable efforts to cure or cause to be cured by a receiver such breach or default within the period permitted by this paragraph, Mortgagee's cure period shall continue for such additional time (the "Extended Cure Period") as Mortgagee may reasonably require to either (a) obtain possession and control of Landlord's Premises and thereafter cure the breach or default with reasonable diligence and continuity or (b) obtain the appointment of a receiver and give such receiver a reasonable period of time in which to cure the default.

7. Confirmation of Facts.⁷⁶

Tenant represents to Mortgagee and to any Successor Landlord, in each case as of the Effective Date:

7.1 *Effectiveness of Lease.* The Lease is in full force and effect, has not been modified, and constitutes the entire agreement between Landlord and Tenant relating to Tenant's Premises. Tenant has no interest in Landlord's Premises except pursuant to the Lease. No unfulfilled conditions exist to Tenant's obligations under the Lease.

7.2 *Rent.* Tenant has not paid any Rent that is first due and payable under the Lease after the Effective Date.

7.3 *No Landlord Default.* To the best of Tenant's knowledge, no breach or default by Landlord exists and no event has occurred that, with the giving of notice, the passage of time or both, would constitute such a breach or default.

7.4 *No Tenant Default.* Tenant is not in default under the Lease and has not received any uncured notice of any default by Tenant under the Lease.

7.5 *No Termination.* Tenant has not commenced any action nor sent or received any notice to terminate the Lease. Tenant has no presently exercisable Termination Right(s) or Offset Right(s).

7.6 *Commencement Date.* The "Commencement Date" of the Lease was _____.

7.7 *Acceptance.* Subject to any exceptions set forth following this paragraph: (a) Tenant has accepted possession of Tenant's Premises; and (b) Landlord has performed all Construction-Related Obligations related to Tenant's initial occupancy of Tenant's Premises and Tenant has accepted such performance by Landlord. The only exceptions are as follows:

NONE

⁷⁶ This section overlaps with an estoppel certificate. If you include this section, you don't need an estoppel certificate. If you get an estoppel certificate, you don't need this section (except the last paragraph).

7.8 *No Transfer.* Tenant has not transferred, encumbered, mortgaged, assigned, conveyed or otherwise disposed of the Lease or any interest therein, other than sublease(s) made in compliance with the Lease.

7.9 *Due Authorization.* Tenant has full authority to enter into this Agreement, which has been duly authorized by all necessary actions.

8. Miscellaneous.

8.1 *Rent Payment Notices.* From and after Tenant's receipt of written notice from Mortgagee (a "Rent Payment Notice"), Tenant shall pay all Rent to Mortgagee or as Mortgagee shall direct in writing, until such time as Mortgagee directs otherwise in writing. Tenant shall comply with any Rent Payment Notice notwithstanding any contrary instruction, direction or assertion from Landlord. Mortgagee's delivery to Tenant of a Rent Payment Notice, or Tenant's compliance therewith, shall not be deemed to: (a) cause Mortgagee to succeed to or to assume any obligations or responsibilities as Landlord under the Lease, all of which shall continue to be performed and discharged solely by Landlord unless and until any attornment has occurred pursuant to this Agreement; or (b) relieve Landlord of any obligations under the Lease.

8.2 *Notices.* All notices or other communications required or permitted under this Agreement shall be in writing and given by certified mail (return receipt requested) or by nationally recognized overnight courier service that regularly maintains records of items delivered. Each party's address is as set forth in the opening paragraph of this Agreement, subject to change by notice under this paragraph. Notices shall be effective the next business day after being sent by overnight courier service, and five business days after being sent by certified mail (return receipt requested).

8.3 *Successors and Assigns.* This Agreement shall bind and benefit the parties, their successors and assigns, any Successor Landlord, and its successors and assigns. If Mortgagee assigns the Mortgage, then upon delivery to Tenant of written notice thereof accompanied by the assignee's written assumption of all obligations under this Agreement, all liability of the assignor shall terminate.

8.4 *Entire Agreement.* This Agreement constitutes the entire agreement between Mortgagee and Tenant regarding the subordination of the Lease to the Mortgage and the rights and obligations of Tenant and Mortgagee as to the subject matter of this Agreement.

8.5 *Interaction with Lease and with Mortgage.* If this Agreement conflicts with the Lease, then this Agreement shall govern as between the parties and any Successor Landlord, including upon any attornment pursuant to this Agreement. This Agreement supersedes, and constitutes full compliance with, any provisions in the Lease that provide for subordination of the Lease to, or for delivery of nondisturbance agreements by the holder of, the Mortgage. Mortgagee confirms that Mortgagee has consented to Landlord's entering into the Lease.

8.6 *Mortgagee's Rights and Obligations.* Except as expressly provided for in this Agreement, Mortgagee shall have no obligations to Tenant with respect to the Lease. If an attornment occurs pursuant to this Agreement, then all rights and obligations of Mortgagee under this Agreement shall terminate, without thereby affecting in any way the rights and obligations of Successor Landlord provided for in this Agreement.

8.7 *Interpretation; Governing Law.* The interpretation, validity and enforcement of this Agreement shall be governed by and construed under the internal laws of the State where Landlord's Premises are located, excluding its principles of conflict of laws.

8.8 *Amendments.* This Agreement may be amended, discharged or terminated, or any of its provisions waived, only by a written instrument executed by the party to be charged.

8.9 *Execution.* This Agreement may be executed in any number of counterparts, each of which shall be deemed an original and all of which together shall constitute one and the same instrument.

8.10 *Mortgagee's Representation.* Mortgagee represents that Mortgagee has full authority to enter into this Agreement, and Mortgagee's entry into this Agreement has been duly authorized by all necessary actions.

IN WITNESS WHEREOF, this Agreement has been duly executed by Mortgagee and Tenant as of the Effective Date.

MORTGAGEE

TENANT

By: _____

By: _____

Name: _____

Name: _____

Title: _____

Title: _____

Landlord consents and agrees to the foregoing Agreement, which was entered into at Landlord's request. The foregoing Agreement shall not alter, waive or diminish any of Landlord's obligations under the Mortgage or the Lease. The above Agreement discharges any obligations of Mortgagee under the Mortgage and related loan documents to enter into a non-disturbance agreement with Tenant. Landlord is not a party to the above Agreement. Landlord irrevocably directs Tenant to comply with any Rent Payment Notice, notwithstanding any contrary direction, instruction, or assertion by Landlord. Tenant shall be entitled to rely on any Rent Payment Notice. Tenant shall be under no duty to controvert or challenge any Rent Payment Notice. Tenant's compliance with a Rent Payment Notice shall not be deemed to violate the Lease. Landlord hereby releases Tenant from, and shall indemnify and hold Tenant harmless from and against, any and all loss, claim, damage, liability, cost or expense (including payment of reasonable attorneys' fees and disbursements) arising from any claim based upon Tenant's compliance with any Rent Payment Notice. Landlord shall look solely to Mortgagee with respect to any claims Landlord may have on account of an incorrect or wrongful Rent Payment Notice. Tenant shall be entitled to full credit under the Lease for any Rent paid to Mortgagee pursuant to a Rent Payment Notice to the same extent as if such Rent were paid directly to Landlord.

LANDLORD

By: _____

Name

Title

Dated: _____, 201__

Each of the undersigned, a guarantor of Tenant’s obligations under the Lease (a “**Guarantor**”), consents to Tenant’s execution, delivery and performance of the foregoing Agreement. From and after any attornment pursuant to the foregoing Agreement, that certain _____ **Guaranty** dated _____, ____ (the “**Guaranty**”) executed by Guarantor in favor of _____ shall automatically benefit and be enforceable by Successor Landlord with respect to Tenant’s obligations under the Lease as affected by the foregoing Agreement. Successor Landlord’s rights under the Guaranty shall not be subject to any defense, offset, claim, counterclaim, reduction or abatement of any kind resulting from any act, omission or waiver by any Former Landlord for which Successor Landlord would, pursuant to the foregoing Agreement, not be liable or answerable after an attornment. The foregoing does not limit any waivers or other provisions contained in the Guaranty. Guarantor confirms that the Guaranty is in full force and effect and Guarantor presently has no offset, defense (other than any arising from actual payment or performance by Tenant, which payment or performance would bind a Successor Landlord under the foregoing Agreement), claim, counterclaim, reduction, deduction or abatement against Guarantor’s obligations under the Guaranty.

GUARANTOR

By: _____

Its: _____

Dated: _____, 201__

Attachments:

Acknowledgments

Schedule A = Description of Landlord’s Premises

CHAPTER FORTY-SEVEN

NEW YORK STATUTES ON COMMERCIAL LEASING

Joshua Stein, Esq.*

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[47.0] OVERVIEW

This chapter collects extracts from New York statutes, and from the New York City Administrative Code and only certain city regulations, that directly affect commercial leasing in New York State and New York City. Each statute has been limited to matters that affect current commercial leasing transactions. Provisions that do not relate to commercial leasing, or no longer apply but remain in the statute, are omitted. Most landlord-tenant procedural law beyond initiation of an action is not covered. This collection modifies most references to dates, numbers above nine, and statutes to make them as simple and short as possible (e.g., “Universal Law § 704(b)(2)”), even though the Legislature’s practice seems to be to make them all rather complicated and long-winded (e.g., “subsection two of section b of section seven hundred and four of the universal law”). Spelling errors and inconsistencies (such as regarding capitalization) have been corrected. This collection therefore does not provide the complete precise text of each statute, but only the part(s) normally relevant. These and other deletions and changes are marked. This is a “simplified” collection of statutory language and should not be relied upon as a more general reference source, particularly when quoting or citing a statute in any papers to be filed with any court. Any user should check for updates and changes to any statute before relying upon it.

This chapter is not intended to constitute an authoritative source for any statute, but merely a practical handbook with the relevant portions of each statute, in a readily comprehensible format, followed by commentary. Some of these commentaries (and these introductory notes) include expressions of opinion rather than explications of law. It is assumed that anyone reading a work of this type knows how to tell the difference. Therefore, disclosure notices are not provided for every expression of opinion.

Statutes that indirectly affect commercial leasing, such as those relating to construction, are not included. Almost any New York statute could, under some circumstance, affect some commercial lease. Building and other codes are excluded. This collection seeks to identify only statutes specifically relevant to commercial leasing and reasonably likely to be encountered in a typical commercial leasing practice.

In some cases, sample lease language is provided, set off as block quotations and italicized for clarity. Terms used in that sample language will often need to be defined elsewhere in the lease. No representation or war-

ranty is made on the efficacy or validity of any proposed lease language, particularly where it is noted as unusual or “cutting edge.”

This collection makes no effort to include any of New York’s vast array of statutory and regulatory provisions on residential leases. Those provisions are so extensive that anyone participating in any way in a transaction involving New York residential rental property should not proceed without consulting counsel who practices primarily in that area. Entire volumes of New York’s statutes and regulations are devoted to protecting residential tenants from their landlords. Much of this tension, and the related permanent “housing crisis,” arises from half a century of rent regulation (both “rent control” and “rent stabilization”), itself an encyclopedic body of law and regulations that applies in New York City and a few urban areas outside the city. New York politicians do occasionally call for regulation of commercial rents or for indirect market burdens such as “arbitration” for renewal rents. Those proposals generally go nowhere. As a result, market forces eventually correct imbalances of supply and demand in the commercial market. The body of New York law governing commercial leases, though perhaps large when compared against other states, remains only a fraction of the size of the body of New York law on governing residential leases.

The statutes presented here can also be found in any New York law library, through online research services, or on the internet.¹

Here is a list of acronyms used in this chapter:

ABC = Alcoholic Beverage Control

BCL = Business Corporation Law

BNK = Banking Law

CPLR = Civil Practice Law and Rules

DCL = Debtor and Creditor Law

DEC = Department of Environmental Conservation

ECL = Environmental Conservation Law

¹ <http://public.leginfo.state.ny.us> (click on “Laws” dropdown). This website is operated by NYS and appears to be the most current and reliable. Other online services are sometimes not entirely up to date.

EDL = Education Law

EDPL = Eminent Domain Procedure Law

EPTL = Estates, Powers and Trusts Law

ESRA = Electronic Signatures and Records Act

GBL = General Business Law

GOL = General Obligations Law

GML = General Municipal Law

ISL = Insurance Law

JUD = Judiciary Law

LAB = Labor Law

LLC = Limited Liability Company Law

LIE = Lien Law

MDL = Multiple Dwelling Law

NPC = Not-For-Profit Corporation Law

NYC = New York City

NYC Admin. Code = New York City Administrative Code

RCNY = Rules of the City of New York

NYS = New York State

PL = Penal Law

RCO = Religious Corporations Law

RPAPL = Real Property Actions and Proceedings Law

RPL = Real Property Law

SCPA = Surrogate's Court Procedure Act

SFL = State Finance Law

RPT = Real Property Tax Law

STL = State Technology Law

TAX = Tax Law

Acknowledgments—Uniform Recognition of Acknowledgments Act

[No Applicable Statute]

COMMENTARY

New York has not adopted the Uniform Recognition of Acknowledgments Act and has instead adopted requirements described in RPL §§ 298 *et seq.* See “Formalities of Execution.”

Actions Against Landowner by Invitees, Licensees, and Trespassers

[GOL § 9-103] Statutory Excerpt or Summary

1. Except as provided in [GOL § 9-103(2)]
 - a. an owner, lessee or occupant of premises, whether or not posted as provided in [ECL § 11-2111], owes no duty to keep the premises safe for entry or use by others for hunting, fishing, organized gleaning as defined in [Agriculture and Markets Law § 71-y], canoeing, boating, trapping, hiking, cross-country skiing, tobogganing, sledding, speleological activities, horseback riding, bicycle riding, hang gliding, motorized vehicle operation for recreational purposes, snowmobile operation, cutting or gathering of wood for non-commercial purposes or training of dogs, or to give warning of any hazardous condition or use of or structure or activity on such premises to persons entering for such purposes;
 - b. an owner, lessee or occupant of premises who gives permission to another to pursue any such activities upon such premises does not thereby (1) extend any assurance that the premises are safe for such purpose, or (2) constitute the person to whom permission is granted an invitee to whom a duty of care is owed, or (3) assume responsibility for or incur liability

for any injury to person or property caused by any act of persons to whom the permission is granted.

c. an owner, lessee or occupant of a farm, as defined in [LAB § 671], whether or not posted as provided in [ECL § 11-2111], owes no duty to keep such farm safe for entry or use by a person who enters or remains in or upon such farm without consent or privilege, or to give warning of any hazardous condition or use of or structure or activity on such farm to persons so entering or remaining. This shall not be interpreted, or construed, as a limit on liability for acts of gross negligence in addition to those other acts referred to in [GOL § 9-103(2)].

2. This [GOL § 9-103] does not limit the liability which would otherwise exist

a. for willful or malicious failure to guard, or to warn against, a dangerous condition, use, structure or activity; or

b. for injury suffered in any case where permission to pursue any of the activities enumerated in this [GOL § 9-103] was granted for a consideration other than the consideration, if any, paid to said landowner by the state or federal government, or permission to train dogs was granted for a consideration other than that provided for in [ECL § 11-0925]; or

c. for injury caused, by acts of persons to whom permission to pursue any of the activities enumerated in this [GOL § 9-103] was granted, to other persons as to whom the person granting permission, or the owner, lessee or occupant of the premises, owed a duty to keep the premises safe or to warn of danger.

3. Nothing in this [GOL § 9-103] creates a duty of care or ground of liability for injury to person or property.

COMMENTARY

This statute does not address an owner's or a lessee's more general liability to trespassers, a matter of common law.

[47.1] Adverse Possession

[RPAPL § 531] Statutory Excerpt or Summary

Adverse possession, how affected by relation of landlord and tenant.

Where the relation of landlord and tenant has existed, the possession of the tenant is deemed the possession of the landlord until the expiration of [10] years after the termination of the tenancy; or, where there has been no written lease, until the expiration of [10] years after the last payment of rent; notwithstanding that the tenant has acquired another title or has claimed to hold adversely to his landlord. But this presumption shall cease after the periods prescribed in this [RPAPL § 531] and such tenant may then commence to hold adversely to his landlord.

COMMENTARY

Certain types of landlords or tenants also require certain internal or court approvals. *See* “Contract or Conveyance.”

[RPAPL § 1901] Statutory Excerpt or Summary

Release of rents reserved by leases in perpetuity.

1. Any person interested in lands held under a lease in perpetuity, upon which no rent has been paid for at least [20] years, may present his petition to the courts mentioned in this [RPAPL § 1901] asking that it be declared that the rents and reversion have been released to the owner of the fee. Such petition shall be verified, shall describe the lease and allege that the rents and reversion have been released, and shall state such facts as the petitioner can ascertain relative to the execution of a release and the identity of the persons who would otherwise be the present owners of the rents and reversion and the last known owner thereof.

2. Such petition may be presented to the supreme court or to the county court of the county where the lands are situated. The court may thereupon order all persons interested to show cause at a certain time and place why the rents and reversion should not be declared to have been released. A description of the lease and lands affected thereby and the name of the last known owner of the rents and reversion shall be specified in such order, and the order shall be published in such newspaper

or newspapers and for such time as the court shall direct. The court may also direct the order to be personally served upon such persons as it shall designate.

3. The court may issue commissions to take the testimony of witnesses and may refer the petition to a referee to take and report proofs of the facts stated in the petition. Upon being satisfied that the matters alleged in the petition are true, the court may make an order declaring that the rents and reversion have been released to the owner of the fee. The nonpayment of rent under any such lease for [20] years shall be presumptive evidence of such a release.

4. The entry of such order in the office of the clerk of the county where such lands are situated shall have the same effect as a release of such rents and reversion to such owner then duly executed and recorded. The county clerk shall note on the margin of the record of the original lease a minute of the entry of such order.

[47.2] Agency

[CPLR § 318] Statutory Excerpt or Summary

Designation of agent for service.

A person may be designated by a natural person, corporation or partnership as an agent for service in a writing, executed and acknowledged in the same manner as a deed, with the consent of the agent endorsed thereon. The writing shall be filed in the office of the clerk of the county in which the principal to be served resides or has its principal office. The designation shall remain in effect for three years from such filing unless it has been revoked by the filing of a revocation, or by the death, judicial declaration of incompetency or legal termination of the agent or principal.

COMMENTARY

Failure to record the designation of an agent does not seem to make the designation ineffective. This statute is not well known in the commercial real estate bar. Does the three-year time limit apply to all designations of agents for service?

Alienage—Abolished

[No applicable statute]

CROSS-REFERENCES

See “Foreign Ownership.”

Arbitration—Uniform Arbitration Act

[No applicable statute]

CROSS-REFERENCES

But see “Arbitration—Other.”

Arbitration—Other

[CPLR §§ 7501–7514]

COMMENTARY

New York has not adopted the Uniform Arbitration Act. Arbitration is addressed primarily in CPLR art. 75 (§§ 7501–7514). New York law generally favors arbitration.

[CPLR § 7601] Statutory Excerpt or Summary

Special proceeding to enforce agreement that issue or controversy be determined by a person named or to be selected

A special proceeding may be commenced to specifically enforce an agreement that a question of valuation, appraisal or other issue or controversy be determined by a person named or to be selected. The court may enforce such an agreement as if it were an arbitration agreement, in which case the proceeding shall be conducted as if brought under [CPLR art. 75 (Arbitration)]. Where there is a defense which would require dismissal of an action for breach of the agreement, the proceeding shall be dismissed. Provided, however, that this section shall not apply to any agreement contained in the standard fire insurance policy of the state with the exception of an action to enforce the appraisal clause pursuant to [ISL § 3408,] which shall not be enforced as an arbitration agreement.

[47.3] Assignment of Rents**[RPL § 291-f] Statutory Excerpt or Summary**

Rights where recorded mortgage restricts landlord's action in respect to leases.

An agreement, referring to this [RPL § 291-f], contained in a recorded mortgage of real property, or in a recorded instrument relating to such mortgage, restricting the right or power, as against the holder of the mortgage without his consent, of the owner of the mortgaged real property to cancel, abridge or otherwise modify tenancies, subtenancies, leases or subleases of the mortgaged real property in existence at the time of the agreement, or to accept prepayments of [installments] of rent to become due thereunder, shall become binding on a tenant or subtenant after written notice of such agreement, accompanied by a copy of the text thereof; and any such cancellation, abridgement, modification or prepayment made by such tenant or subtenant, after such written notice, without the consent of the holder of such mortgage, shall be voidable as against the holder, at his option. The recording on or after [July 1, 1960], of any such mortgage or instrument relating thereto shall for the purposes of this [RPL § 291-f] be in itself a sufficient notice of the restrictive agreement to any tenant or subtenant who, after such recording, acquires by assignment, whether the assignment is by instrument or by operation of law, a leasehold estate in existence at the time of the restrictive agreement. This [RPL § 291-f] shall not apply (1) to any tenancy, subtenancy, lease or sublease primarily for the residential purposes of the owner of the leasehold estate, or (2) to any tenancy, subtenancy, lease or sublease having at the time of the restrictive agreement an unexpired term of less than five years.

COMMENTARY

Mortgagees often fear that when a mortgagor is in distress, the mortgagor may (a) enter into a scheme to pull money out of the collateral by making agreements with tenants of the types described in RPL § 291-f, and then (b) leave the mortgagee as the bagholder after the foreclosure. Such concerns motivate some of the mortgagee protections commonly included in nondisturbance agreements. The quoted statute gives mortgagees a convenient mechanism to protect themselves from the same bad-faith schemes

(involving commercial leases with a remaining term of at least five years) without having to negotiate nondisturbance agreements. The statute does not, however, go as far as a typical lender-friendly nondisturbance agreement would. The statute does not, for example, protect mortgagees (after foreclosure) from any claims the tenants might have been able to assert based on the prior landlord's default. Although lenders often do take the steps that RPL § 291-f contemplates, lenders also often use nonrecourse carveouts toward the same end.

For more on this statute and a sample notice to tenants, see Joshua Stein, Stein on New York Commercial Mortgage Transactions, Ch. 12.

[RPL § 294-a] Statutory Excerpt or Summary

Recording assignments of rent.

1. An assignment of rent to accrue from tenancies, subtenancies, leases or subleases of real property, irrespective of the term of their duration, in existence at the time of the assignment, made, subscribed and acknowledged or proved, and certified in a manner to entitle a conveyance to be recorded may be recorded in the office of the recording officer of any county in which any of the real property to which the tenancies, subtenancies, leases or subleases relate is situated, and such recording officer shall, upon the request of any party, on tender of the lawful fees therefor, record the same in his said office.
2. Every such assignment not so recorded shall be void as against any person who subsequently purchases or acquires by exchange, or contracts to purchase or acquire by exchange, the same real property, or any portion thereof, or acquires by assignment the rent to accrue therefrom as provided in this [RPL § 294-a], in good faith and for a valuable consideration, from the same vendor or assignor, his distributees or devisees, and whose conveyance, contract or assignment is first duly recorded.
3. The recording of such assignment shall not be in itself a notice of the assignment to a lessee or tenant, his distributees or devisees, so as to invalidate a payment of rent made by the lessee or tenant, his distributees or devisees, to the assignor or a prior assignee of the rent.

COMMENTARY AND CROSS-REFERENCES

A mortgagee will typically obtain and record an assignment of rents in addition to the mortgage. The recording of an assignment of rents (unless ancillary to a mortgage) may trigger New York's mortgage recording tax. See Tax Law §§ 250 et seq. and Joshua Stein, *New York Commercial Mortgage Transactions*, chapters 6–9.

[47.4] Assignments and Subleases**[RPL § 226] Statutory Excerpt or Summary***Effect of Renewal on Sub-lease*

The surrender of an under-lease is not requisite to the validity of the surrender of the original lease, where a new lease is given by the chief landlord. Such a surrender and renewal do not impair any right or interest of the chief landlord, his lessee or the holder of an under-lease, under the original lease; including the chief landlord's remedy by entry, for the rent or duties secured by the new lease, not exceeding the rent and duties reserved in the original lease surrendered.

COMMENTARY

Does this imply that if a tenant surrenders a lease but does not obtain a new lease, and the subtenant does not surrender its estate, then the landlord (property owner) can enforce the sublease directly against the subtenant? Can the subtenant claim any rights under this statute? No reported case seems to have interpreted this statute.

[47.5] Attorneys—Unauthorized Practice of Law**[JUD § 476-a] Statutory Excerpt or Summary***Action for Unlawful Practice of the Law*

1. The attorney-general may maintain an action upon his or her own information or upon the complaint of a private person or of a bar association organized and existing under the laws of this state against any person, partnership, corporation, or association, and any employee, agent, director, or officer thereof who commits any act or engages in any conduct prohibited by law as constituting the unlawful practice of the law. The term

“action” as used in [JUD § 476-a(1)] shall be construed to include both civil actions and criminal actions.

The term “unlawful practice of the law” as used in this article shall include, but is not limited to,

(a) any act prohibited by [JUD §§ 478, 479, 483, 484, 489, 490, 491, 495 or GBL § 337],² or

(b) any other act forbidden by law to be done by any person not regularly licensed and admitted to practice law in this state, or

(c) any act punishable by the supreme court as a criminal contempt of court under [JUD § 750(B)].³

2. Such a civil action may also be maintained by a bar association organized and existing under the laws of [NYS], upon an application to the supreme court of the state of New York, or a justice thereof, for leave to bring the same by such bar association on good cause shown therefor and proof that a written request was made upon the attorney-general to bring such an action and that more than [20] days have elapsed since the making of such request and he or she has failed or refused to bring such an action.

[JUD § 478] Statutory Excerpt or Summary

Practicing or appearing as attorney-at-law without being admitted and registered.

It shall be unlawful for any natural person to practice or appear as an attorney-at-law or as an attorney and counselor-at-law for a person other than himself or herself in a court of record in this state, or to furnish attorneys or counsel or an attorney and counsel to render legal services, or to hold himself or herself out to the public as being entitled to practice law as aforesaid,

2 The statute actually cites PL §§ 270, 270-a, 270-e, 271, 275, 275-a, 276, 280, and 1452. These statutes were repealed by PL § 500.05. The same subject matter is now covered by Judiciary Law §§ 478, 479, 483, 484, 491 and 495, which describe unlawful practices of attorneys and appearances as attorneys; Judiciary Law §§ 489 and 490, which forbid corporations and collection agencies from purchasing claims to bring an action or proceeding on such claims; and GBL § 337, which prohibits certain advertising to procure divorces and dissolutions of marriages. See Judiciary Law §§ 478, 479, 484 and 495, which are excerpted below

3 The actual language of the statute refers to Judiciary Law § 750(B), excerpted below.

or in any other manner, or to assume to be an attorney or counselor-at-law, or to assume, use, or advertise the title of lawyer, or attorney and counselor-at-law, or attorney-at-law or counselor-at-law, or attorney, or counselor, or attorney and counselor, or equivalent terms in any language, in such manner as to convey the impression that he or she is a legal practitioner of law or in any manner to advertise that he or she either alone or together with any other persons or person has, owns, conducts or maintains a law office or law and collection office, or office of any kind for the practice of law, without having first been duly and regularly licensed and admitted to practice law in the courts of record of this state, and without having taken the constitutional oath.

[JUD § 479] Statutory Excerpt or Summary

Soliciting business on behalf of an attorney.

It shall be unlawful for any person or his agent, employee or any person acting on his behalf, to solicit or procure through solicitation either directly or indirectly legal business, or to solicit or procure through solicitation a retainer, written or oral, or any agreement authorizing an attorney to perform or render legal services, or to make it a business so to solicit or procure such business, retainers or agreements.

COMMENTARY

The language of this statute seems rather broad. Would it, for example, prohibit efforts to have a third party “find a good plaintiff,” once an attorney has identified some malfeasance by someone sufficient to support a lawsuit? Might it also be broad enough to prohibit constitutionally protected communications?

[JUD § 484] Statutory Excerpt or Summary

None but attorneys to practice in the state.

No natural person shall ask or receive, directly or indirectly, compensation for appearing for a person other than himself as attorney in any court or before any magistrate, or for preparing deeds, mortgages, assignments, discharges, leases or any other instruments affecting real estate, wills, codicils, or any other instrument affecting the disposition of property after death, or

decedents' estates, or pleadings of any kind in any action brought before any court of record in this state, or make it a business to practice for another as an attorney in any court or before any magistrate unless he has been regularly admitted to practice, as an attorney or counselor, in the courts of record in the state. . . .

[JUD § 495] Statutory Excerpt or Summary

Corporations and voluntary associations not to practice law.

1. No corporation or voluntary association shall

(a) practice or appear as an attorney-at-law for any person in any court in this state or before any judicial body, nor

(b) make it a business to practice as an attorney-at-law, for any person, in any of said courts, nor

(c) hold itself out to the public as being entitled to practice law, or to render legal services or advice, nor

(d) furnish attorneys or counsel, nor

(e) render legal services of any kind in actions or proceedings of any nature or in any other way or manner, nor

(f) assume in any other manner to be entitled to practice law, nor

(g) assume, use or advertise the title of lawyer or attorney, attorney-at-law, or equivalent terms in any language in such manner as to convey the impression that it is entitled to practice law or to furnish legal advice, services or counsel, nor

(h) advertise that either alone or together with or by or through any person whether or not a duly and regularly admitted attorney-at-law, it has, owns, conducts or maintains a law office or an office for the practice of law, or for furnishing legal advice, services or counsel.

[§§ 495(3)–(7)]

3. No voluntary association or corporation shall ask or receive directly or indirectly, compensation for preparing deeds, mortgages, assignments, discharges, leases, or any other instruments affecting real estate, wills, codicils, or any other instruments affecting disposition of property after death or decedents' estates, or pleadings of any kind in actions or proceedings of any nature. Any association or corporation violating the provisions of this [JUD § 495(3)] is guilty of a misdemeanor.

4. [JUD § 495(1) and (2)] shall not apply to any corporation or voluntary association lawfully engaged in a business authorized by the provisions of any existing statute.

5. [JUD § 495] shall not apply to a corporation or voluntary association lawfully engaged in the examination and insuring of titles to real property, in the preparation of any deeds, mortgages, assignments, discharges, leases or any other instruments affecting real property insofar as such instruments are necessary to the examination and insuring of titles, and necessary or incidental to loans made by any such corporation or association; nor shall it prohibit a corporation or voluntary association from employing an attorney or attorneys in and about its own immediate affairs or in any litigation to which it is or may be a party. Nothing herein contained shall be construed to prevent a corporation or association from furnishing to any person, lawfully engaged in the practice of law, such information or such clerical services in and about his professional work as, except for the provisions of this [JUD § 495], may be lawful, provided that at all times the lawyer receiving such information or such services shall maintain full professional and direct responsibility to his clients for the information and services so received. But no corporation shall be permitted to render any services which cannot lawfully be rendered by a person not admitted to practice law in this state nor to solicit directly or indirectly professional employment for a lawyer.

6. [JUD § 495] shall not apply to a corporation organized under [BCL art. 15 (§§ 1501 to 1516)], or authorized to do

business in this state under [BCL art. 15-A (§§ 1525 to 1533)].⁴

7. [JUD § 495] does not apply to organizations which offer prepaid legal services; to non-profit organizations whether incorporated or unincorporated, organized and operating primarily for a purpose other than the provision of legal services and which furnish legal services as an incidental activity in furtherance of their primary purpose; or to organizations which have as their primary purpose the furnishing of legal services to indigent persons.

[JUD § 750] Statutory Excerpt or Summary

Power of courts to punish for criminal contempts.

[§ 750(b)]

B. In addition to the power to punish for a criminal contempt as set forth in [JUD § 750(A)], the supreme court has power under this [JUD § 750(B)] to punish for a criminal contempt any person who unlawfully practices or assumes to practice law; and a proceeding under [JUD § 750(B)] may be instituted on the court's own motion or on the motion of any officer charged with the duty of investigating or prosecuting unlawful practice of law, or by any bar association incorporated under the laws of this state.

[47.6] Attorneys' Fees

[No applicable statute]

COMMENTARY

Absent a statute or contract to the contrary, New York generally requires each party to any commercial litigation to bear its own attorneys' fees. Some exceptions to the rule that may affect commercial leasing include: (1) if a property owner fails to file a copy of any bond the owner obtained, *see* GOL § 5-322.3 ("Mechanics Liens"); (2) if a conveyance is determined to be fraudulent, *see* DCL § 276-a ("Fraudulent Conveyances"); and (3) if

⁴ These statutory sections relate to professional service corporations and foreign professional service corporations.

a property owner signs a statutorily prohibited lease with a banking entity, *see* BNK § 674-a (“Discrimination in Leasing”). Other New York statutes may authorize attorneys’ fees in other circumstances relevant to commercial leasing.

[47.7] Attornment

[RPL § 224] Statutory Excerpt or Summary

Attornment by tenant

The attornment of a tenant to a stranger is absolutely void and does not in any way affect the possession of the landlord unless made either:

1. With the consent of the landlord; or
2. Pursuant to or in consequence of a judgment, order, or decree of a court of competent jurisdiction; or
3. To a purchaser at foreclosure sale.

[47.8] Common Interest Communities—[No applicable statute]

COMMENTARY AND CROSS-REFERENCES

New York has a large body of law and regulations on common interest communities (and the sales of real estate within them), but nothing specific to commercial leasing. *See* “Condominium Leaseholds.”

[47.9] Condemnation

[EDPL § 103] Statutory Excerpt or Summary

Definitions.

As used in this law:

[§ 103(C), (D) and (F)]

(C) “Condemnee” means the holder of any right, title, interest, lien, charge or encumbrance in real property subject to an acquisition or proposed acquisition.

(D) “Condemnor” means any entity vested with the power of eminent domain.

(F) “Real property” includes all land and improvements, lands under water, waterfront property, the water of any lake, pond or stream, all easements and hereditaments, corporeal or incorporeal, and every estate, interest and right, legal or equitable, in lands or water, and right, interest, privilege, easement and franchise relating to the same, including terms for years and liens by way of mortgage or otherwise.

COMMENTARY

Although the Eminent Domain Procedure law would treat a tenant as a condemnee, most leases require the tenant to relinquish to the landlord any rights to participate in a condemnation award.

Landlord’s counsel may want to include this language: “The entire Condemnation award shall belong to Landlord, except any sum expressly awarded to Tenant for trade fixtures, goodwill, and moving costs, provided it does not reduce any payments to Landlord (or Landlord’s underlying ground lessor or mortgagee) and Tenant has cured any Default.”

The proviso language represents a common concession to a tenant.

A ground lease will trigger an entirely different conversation between Landlord and Tenant.

[EDPL § 405] Statutory Excerpt or Summary

Possession.

[§ 405(A)]

(A) If the condemnor has a right to possession of real property as provided for in this law, and the condemnor shall deem it necessary to cause the removal of a condemnee or other occupant[,] it may cause such condemnee or other occupant to be removed therefrom and possession to be delivered to it, pursuant to the procedures of landlord and tenant law, or by application to the supreme court in which the proceeding is pending for a writ of assistance for possession or pursuant to other law,

except that no condemnee shall be required to surrender possession prior to the condemnor's payment to him of its advance payment or the deposit of such amount in accordance with [EDPL art. 3 (§§ 301 to 305)], unless the condemnee has not complied with [EDPL §302].

[EDPL § 702] Statutory Excerpt or Summary

Incidental expenses.

[§ 702(A)(2)]

(A) The condemnor shall reimburse a condemnee an amount separately computed and stated, representing the following incidental expenses: ...

(2) any penalty incurred by the condemnee for prepayment of any preexisting recorded mortgage entered into in good faith, encumbering such property[.]

COMMENTARY

Assuming the courts apply this statute as written, it should address a leasehold borrower's concern about possible application of a prepayment premium in the event of a condemnation. No reported case seems to interpret or apply this case in the context of leasehold mortgages.

[47.10] Condominium Leaseholds

[RPL § 339-e] Statutory Excerpt or Summary

Definitions.

[§§ 339-e(11) and (12)]

11. "Property" means and includes the land, the building and all other improvements thereon, (i) owned in fee simple absolute, or (ii) in the case of a condominium devoted exclusively to non-residential purposes, held under a lease or sublease, or separate unit leases or subleases, the unexpired term or terms of which on the date of recording of the declaration shall not

be less than [30] years, or (iii) in the case of a qualified leasehold condominium, held under a lease or sublease, or separate unit leases or subleases, the unexpired term or terms of which on the date of recording of the declaration shall not be less than [50] years, and all easements, rights and appurtenances belonging thereto, and all other property, personal or mixed, intended for use in connection therewith, which have been or are intended to be submitted to the provisions of this [RPL art. 9-B (§§ 339-d to 339-kk)].

12. “Qualified leasehold condominium” means any leasehold interest in real property intended to be used for either residential purposes, commercial purposes, industrial purposes or any combination of such purposes, together with any fee simple absolute or leasehold interest in the buildings and all other improvements which have been or at any time hereafter may be erected upon such real property, which has been or is intended to be submitted to the provisions of this article, provided that, on the date of the recording of the declaration: (i) the battery park city authority or the Roosevelt Island operating corporation is the holder of the tenant’s interest in such leasehold interest (ii) the Queens West development corporation is the holder of the landlord’s interest in such leasehold interest or (iii) the Brooklyn bridge park development corporation is the holder of the landlord’s interest in such leasehold interest, or (iv) [NYC] educational construction fund is the holder of the landlord’s interest in such leasehold interest for property located in the borough of Manhattan, in [NYC], bounded on the east by Second Avenue on the west by Third Avenue to the north by East [57th] Street, and to the south by East [56th] Street [commonly known as 250 East 57th Street, the Whole Foods Market Project].

COMMENTARY

As in so many other contexts, the Legislature decides to prohibit something or make it impossible (in this case leasehold condominiums), but then decides to allow it for specific projects that are deemed “desirable.” Similar dynamics apply to bond financing, tax exemptions and abatements, extra development rights, and other “goodies.” This approach to facilitating development maximizes the importance of political connections, discourages new entrants, helps perpetuate the “housing crisis” in NYC, and thus helps maintain the value of existing improvements.

New York law allows cooperative apartment buildings structured on leaseholds. The New York State Attorney General tends, quite appropriately, to view any leasehold-based coops (and the occasional condo, as indicated above) with skepticism and requires particularly full disclosure of the risks they create.

[RPL § 339-y] Statutory Excerpt or Summary

Separate taxation.

[RPL § 339-y(2)(a)]

2. With respect only to qualified leasehold condominiums:

(a) Each unit, its common interest, not including any personal property, and the proportionate undivided part of the real property which is the subject of a qualified leasehold condominium and is allocated to such unit (as expressed in the declaration), shall be deemed to be a parcel, shall be subject to separate assessment to the unit owner and shall be subject to taxation by each assessing unit, school district, special district, county or other taxing unit for all types of taxes authorized by law including, but not limited to, special ad valorem levies and special assessments. Neither the real property which is the subject of a qualified leasehold condominium, the building, the property nor any of the common elements shall be deemed to be a parcel. In no event shall the aggregate of the assessment of the units plus their common interests plus their proportionate undivided parts (as expressed in the declaration) of said real property exceed the total valuation of the property and said real property assessed as a single parcel owned in fee. No provision of this [RPL § 339-y(2)(a)] shall be deemed to subject to taxation any parcel or part thereof which, pursuant to applicable law, is either exempt from taxation or with respect to which no taxes are payable.

[47.11] Covenants of Good Faith and Fair Dealing

[No applicable statute]

COMMENTARY

New York common law recognizes an implied covenant of good faith and fair dealing. This “tort” theory may give creative tenants a neat technique to persuade courts to ignore limitations on a landlord’s liability under a lease. *See, e.g., Tapps of Nassau Supermarkets, Inc. v. Linden Blvd. L.P.*, 269 A.D.2d 306 (1st Dep’t 2000). Similar strategies might be available for nonrecourse mortgages.

[47.12] Covenants Running With the Land

[RPL § 223] Statutory Excerpt or Summary

Rights where property or lease is transferred.

The grantee of leased real property, or of a reversion thereof, or of any rent, the devisee or assignee of the lessor of such a lease, or the heir or personal representative of either of them, has the same remedies, by entry, action or otherwise, for the nonperformance of any agreement contained in the assigned lease for the recovery of rent, for the doing of any waste, or for other cause of forfeiture as his grantor or lessor had, or would have had, if the reversion had remained in him. A lessee of real property, his assignee or personal representative, has the same remedy against the lessor, his grantee or assignee, or the representative of either, for the breach of an agreement contained in the lease, that the lessee might have had against his immediate lessor, except a covenant against incumbrances or relating to the title or possession of the premises leased. This [RPL § 223] applies as well to a grant or lease in fee, reserving rent, as to a lease for life or for years; but not to a deed of conveyance in fee, made [before April 9, 1805], or after [April 14, 1860].

COMMENTARY

Would this language apply to and protect a foreclosure purchaser of the fee estate? One would think so, because the statute refers to any grantee or assignee of the lessor without excluding a grant or assignment that might take place through foreclosure.

[47.13] Damage or Destruction

[RPL § 227] Statutory Excerpt or Summary

When tenant may surrender premises.

Where any building, which is leased or occupied, is destroyed or so injured by the elements, or any other cause as to be untenable, and unfit for occupancy, and no express agreement to the contrary has been made in writing, the lessee or occupant may, if the destruction or injury occurred without his or her fault or neglect, quit and surrender possession of the leasehold premises, and of the land so leased or occupied; and he or she is not liable to pay to the lessor or owner, rent for the time subsequent to the surrender. Any rent paid in advance or which may have accrued by the terms of a lease or any other hiring shall be adjusted to the date of such surrender.

COMMENTARY

Most leases require the tenant to waive any rights under this statute, for example as follows:

The provisions of this Lease on casualty constitutes an express agreement on damage or destruction of the Premises by fire or other casualty. Therefore, Real Property Law § 227, providing for this contingency absent express agreement, shall not apply in such case.

[47.14] Discrimination in Leasing

[RPL § 235-d] Statutory Excerpt or Summary

Harassment.

1. Notwithstanding any other provision of law, within a city having a population of [1,000,000] or more, it shall be unlawful and shall constitute harassment for any landlord of a building which at any time was occupied for manufacturing or warehouse purposes, or other person acting on his behalf, to engage in any course of conduct, including, but not limited to intentional interruption or discontinuance or willful failure to restore services customarily provided or required by written lease or other rental agreement, which interferes with or disturbs the comfort, repose, peace or quiet of a tenant in the tenant's use or occupancy of rental space if such conduct is intended to cause the tenant (i) to vacate a building or part thereof; or (ii) to surrender or waive any rights of such tenant under the tenant's written lease or other rental agreement.

2. The lawful termination of a tenancy or lawful refusal to renew or extend a written lease or other rental agreement shall not constitute harassment for purposes of this [RPL § 235-d].

3. As used in this [RPL § 235-d], the term “tenant” means only a person or business occupying or residing at the premises pursuant to a written lease or other rental agreement, if such premises are located in a building which at any time was occupied for manufacturing or warehouse purposes and a certificate of occupancy for residential use of such building is not in effect at the time of the last alleged acts or incidents upon which the harassment claim is based.

4. A tenant may apply to the supreme court for an order enjoining acts or practices which constitute harassment under this [RPL § 235-d(1)]; and upon sufficient showing, the supreme court may issue a temporary or permanent injunction, restraining order or other order, all of which may, as the court determines in the exercise of its sound discretion, be granted without bond. In the event the court issues a preliminary injunction it shall make provision for an expeditious trial of the underlying action.

5. The powers and remedies set forth in this [RPL § 235-d] shall be in addition to all other powers and remedies in relation to harassment including the award of damages. Nothing contained herein shall be construed to amend, repeal, modify or affect any existing local law or ordinance, or provision of the charter or administrative code of [NYC], or to limit or restrict the power of the city to amend or modify any existing local law, ordinance or provision of the charter or administrative code, or to restrict or limit any power otherwise conferred by law with respect to harassment.

6. Any agreement by a tenant in a written lease or other rental agreement waiving or modifying his rights as set forth in this [RPL § 235-d] shall be void as contrary to public policy.

COMMENTARY

This statute protects tenants in buildings that are undergoing a change of use from manufacturing or warehouse use to other uses (generally residential). Under the statute, mere failure to renew a lease does not consti-

tute “harassment.” The fact that the Legislature needed to say this tells a great deal about the overall attitude of the New York courts toward owners of commercial investment property.

[BNK § 674-a]

Unlawful undertakings.

1. Every undertaking, whether written or oral, express or implied, constituting or contained in a contract heretofore or hereafter entered into, directly or indirectly, between a banking organization, bank holding company, national banking association, federal savings and loan association or foreign banking corporation and the owner of an interest in real property located in the state, which bars such owner from leasing, selling or otherwise disposing of any interest in real property to any other banking organization, bank holding company, national banking association, federal savings and loan association or foreign banking corporation shall be null and void.

2. Any banking organization, bank holding company, national banking association, federal savings and loan association, foreign banking corporation or any other entity or person injured in his business or property by reason of an undertaking which violates [BNK § 674-a(1)] may sue on account thereof and be entitled to recover three times the amount of the damages sustained, and the cost of suit, including reasonable attorneys’ fees.

3. If any provision of [BNK § 674-a], or the application of such provision to any individual, company or circumstance, shall be held invalid, the remainder of [BNK § 674-a], and the application of [BNK § 674-a] to individuals, companies or circumstances other than those to which it is held invalid, shall not be affected thereby.

COMMENTARY

Would federal law supersede this statute for federally chartered institutions?

[47.15] Distraint

[No applicable statute]

COMMENTARY

New York does not, by either statute or common law, give a landlord any lien on a tenant's personal property. A landlord that wants such a lien must obtain it under the Uniform Commercial Code. The parties would typically not mention the landlord's lien in any memorandum of the lease, for fear of attracting a mortgage recording tax. A nervous tenant might ask the landlord to agree in advance to waive or subordinate any "landlord lien" the legislature might decide to create in the future. Any such legislative measures would seem highly unlikely, though.

[47.16] Ejectment

[No applicable statute]

COMMENTARY

In New York, ejectment is generally a common law remedy and statutes are not particularly useful. But see "Landlord's Remedies."

[47.17] Electronic Transactions**[ESRA § 301[STL § 301]]Statutory Excerpt or Summary**

Short title.

This [ESRA §§ 301-309] shall be known and may be cited as the "electronic signatures and records act."

[ESRA § 302 [STL § 302]]Statutory Excerpt or Summary

Definitions.

For the purpose of [ESRA §§ 301-309]:

1. "Electronic" shall mean of or relating to technology having electrical, digital, magnetic, wireless, optical, electromagnetic, or similar capabilities.
2. "Electronic record" shall mean information, evidencing any act, transaction, occurrence, event, or other activity, produced or stored by electronic means and capable of being accurately reproduced in forms perceptible by human sensory capabilities.

3. “Electronic signature” shall mean an electronic sound, symbol, or process, attached to or logically associated with an electronic record and executed or adopted by a person with the intent to sign the record.
4. “Person” shall mean a natural person, corporation, trust, estate, partnership, incorporated or unincorporated association or any other legal entity, and also includes any department, agency, authority, or instrumentality of the state or its political subdivisions.
5. “Governmental entity” shall mean any state department, board, bureau, division, commission, committee, public authority, public benefit corporation, council, office, or other governmental entity or officer of the state having statewide authority, except the state legislature, and any political subdivision of the state.

[ESRA § 303 [STL § 303]]

Electronic facilitator.

1. The office of information technology services shall be the electronic facilitator and administer this [STL art. III (§§ 301 to 309)]. In addition to the authority, duties and responsibilities set forth in [STL art. I (§§ 101 to 109)], the electronic facilitator shall have the authority, duties and responsibilities granted in [STL art. III (§§ 301 to 309)].
2. The electronic facilitator shall have the following functions, powers, and duties:
 - (a) To promulgate rules and regulations consistent with the provisions of [STL art. III (§§ 301-309)]. In developing rules and regulations, the electronic facilitator shall seek the advice of the attorney general, the state comptroller, the director of budget, government and private entities and individuals as the electronic facilitator deems appropriate.
 - (b) To cooperate with government and private entities and individuals in order to assist in the development and implementation of [STL art. III (§§ 301-309)].

I To develop guidelines for the improvement of business and commerce by electronic means. Such guidelines shall identify preferred technology standards relating to security, confidentiality and privacy of electronic signatures and electronic records.

[ESRA § 304 [STL § 304]]

Use of electronic signatures.

1. The electronic facilitator shall establish rules and regulations governing the use of electronic signatures and authentication. The electronic facilitator shall not establish rules or regulations that seek to apportion fault or impose or limit liability relating to the use of electronic signatures.
2. In accordance with [ESRA § 304] unless specifically provided otherwise by law, an electronic signature may be used by a person in lieu of a signature affixed by hand. The use of an electronic signature shall have the same validity and effect as the use of a signature affixed by hand.

[ESRA § 305 [STL § 305]]

Use of electronic records.

1. In accordance with rules and regulations promulgated by the electronic facilitator, government entities are authorized and empowered to produce, receive, accept, acquire, record, file, transmit, forward, and store information by use of electronic means. If any such government entity uses electronic records, it must also ensure that anyone who uses the services of such government entity may obtain access to records as permitted by statute, and receive copies of such records in paper form in accordance with fees prescribed by statute. No person shall be required to submit or file any record electronically to any government entity except as otherwise provided by law. Government entities that obtain, store, or utilize electronic records shall not refuse to accept hard copy, non-electronic forms, reports, and other paper documents for submission or filing except as otherwise provided by law.

2. A government entity shall have the authority to dispose of or destroy a record in accordance with the arts and cultural affairs law, regardless of format or media.
3. An electronic record shall have the same force and effect as those records not produced by electronic means.

[ESRA § 306 [STL § 306]]

Admissibility into evidence.

In any legal proceeding where the provisions of the [CPLR] are applicable, an electronic record or electronic signature may be admitted into evidence pursuant to the provisions of [CPLR art. 45 (§§ 4501 to 4548)] including, but not limited to [CPLR § 4539].

[ESRA § 307 [STL § 307]]

Exceptions.

This [STL art. III (§§ 301-309)] shall not apply:

1. To any document providing for the disposition of an individual's person or property upon death or incompetence, or appointing a fiduciary of an individual's person or property, including, without limitation, wills, trusts, decisions consenting to orders not to resuscitate, powers of attorney and health care proxies, with the exception of:
 - (a) contractual beneficiary designations; and (b) the registration of making, amending, or revoking an anatomical gift under [Public Health Law § 4310].
2. To any negotiable instruments and other instruments of title wherein possession of the instrument is deemed to confer title, unless an electronic version of such record is created, stored or transferred pursuant to [STL art. III (§§ 301 to 309)] in a manner that allows for the existence of only one unique, identifiable and unalterable version which cannot be copied except in a form that is readily identifiable as a copy.

3. To any other document that the electronic facilitator has specifically excepted, pursuant to the rules and regulations of the electronic facilitator, from the application of [STL art. III (§§ 301-309)].

COMMENTARY

Until 2012, New York's electronic signature law expressly excluded recordable documents. As of 2014, some counties have implemented electronic recording.

[ESRA § 308 [STL § 308]]

Personal privacy protection.

1. Any information reported to the electronic facilitator by a government entity in connection with the authorization of an electronic signature shall continue to be withheld from public disclosure if such information was withheld from public disclosure by such government entity. Electronic records shall be considered and treated as any other records for the purposes of the [F]reedom of [I]nformation [L]aw as set forth in [N.Y. Public Officers Law art. 6 (§§ 84 to 90)] and the [P]ersonal [P]rivacy [P]rotection [L]aw as set forth in [N.Y. Public Officers Law art. 6-A (§§ 91 to 99)].

2. A person or an entity that acts as an authenticator of electronic signatures shall not disclose to a third party any personal information reported to it by the electronic signatory other than the information necessary to authenticate the signature unless the disclosure is made pursuant to a court order or statute, or if the information or data is used solely for statistical purposes in aggregate form. For purposes of [Electronic Signatures and Records Act § 308], "personal information" shall mean data that identifies a specific person, including but not limited to home and work addresses, telephone number, e-mail address, social security number, birth date, gender, marital status, mother's maiden name, and health data.

[ESRA § 309 [STL § 309]]

Use of electronic records and signatures to be voluntary.

Nothing in [STL art III. (§§ 301-309)] shall require any entity or person to use an electronic record or an electronic signature unless otherwise provided by law.

[47.18] Electronic Transactions—Uniform Electronic Transactions Act

[No applicable statute]

COMMENTARY

New York has not adopted the Uniform Electronic Transactions Act and instead has adopted requirements described in Electronic Signatures and Records Act §§ 301 – 309. *See* “Electronic Transactions.” Those provisions were amended in 2012 to remove the exception for recordable documents.

[47.19] Enforcement of Judgments

[CPLR § 5102] Statutory Excerpt or Summary

Enforcement of judgment or order awarding possession of real property or a chattel.

A judgment or order, or a part thereof, awarding possession of real property or a chattel may be enforced by an execution, which shall particularly describe the property and designate the party to whom the judgment or order awards its possession. The execution shall comply with the provisions of [CPLR § 5230], except that it shall direct the sheriff to deliver possession of the property to the party designated.

CROSS-REFERENCES

See “Landlord’s Remedies,” relating to enforcement of judgments in landlord-tenant summary proceedings.

[CPLR § 5103] Statutory Excerpt or Summary

Enforcement of judgment or order directing sale of real property.

[CPLR § 5103(a)] Statutory Excerpt or Summary

(a) Entry in county where real property situated. Where real property directed by a judgment or order to be sold is not situated in the county in which the judgment or order is entered, the judgment or order shall also be entered by the clerk of the county in which the property is situated upon filing with him a certified copy of the judgment or order. A purchaser of the property is not required to pay the purchase money or accept a deed until the judgment or order is so entered.

[47.20] Environmental

[ECL § 27-2405] Statutory Excerpt or Summary

Tenant notification of indoor air contamination.

1. For purposes of this [ECL § 27-2405]:

a. “test results” shall include the results of any tests conducted on indoor air, subslab air, ambient air, subslab groundwater samples, and subslab soil samples; and

b. “issuer” means:

(i) a person subject to an order issued pursuant to [ECL §§ 27-1301–27-1323], [Navigation Law art. 12 (§§ 170–197)], or [Public Health Law §§ 1389-a–1389-e)].

(ii) a participant as defined in [ECL § 27-1405(1)] subject to an agreement entered into pursuant to [ECL §§ 27-1401–27-1435], or

(iii) by a municipality subject to a contract entered into pursuant to [ECL §§ 56-0501–56-0515]; or

(iv) by the [DEC].

2. Any owner of real property or any owner's agent to whom indoor air contamination test results have been provided by an issuer shall, in cases where test results exceed [Department of Health] indoor air guidelines or the [Occupational Safety and Health Administration] guidelines for indoor air quality, provide a fact sheet and timely notice of any public meetings required to be held to discuss such results to all tenants and occupants and upon request such test results and any closure

letter, within [15] days of receipt of such results. Generic fact sheets shall be prepared by the [Department of Health] and shall identify at a minimum the compound or contaminant of concern, reportable detection levels established by the [Department of Health] indoor air guidelines or the [Occupational Safety and Health Administration] guidelines for indoor air quality and health risks associated with exposure to such compound or contaminant and a means to obtain more information on the compound or contaminant.

3. For real property for which an engineering control is in place to mitigate indoor air contamination, or if the real property is subject to ongoing monitoring pursuant to an ongoing remedial program, the owner or owner's agent of real property to whom indoor air contamination test results have been provided by an issuer shall provide, or cause to be provided, fact sheets, and upon request any test results, or closure letter received by such owner or owner's agent to any prospective tenant prior to the signing of a binding lease or rental agreement. Generic fact sheets shall be prepared by the [Department of Health] and shall identify at a minimum the compound or contaminant of concern, reportable detection levels established by the [Department of Health] indoor air guidelines or the occupational safety and health administration guidelines for indoor air quality and health risks associated with exposure to such compound or contaminant and a means to obtain more information on the compound or contaminant. Such notice shall be included in the rental or lease agreement and shall contain the following in at least [12] point type in bold face on the first page:

“NOTIFICATION OF TEST RESULTS The property has been tested for contamination of indoor air: test results and additional information are available upon request.”

COMMENTARY

If a property tests positive for some forms of air contamination, this statute requires the property owner to notify tenants and prospective tenants of the issue, i.e., perhaps stop signing new leases. Thus a statute that nominally requires disclosure in fact incentivizes the landlord to act quickly to solve whatever problems exist, a dynamic common in many “disclosure” statutes. In addition to the quoted statute, which specifically relates to

leasing, New York has a large body of environmental law, much of it sometimes relevant to commercial leasing transactions, especially with contaminated property. Also see “Government Leases.”

[47.21] Fixtures

[RPL § 226-a] Statutory Excerpt or Summary

Effect of new lease on tenant’s right to remove fixtures or improvements.

Unless otherwise expressly agreed, where a tenant has a right to remove fixtures or improvements, such right shall not be lost or impaired by reason of his acceptance of a new lease of the same premises without any surrender of possession between terms.

Under the circumstances where this statute applies, it creates a possible small trap for the unwary landlord’s counsel: If the new lease fails to address this issue, then the terms of the old lease will continue to apply. That will often—but not always—be the correct result.

[47.22] Foreign Ownership

[RPL § 10] Statutory Excerpt or Summary

Capacity to hold real property.

[RPL § 10(2)]

Aliens are empowered to take, hold, transmit, and dispose of real property within this state in the same manner as native-born citizens and their heirs and devisees take in the same manner as citizens’.

COMMENTARY

These statutory provisions have not been highly controversial. As home to the United Nations, numerous foreign embassies and consulates, and other international organizations, the New York commercial leasing market is uniquely affected by principles of diplomatic immunity and other

limits on the liability of foreign governments and their instrumentalities. That body of law is a matter of federal and international law, not NYS or NYC law, hence it lies outside the scope of this collection. For a discussion of these matters, see the separate chapter in this work.⁵

[RPL § 15]

Title through alien.

The right, title or interest in or to real property in this state now held or hereafter acquired by any person entitled to hold the same can not be questioned or impeached by reason of the alienage of any person through whom such title may have been derived. Nothing in this [RPL §15] affects or impairs the right of any heir, devisee, mortgagee, or creditor by judgment or otherwise.

[47.23] Formalities of Execution

[RPL § 292-a]

Conveyances by certain corporations executed and acknowledged by attorneys in fact entitled to recordation.

A conveyance of real property, within the state, or of any interest therein, including an instrument discharging or satisfying a lien created by any such conveyance, executed and acknowledged by an attorney in fact of any corporation wholly owned, directly or indirectly, by the United States of America, or any other corporation which has so filed a power of attorney, whether heretofore or hereafter so executed and acknowledged, shall be entitled to recordation under this article on tender of the lawful fees therefor, even though the corporate seal of such corporation be not annexed or affixed, if the power of attorney pursuant to which such attorney in fact has executed such conveyance, duly acknowledged or proved by such corporation, and certified, as required by [RPL § 294], is filed or recorded in the office of the clerk of the county where the real property, which is the subject of such conveyance, is located.

5 **CHAPTER

COMMENTARY

This statute should eliminate any of the doubt sometimes expressed about whether a corporation can act through a power of attorney. As a practical matter, of course, one should always check in advance. This statute also eliminates any requirement for a corporate seal where an instrument is signed by an attorney in fact under a recorded power of attorney. The reporter is not aware of a statute that expressly eliminates the need for a seal where a corporation merely acts through one of its officers. Nevertheless, under New York practice, corporate seals are not required and are rarely seen, at least in real estate. The use of a corporate seal does constitute prima facie evidence that the instrument was executed by appropriate corporate authority. *See* BCL § 107.

[RPL § 298] Statutory Excerpt or Summary

Acknowledgments and proofs within the state.

The acknowledgment or proof, within this state, of a conveyance of real property situate in this state may be made:

1. At any place within the state, before (a) a justice of the supreme court; (b) an official examiner of title; (c) an official referee; or (d) a notary public.
2. Within the district wherein such officer is authorized to perform official duties, before (a) a judge or clerk of any court of record; (b) a commissioner of deeds outside of [NYC], or a commissioner of deeds of [NYC] within the five counties comprising [NYC]; (c) the mayor or recorder of a city; (d) a surrogate, special surrogate, or special county judge; or I the county clerk or other recording officer of a county.
3. Before a justice of the peace, town councilman, village police justice or a judge of any court of inferior local jurisdiction, anywhere within the county containing the town, village or city in which he is authorized to perform official duties.

COMMENTARY

New York has not adopted the Uniform Recognition of Acknowledgments Act and has instead adopted requirements described in RPL §§ 298 et seq. The Legislature has almost succeeded in making acknowledgments as simple and straightforward as they should be. New York leases are usually

not acknowledged, unless they will be recorded. New York law and practice do not require the use of “Attest” signatures, “Witness” signatures, or any particular number of signers for any particular entity type.

[RPL § 299] Statutory Excerpt or Summary

Acknowledgments and proofs without the state, but within the United States or any territory, possession, or dependency thereof.

The acknowledgment or proof of a conveyance of real property situate in this state, if made (a) without the state but within the United States, (b) within any territory, possession, or dependency of the United States, or (c) within any place over which the United States, at the time when such acknowledgment or proof is taken, has or exercises jurisdiction, sovereignty, control, or a protectorate, may be made before any of the following officers acting within his territorial jurisdiction or within that of the court of which he is an officer:

1. A judge or other presiding officer of any court having a seal, or the clerk or other certifying officer thereof.
2. A mayor or other chief civil officer of any city or other political subdivision.
3. A notary public.
4. A commissioner of deeds appointed pursuant to the laws of this state to take acknowledgments or proofs without this state.
5. Any person authorized, by the laws of the state, District of Columbia, territory, possession, dependency, or other place where the acknowledgment or proof is made, to take the acknowledgment or proof of deeds to be recorded therein.

CROSS-REFERENCES

See RPL §§ 311 and 312.

[RPL § 299-a] Statutory Excerpt or Summary

Acknowledgment to conform to law of New York or of place where taken; certificate of conformity.

1. An acknowledgment or proof made pursuant to the provisions of [RPL § 299] may be taken in the manner prescribed either by the laws of [NYS] or by the laws of the state, District of Columbia, territory, possession, dependency, or other place where the acknowledgment or proof is taken. The acknowledgment or proof, if taken in the manner prescribed by such state, District of Columbia, territory, possession, dependency, or other place, must be accompanied by a certificate to the effect that it conforms with such laws. Such certificate may be made by

(a) An attorney-at-law admitted to practice in [NYS], resident in the place where the acknowledgment or proof is taken, or by

(b) An attorney-at-law admitted to practice in the state, District of Columbia, territory, possession, dependency, or other place where the acknowledgment or proof is taken, or by

I Any other person deemed qualified by any court of [NYS], if, in any action, proceeding, or other matter pending before such court, it be necessary to determine that such acknowledgment or proof conforms with the laws of such state, District of Columbia, territory, possession, dependency, or other place; or by the supreme court of [NYS], on application for such determination. The justice, judge, surrogate, or other presiding judicial officer shall append to the instrument so acknowledged or proved his signed statement that he deemed such person qualified to make such certificate.

2. (a) The signature to such a certificate of conformity shall be presumptively genuine, and the qualification of the person whose name is so signed as a person authorized to make such certificate shall be presumptively established by the recital thereof in the certificate.

(b) The statement of a judicial officer appended to the instrument that he deemed the person making such certificate qualified shall establish the qualification of the person designated therein to make such certificate; and the recording, filing, reg-

istering or use as evidence of the instrument shall not depend on the power of the court to make the statement and proof shall not be required of any action, proceeding, matter or application in which or in connection with which the statement is made.

I When an instrument so acknowledged or proved is accompanied by the certificate of conformity and the statement of a judicial officer, if any be required, the acknowledgment or proof of the instrument, for the purpose of recording, filing or registering in any recording or filing office in this state or for use as evidence, shall be equivalent to one taken or made in the form prescribed by law for use in this state; and if the acknowledgment or proof is properly authenticated, where authentication is required by law, and if the instrument be otherwise entitled to record, filing or registering, such instrument, together with the acknowledgment or proof, the certificate of conformity and any certificate of authentication or statement of a judicial officer, may be recorded, filed or registered in any recording or filing office in this state, and shall be so recorded, filed or registered upon payment or tender of lawful fees therefor. In fixing the fees of a recording, filing or registering officer, the certificate of conformity and the statement of a judicial officer appended, if any, shall be treated as certificates of authentication required by other provisions of [RPL ch. 50].

[RPL § 301] Statutory Excerpt or Summary

Acknowledgments and proofs in foreign countries.

The acknowledgment or proof of a conveyance of real property situate in this state may be made in foreign countries before any of the following officers acting within his territorial jurisdiction or within that of the court of which he is an officer:

1. An ambassador, envoy, minister, charge d'affaires, secretary of legation, consul-general, consul, vice-consul, consular agent, vice-consular agent, or any other diplomatic or consular agent or representative of the United States, appointed or accredited to, and residing within, the country where the acknowledgment or proof is taken.
2. A judge or other presiding officer of any court having a seal, or the clerk or other certifying officer thereof.

3. A mayor or other chief civil officer of any city or other political subdivision.
4. A notary public.
5. A commissioner of deeds appointed pursuant to the laws of this state to take acknowledgments or proofs without this state.
6. A person residing in, or going to, the country where the acknowledgment or proof is to be taken, and specially authorized for that purpose by a commission issued to him under the seal of the supreme court of [NYS].
7. Any person authorized, by the laws of the country where the acknowledgment or proof is made, to take acknowledgments of conveyances of real estate or to administer oaths in proof of the execution thereof.

COMMENTARY AND CROSS-REFERENCES

See RPL §§ 311 and 312.

[RPL § 301-a] Statutory Excerpt or Summary

Acknowledgment to conform to law of New York or of foreign country; certificate of conformity.

1. An acknowledgment or proof made pursuant to the provisions of [RPL § 301] may be taken in the manner prescribed either by the laws of [NYS] or by the laws of the country where the acknowledgment or proof is taken. The acknowledgment or proof, if taken in the manner prescribed by the laws of such foreign country, must be accompanied by a certificate to the effect that it conforms with such laws. Such certificate may be made by

(a) An attorney-at-law admitted to practice in [NYS], resident in such foreign country, or by

(b) A consular officer of the United States, resident in such foreign country, under the seal of his office, or by

I A consular officer of such foreign country, resident in [NYS], under the seal of his office, or by

(d) Any other person deemed qualified by any court of [NYS], if, in any action, proceeding, or other matter pending before such court, it be necessary to determine that such acknowledgment or proof conforms with the laws of such foreign country; or by the supreme court of [NYS], on application for such determination.

The justice, judge, surrogate, or other presiding judicial officer shall append to the instrument so acknowledged or proved his signed statement that he deemed such person qualified to make such certificate.

2. (a) The signature to such a certificate of conformity shall be presumptively genuine, and the qualification of the person whose name is so signed as a person authorized to make such certificate shall be presumptively established by the recital thereof in the certificate.

(b) The statement of a judicial officer appended to the instrument that he deemed the person making such certificate qualified shall establish the qualification of the person designated therein to make such certificate; and the recording, filing, registering or use as evidence of the instrument shall not depend on the power of the court to make the statement and proof shall not be required of any action, proceeding, matter or application in which or in connection with which the statement is made.

I When an instrument so acknowledged or proved is accompanied by the certificate of conformity and the statement of a judicial officer, if any be required, the acknowledgment or proof of the instrument, for the purpose of recording, filing or registering in any recording or filing office in this state or for use as evidence, shall be equivalent to one taken or made in the form prescribed by law for use in this state; and if the acknowledgment or proof is properly authenticated, where authentication is required by law, and if the instrument be otherwise entitled to record, filing or registering, such instrument, together with the acknowledgment or proof, the certificate of conformity and any certificate of authentication or statement of a judicial officer, may be recorded, filed or registered in any recording or filing office in this state, and shall be so recorded, filed or registered upon payment or tender of lawful fees therefor. In fixing the fees of a recording, filing or registering offi-

cer, the certificate of conformity and the statement of a judicial officer appended, if any, shall be treated as certificates of authentication required by other provisions of this [RPL §§ 290 to 602].

[RPL § 303] Statutory Excerpt or Summar

Requisites of acknowledgment.

An acknowledgment must not be taken by any officer unless he knows or has satisfactory evidence, that the person making it is the person described in and who executed such instrument.

[RPL § 306] Statutory Excerpt or Summary

Certificate of acknowledgment or proof.

A person taking the acknowledgment or proof of a conveyance must indorse thereupon or attach thereto, a certificate, signed by himself, stating all the matters required to be done, known, or proved on the taking of such acknowledgment or proof; together with the name and substance of the testimony of each witness examined before him, and if a subscribing witness, his place of residence.

Any conveyance which has heretofore been recorded, or which may hereafter be recorded, shall be deemed to have been duly acknowledged or proved and properly authenticated, when [10] years have elapsed since such recording; saving, however, the rights of every purchaser in good faith and for a valuable consideration deriving title from the same vendor or grantor, his heirs or devisees, to the same property or any portion thereof, whose conveyance shall have been duly recorded before the said period of [10] years shall have elapsed.

[RPL § 307] Statutory Excerpt or Summary

When certificate to state time and place.

When the acknowledgment or proof is taken by a commissioner of deeds appointed pursuant to the laws of this state to take acknowledgments or proofs without this state, whether within or without the United States, the certificate must also state the day on which, and the city or other political subdivi-

sion, and the state or country or other place in which, the same was taken.

[RPL § 308] Statutory Excerpt or Summary

When certificate must be under seal.

1. When a certificate of acknowledgment or proof is made without this state, whether within or without the United States, (a) if made by a judge or other presiding officer of a court having a seal, or by the clerk or other certifying officer thereof, such certificate must be under the seal of such court; (b) if made by a commissioner of deeds appointed pursuant to the laws of this state to take acknowledgments or proofs without this state, such certificate must be under his seal of office; [and] (c) if made by any officer specified in [RPL § 301(1)], such certificate must be under the seal of the legation or consulate to which such officer is attached.

2. Any certificate, required by the provisions of [RPL § 311] to be authenticated, must be so authenticated, in addition to being under seal as provided in this [RPL § 308].

[RPL § 309] Statutory Excerpt or Summary

Acknowledgment by corporation and form of certificate.

1. The acknowledgment of a conveyance or other instrument by a corporation, must be made by an officer or attorney in fact duly appointed, or in case of a dissolved corporation, by an officer, director or attorney in fact duly appointed thereof authorized to execute the same by the board of directors of said corporation.

3. [RPL § 309(2)] shall be inapplicable to the acknowledgment, within this state, of a conveyance or other instrument in respect to real property situate in this state executed on or after [September 1, 1999]. A certificate of such an acknowledgment shall be subject to the provisions of [RPL § 309-a].

COMMENTARY

When the Legislature simplified the form of New York acknowledgment in 1997, some confusion remained for corporate acknowledgments. So with the result that the form of corporate acknowledgment still varies depending on whether the instrument relates to real property within the state or relates to something else RPL § 309 offers two forms of corporate acknowledgment, but RPL § 309(3) says those forms must not be used for conveyances or other instruments affecting real property. The reference to a corporation's signing by an attorney in fact further demonstrates the lack of any issue in that regard.

[RPL § 309-a]

Uniform forms of certificates of acknowledgment or proof within this state.

1. The certificate of an acknowledgment, within this state, of a conveyance or other instrument in respect to real property situate in this state, by a person, must conform substantially with the following form, the blanks being properly filled:

State of New York)

) ss.:

County of _____)

On the _____ day of _____ in the year _____ before me, the undersigned, personally appeared _____, personally known to me or proved to me on the basis of satisfactory evidence to be the individual(s) whose name(s) is (are) subscribed to the within instrument and acknowledged to me that he/she/they executed the same in his/her/their capacity(ies), and that by his/her/their signature(s) on the instrument, the individual(s), or the person upon behalf of which the individual(s) acted, executed the instrument.

(Signature and office of individual taking acknowledgment.)

2. The certificate for a proof of execution by a subscribing witness, within this state, of a conveyance or other instrument made by any person in respect to real property situate in this state, must conform substantially with the following form, the blanks being properly filled:

State of New York)

) ss.:

County of _____)

On the _____ day of _____ in the year _____ before me, the undersigned, personally appeared _____, the subscribing witness to the foregoing instrument, with whom I am personally acquainted, who, being by me duly sworn, did depose and say that he/she/they reside(s) in _____ (if the place of residence is in a city, include the street and street number, if any, thereof); that he/she/they know(s) _____ to be the individual described in and who executed the foregoing instrument; that said subscribing witness was present and saw said _____ execute the same; and that said witness at the same time subscribed his/her/their name(s) as a witness thereto.

(Signature and office of individual taking proof.)

3. A certificate of an [acknowledgment] or proof taken under [RPL § 300]⁶ shall include the additional information required by [RPL § 300].

4. For the purposes of this [RPL § 309-a], the term “person” means any corporation, joint stock company, estate, general partnership (including any registered limited liability partnership or foreign limited liability partnership), limited liability company (including a professional service limited liability company), foreign limited liability company (including a foreign professional service limited liability company), joint venture, limited partnership, natural person, attorney in fact, real estate investment trust, business trust or other trust, custodian, nominee or any other individual or entity in its own or any representative capacity.

COMMENTARY

The statute defines “person” to include an attorney in fact. That should counter occasional efforts to complicate acknowledgments when the signer is an attorney in fact.

[RPL § 309-b] Statutory Excerpt or Summary

6 N.Y. RPL § 300 requires additional information when an acknowledgment or proof of conveyance of real property is made by a person in the armed forces.

Uniform forms of certificates of acknowledgment or proof without this state.

1. The certificate of an acknowledgment, without this state, of a conveyance or other instrument with respect to real property situate in this state, by a person, may conform substantially with the following form, the blanks being properly filled:

State, District of Columbia, Territory, Possession, or Foreign Country)
ss.:

On the _____ day of _____ in the year _____ before me, the undersigned, personally appeared _____, personally known to me or proved to me on the basis of satisfactory evidence to be the individual(s) whose name(s) is (are) subscribed to the within instrument and acknowledged to me that he/she/they executed the same in his/her/their capacity(ies), and that by his/her/their signature(s) on the instrument, the individual(s), or the person upon behalf of which the individual(s) acted, executed the instrument.

(Signature and office of individual taking acknowledgment.)

2. The certificate for a proof of execution by a subscribing witness, without this state, of a conveyance or other instrument made by any person in respect to real property situate in this state, may conform substantially with the following form, the blanks being properly filled:

State, District of Columbia, Territory, Possession, or Foreign Country)
ss.:

On the _____ day of _____ in the year _____ before me, the undersigned, personally appeared _____, the subscribing witness to the foregoing instrument, with whom I am personally acquainted, who, being by me duly sworn, did depose and say that he/she resides in _____ (if the place of residence is in a city, include the street and street number, if any, thereof); that he/she knows _____ to be the individual described in and who executed the foregoing instrument; and that said subscribing witness was present and saw said _____ execute the same; and that said witness at the same time subscribed his/her name as a witness thereto.

(Signature and office of individual taking proof.)

3. No provision of this [RPL § 309-b] shall be construed to: (a) modify the choice of laws afforded by [RPL §§ 299-a and 301-a]⁷ pursuant to which an acknowledgment or proof may be taken; (b) modify any requirement of [RPL § 307]⁸; (c) modify any requirement for a seal imposed by [RPL § 308(1)]⁹; (d) modify any requirement concerning a certificate of authentication imposed by [RPL §§ 308, 311, 312, 314 or 318]¹⁰; or I modify any requirement imposed by any provision of this article when the certificate of acknowledgment or proof purports to be taken in the manner prescribed by the laws of another state, the District of Columbia, territory, possession or foreign country.

4. A certificate of an acknowledgment or proof taken under [RPL § 300]¹¹ shall include the additional information required by [RPL § 300].

5. For the purposes of this [RPL § 309-b], the term “person” means a person as defined in [RPL § 309-a(4)].

COMMENTARY

RPL § 309-b and 309-a cover the basics of acknowledgments required for 95% of typical commercial real estate transactions.

[RPL § 310] Statutory Excerpt or Summary

Authentication of acknowledgments and proofs made within the state.

7 RPL §§ 299-a and 301-a state that an acknowledgment or proof may be taken in a manner prescribed by the laws of New York or by the laws of the state, place, or country where the acknowledgment or proof was taken.

8 RPL § 307 states that when an acknowledgment is taken outside New York State, the certificate must state the time and place that the acknowledgment is taken by certain government officials.

9 RPL § 308(1) requires use of a seal when an acknowledgment is taken by certain government officials.

10 These RPL sections discuss procedures and requirements for sealing a certificate of acknowledgment or proof, authenticating a certificate of acknowledgment or proof and recording of a certificate of acknowledgment or proof.

11 RPL § 300 requires more information when an acknowledgment or proof of conveyance of real property is made by a person in the armed forces.

1. When a certificate of acknowledgment or proof is made, within this state, by a commissioner of deeds, a justice of the peace, town councilman, village police justice, or a judge of any court of inferior local jurisdiction, such certificate does not entitle the conveyance so acknowledged or proved to be read in evidence or recorded in any county of this state except a county in which the officer making such certificate is authorized to act at the time of making the same, unless such certificate is authenticated by a certificate of the clerk of such county; provided, however, that all certificates of acknowledgment or proof, made by a commissioner of deeds of [NYC] residing in any part therein, shall be authenticated by the clerk of any county within said city, in whose office such commissioner of deeds shall have filed a certificate under the hand and seal of the city clerk of said city, showing the appointment and term of office of such commissioner; and no other certificates shall be required from any other officer to entitle such conveyance to be read in evidence or recorded in any county of this state.

2. Except as provided in [RPL § 310], no certificate of authentication shall be required to entitle a conveyance to be read in evidence or recorded in this state when acknowledged or proved before any officer designated in [RPL § 298] to take such acknowledgment or proof, nor shall such authentication be required for recording in the office of the city register of [NYC] of such acknowledgment or proof by a commissioner of deeds of [NYC].

[RPL § 311] Statutory Excerpt or Summary

Authentication of acknowledgments and proofs made without the state.

1. When a certificate of acknowledgment or proof is made, either within or without the United States, by a commissioner of deeds appointed pursuant to the laws of this state to take acknowledgments or proofs without this state, the conveyance so acknowledged or proved is not entitled to be read in evidence or recorded in this state, except as provided in [Executive Law § 108(5)], unless such certificate is authenticated by the certificate of the secretary of state of [NYS].

2. When a certificate of acknowledgment or proof is made by a notary public in a foreign country other than Canada, the conveyance so acknowledged or proved is not entitled to be read in evidence or recorded in this state unless such certificate is authenticated (a) by the certificate of the clerk or other certifying officer of a court in the district in which such acknowledgment or proof was made, under the seal of such court, or (b) by the certificate of the clerk, register, recorder, or other recording officer of the district in which such acknowledgment or proof was made, or (c) by the certificate of the officer having charge of the official records of the appointment of such notary, or having a record of the signature of such notary, or (d) by the certificate of a consular officer of the United States resident in such country.

3. When a certificate of acknowledgment or proof, made by the mayor or other chief civil officer of a city or other political subdivision, is not under the seal of such city or other political subdivision, the conveyance so acknowledged or proved is not entitled to be read in evidence or recorded in this state unless such certificate is authenticated by the certificate of the clerk of such city or other political subdivision, or by the certificate of a consular officer of the United States resident in the country where the acknowledgment or proof was made.

4. When a certificate of acknowledgement or proof is made pursuant to the provisions of [RPL § 299(5) or 301(7)] by an officer or person not elsewhere in either of said [RPL § 299(5) or 301(7)] specifically designated to take acknowledgements or proofs, the conveyance so acknowledged or proved is not entitled to be read in evidence or recorded within this state unless such certificate is authenticated (a) by the certificate of the secretary of state of a state, or of the secretary of a territory, of the United States, or (b) by the certificate of any officer designated in [RPL § 311(3)] to authenticate certificates of acknowledgment or proof, or (c) by the certificate of any officer designated in [RPL § 311(2)(a) or (b)] to authenticate certificates of acknowledgment or proof, or (d) by the certificate of the officer having charge of the official records showing that the person taking the acknowledgment or proof is such officer as he purports to be, or having a record of the signature of such person.

5. Except as provided in [RPL § 311(5)], no certificate of authentication shall be required to entitle a conveyance to be read in evidence or recorded in this state when acknowledged or proved before any officer designated in [RPL § 299 or 301] to take such acknowledgment or proof.

[RPL § 312] Statutory Excerpt or Summary

Contents of certificate of authentication.

1. An officer authenticating a certificate of acknowledgment or proof must subjoin or attach to the original certificate a certificate under his hand.
2. When the certificate of acknowledgment or proof is made by a notary public, without the state but within the United States or within any territory, possession, or dependency of the United States, or within any place over which the United States, at the time when such acknowledgment or proof is taken, has or exercises jurisdiction, sovereignty, control, or a protectorate, the certificate of authentication must state in substance that, at the time when such original certificate purports to have been made, the person whose name is subscribed to the certificate was such officer as he is therein represented to be.

In every other case the certificate of authentication must state in substance (a) that, at the time when such original certificate purports to have been made, the person whose name is subscribed to the original certificate was such officer as he is therein represented to be; (b) that the authenticating officer is acquainted with the handwriting of the officer making the original certificate, or has compared the signature of such officer upon the original certificate with a specimen of his signature filed or deposited in the office of such authenticating officer, or recorded, filed, or deposited, pursuant to law, in any other place, and believes the signature upon the original certificate is genuine; and (c),¹² if the original certificate is required to be under seal, that the authenticating officer has compared the impression of the seal affixed thereto with a specimen impression thereof filed or deposited in his office, or recorded, filed, or deposited, pursuant to law, in any other place, and believes

¹² Comma appears in text of statute.

the impression of the seal upon the original certificate is genuine.

3. When such original certificate is made pursuant to [RPL § 299(5)], such certificate of authentication must also specify that the person making such original certificate, at the time when it purports to have been made, was authorized, by the laws of the state, District of Columbia, territory, possession, dependency, or other place where the acknowledgment or proof was made, to take the acknowledgment or proof of deeds to be recorded therein.

4. When such original certificate is made pursuant to [RPL § 301(7)], such certificate of authentication must also specify that the person making such original certificate, at the time when it purports to have been made, was authorized, by the laws of the country where the acknowledgment or proof was made, to take acknowledgments of conveyances of real estate or to administer oaths in proof of the execution thereof.

Fraudulent Conveyances

[DCL § 270] Statutory Excerpt or Summary

Definition of terms.

In this [DCL art. 10 (§§ 270 to 281)] “assets” of a debtor means property not exempt from liability for his debts. To the extent that any property is liable for any debts of the debtor, such property shall be included in his assets.

“Conveyance” includes every payment of money, assignment, release, transfer, lease, mortgage or pledge of tangible or intangible property, and also the creation of any lien or incumbrance.

“Creditor” is a person having any claim, whether matured or unmatured, liquidated or unliquidated, absolute, fixed or contingent.

“Debt” includes any legal liability, whether matured or unmatured, liquidated or unliquidated, absolute, fixed or contingent.

[DCL § 271] Statutory Excerpt or Summar

Insolvency.

1. A person is insolvent when the present fair salable value of his assets is less than the amount that will be required to pay his probable liability on his existing debts as they become absolute and matured.
2. In determining whether a partnership is insolvent there shall be added to the partnership property the present fair salable value of the separate assets of each general partner in excess of the amount probably sufficient to meet the claims of his separate creditors, and also the amount of any unpaid subscription to the partnership of each limited partner, provided the present fair salable value of the assets of such limited partner is probably sufficient to pay his debts, including such unpaid subscription.

[DCL § 272] Statutory Excerpt or Summary*Fair consideration.*

Fair consideration is given for property, or obligation,

- a. When in exchange for such property, or obligation, as a fair equivalent therefor, and in good faith, property is conveyed or an antecedent debt is satisfied, or
- b. When such property, or obligation is received in good faith to secure a present advance or antecedent debt in amount not disproportionately small as compared with the value of the property, or obligation obtained.

[DCL § 273] Statutory Excerpt or Summary*Conveyances by insolvent.*

Every conveyance made and every obligation incurred by a person who is or will be thereby rendered insolvent is fraudulent as to creditors without regard to his actual intent if the conveyance is made or the obligation is incurred without a fair consideration.

[DCL § 273-a]

Conveyances by defendants.

Every conveyance made without fair consideration when the person making it is a defendant in an action for money damages or a judgment in such an action has been docketed against him, is fraudulent as to the plaintiff in that action without regard to the actual intent of the defendant if, after final judgment for the plaintiff, the defendant fails to satisfy the judgment.

[DCL § 274] Statutory Excerpt or Summary*Conveyances by persons in business.*

Every conveyance made without fair consideration when the person making it is engaged or is about to engage in a business or transaction for which the property remaining in his hands after the conveyance is an unreasonably small capital, is fraudulent as to creditors and as to other persons who become creditors during the continuance of such business or transaction without regard to his actual intent.

[DCL § 275] Statutory Excerpt or Summary*Conveyances by a person about to incur debts.*

Every conveyance made and every obligation incurred without fair consideration when the person making the conveyance or entering into the obligation intends or believes that he will incur debts beyond his ability to pay as they mature, is fraudulent as to both present and future creditors.

[DCL § 276] Statutory Excerpt or Summary*Conveyance made with intent to defraud.*

Every conveyance made and every obligation incurred with actual intent, as distinguished from intent presumed in law, to hinder, delay, or defraud either present or future creditors, is fraudulent as to both present and future creditors.

[DCL § 276-a] Statutory Excerpt or Summary

Attorneys' fees in action or special proceeding to set aside a conveyance made with intent to defraud.

In an action or special proceeding brought by a creditor, receiver, trustee in bankruptcy, or assignee for the benefit of creditors to set aside a conveyance by a debtor, where such conveyance is found to have been made by the debtor and received by the transferee with actual intent, as distinguished from intent presumed in law, to hinder, delay or defraud either present or future creditors, in which action or special proceeding the creditor, receiver, trustee in bankruptcy, or assignee for the benefit of creditors shall recover judgment, the justice or surrogate presiding at the trial shall fix the reasonable attorney's fees of the creditor, receiver, trustee in bankruptcy, or assignee for the benefit of creditors in such action or special proceeding, and the creditor, receiver, trustee in bankruptcy, or assignee for the benefit of creditors shall have judgment therefor against the debtor and the transferee who are defendants in addition to the other relief granted by the judgment. The fee so fixed shall be without prejudice to any agreement, express or implied, between the creditor, receiver, trustee in bankruptcy, or assignee for the benefit of creditors and his attorney with respect to the compensation of such attorney.

[DCL § 277] Statutory Excerpt or Summary

Conveyance of partnership property.

Every conveyance of partnership property and every partnership obligation incurred when the partnership is or will be thereby rendered insolvent, is fraudulent as to partnership creditors, if the conveyance is made or obligation is incurred,

- a. To a partner, whether with or without a promise by him to pay partnership debts, or
- b. To a person not a partner without fair consideration to the partnership as distinguished from consideration to the individual partners.

[DCL § 278] Statutory Excerpt or Summary

Rights of creditors whose claims have matured.

1. Where a conveyance or obligation is fraudulent as to a creditor, such creditor, when his claim has matured, may, as against any person except a purchaser for fair consideration without knowledge of the fraud at the time of the purchase, or one who has derived title immediately or mediately from such a purchaser,

a. Have the conveyance set aside or obligation annulled to the extent necessary to satisfy his claim, or

b. Disregard the conveyance and attach or levy execution upon the property conveyed.

2. A purchaser who without actual fraudulent intent has given less than a fair consideration for the conveyance or obligation, may retain the property or obligation as security for repayment.

[DCL § 279] Statutory Summary or Excerpt

Rights of creditors whose claims have not matured.

Where a conveyance made or obligation incurred is fraudulent as to a creditor whose claim has not matured he may proceed in a court of competent jurisdiction against any person against whom he could have proceeded had his claim matured, and the court may,

a. Restrain the defendant from disposing of his property.

b. Appoint a receiver to take charge of the property,

c. Set aside the conveyance or annul the obligation, or

d. Make any order which the circumstances of the case may require.

[DCL § 280]

Cases not provided for in article.

In any case not provided for in this [DCL art. 10 (§§ 270 to 281)] the rules of law and equity including the law merchant, and in particular the rules relating to the law of principal and

agent, and the effect of fraud, misrepresentation, duress or coercion, mistake, bankruptcy or other invalidating cause shall govern.

Government Leases

[NYC Charter, § 197-c] Statutory Excerpt or Summary

Uniform land use review procedure.

[NYC Charter § 197-c(a)(10) and (11)]

a. Except as otherwise provided in this charter, applications by any person or agency for changes, approvals, contracts, consents, permits or authorization thereof, respecting the use, development or improvement of real property subject to city regulation shall be reviewed pursuant to a uniform review procedure in the following categories:

(10) Sale, lease (other than the lease of office space), exchange, or other disposition of the real property of the city, including the sale or lease of land under water pursuant to . . . applicable provisions of law;

(11) Acquisition by the city of real property (other than the acquisition of office space for office use or a building for office use), including acquisition by purchase, condemnation, exchange or lease and including the acquisition of land under water pursuant to . . . applicable provisions of law[.]

COMMENTARY

The quoted statute (a reference to NYC's uniform land use review procedure) is only the tip of the iceberg. New York has a wide range of municipalities, public benefit corporations, and other public and quasi-public entities. Each entity, or entity type, is governed by its own body of law, creating certain powers, procedures, and in some cases oversight requirements. State leases have their own procedures. Environmental and other statutes may require additional procedural steps and clearances. Anyone entering into a lease with any such entity must review the entity's governing statutes and consider obtaining appropriate evidence confirming compliance. In some cases, an opinion of counsel might be appropriate. Even

if the entity complies with all applicable procedures, opponents of any substantial lease or other transaction will often still sue, alleging some form of noncompliance with the rules. The resulting uncertainty, risk, delay, and expense often must be allocated between the parties to the transaction as part of the business negotiations.

[SFL § 138] Statutory Excerpt or Summary

State contracts not to be assigned without consent.

A clause shall be inserted in all specifications or contracts hereafter made or awarded by the state, or any public department or official thereof, prohibiting any contractor, to whom any contract shall be let, granted or awarded, as required by law, from assigning, transferring, conveying, sub-letting or otherwise disposing of the same, or of his right, title or interest therein, or his power to execute such contract to any other person, company or corporation, without the previous consent in writing of the department or official awarding the same.

If any contractor, to whom any contract is hereafter let, granted or awarded, as required by law, by the state, or by any public department or official thereof, shall, without the previous written consent specified in the first paragraph of [SFL § 138], assign, transfer, convey, sublet or otherwise dispose of the same, or his right, title or interest therein, or his power to execute such contract, to any other person, company or other corporation, the state, public department or official, as the case may be, which let, made, granted or awarded said contract, shall revoke and annul such contract, and the state, public department or officer, as the case may be, shall be relieved and discharged from any and all liability and obligations growing out of said contract to such contract, and to the person, company, or corporation to whom he shall assign, transfer, convey, sublet or otherwise dispose of the same, and said contractor, and his assignee, transferee, or sub-lessee, shall forfeit and lose all moneys, theretofore earned under said contract except so much as may be required to pay his employees; provided that nothing herein contained shall be construed to hinder, prevent or affect an assignment by such contract for the benefit of his creditors, made pursuant to the statutes of this state.

Notwithstanding the provisions of this [SFL § 138], the commissioner of general services and state agencies may, with concurrence of the office of state comptroller when the original contract was subject to the office of state comptroller approval, waive prior written consent of an assignment, transfer, conveyance, sublease or other disposition of contracts or monies under a contract let pursuant to article eleven of this chapter. Such waiver may be granted under circumstances where the contractor verifies to the commissioner of general services or state agency, as applicable, that the assignment, transfer, conveyance, sublease or other disposition is due to but not necessarily limited to, a reorganization, merger or consolidation of the contractor's business entity or enterprise. The commissioner of general services and state agencies retain the right, as provided herein, to accept or reject an assignment, transfer, conveyance, sublease or other disposition by the contractor.

COMMENTARY

By its terms, and by NYS's interpretation of those terms, this statute is entirely incompatible with modern commercial real estate financing transactions, because N.Y SFL § 138 limits the assignability of leases with the state. Somehow developers nevertheless manage to finance these projects.

[Court of Claims Act § 8] Statutory Excerpt or Summary

Waiver of immunity from liability. The state hereby waives its immunity from liability and action and hereby assumes liability and consents to have the same determined in accordance with the same rules of law as applied to actions in the supreme court against individuals or corporations, provided the claimant complies with the limitations of this article. Nothing herein contained shall be construed to affect, alter or repeal any provision of the workmen's compensation law.

COMMENTARY

This statute should mean a state lease need not include a waiver of immunity. The wording of this statute is slightly different on the Court of Claims website, part of www.nycourts.gov.

Guaranty—General

[CPLR 3213] Statutory Excerpt or Summary

Motion for summary judgment in lieu of complaint.

When an action is based upon an instrument for the payment of money only or upon any judgment, the plaintiff may serve with the summons a notice of motion for summary judgment and the supporting papers in lieu of a complaint. The summons served with such motion papers shall require the defendant to submit answering papers on the motion within the time provided in the notice of motion. The minimum time such motion shall be noticed to be heard shall be as provided by [CPLR 320(a)] for making an appearance, depending upon the method of service. If the plaintiff sets the hearing date of the motion later than the minimum time therefor, he may require the defendant to serve a copy of his answering papers upon him within such extended period of time, not exceeding [10] days, prior to such hearing date. No default judgment may be entered pursuant to [CPLR 3215(a)] prior to the hearing date of the motion. If the motion is denied, the moving and answering papers shall be deemed the complaint and answer, respectively, unless the court orders otherwise.

COMMENTARY

The holder of “an instrument for the payment of money” qualifies for an expedited proceeding, in which the complaint may also include a motion for summary judgment. A typical guaranty of payment should qualify. If a guaranty contains nonmonetary elements, those may raise issues. Landlord’s counsel may want to cover them in a separate document. Landlord’s counsel may want to include language like this in a guaranty:

“Guarantor acknowledges this Guaranty is an “instrument for the payment of money only,” within the meaning of Civil Practice Law and Rules 3213.”

[SCPA § 1802] Statutory Excerpt or Summary*Effect of failure to present claim*

If any claim [against an estate] is not presented . . . within 7 months from the date of issue of letters [testamentary], the fiduciary [executor] shall not be chargeable for any assets or moneys that he may have paid in good faith in satisfaction of any lawful claims or of any legacies or distributions to the leg-

tees or distributes of the decedent before such claim was presented. Such 7 month period shall begin on the date letters were first issued to any fiduciary, including a temporary administrator or a preliminary executor, and shall not be interrupted by any subsequent issue of letters, except that the time during which there is no fiduciary in office shall not be counted as part of such period.

COMMENTARY

The statute provides elsewhere for the treatment of contingent and unliquidated claims, such as those under a typical guaranty. Failure to file within seven months does not necessarily vitiate the claim entirely, but prevents the landlord from objecting to any distributions made from the estate before the landlord presented the claim. Moral of the story: landlords and other beneficiaries of guaranties should monitor the continued survival of their guarantors and act quickly if a guarantor dies. Similar concerns arise if a guarantor becomes disabled, files bankruptcy, or encounters other difficulties. These concerns are not unique to guaranties or New York commercial leasing.

Guaranty—Statute of Frauds

[GOL § 5-701] Statutory Excerpt of Summary

Agreements required to be in writing.

[GOL § 5-701(a)(2)]Statutory Excerpt or Summary

a. Every agreement, promise or undertaking is void, unless it or some note or memorandum thereof be in writing, and subscribed by the party to be charged therewith, or by his lawful agent, if such agreement, promise or undertaking:

2. Is a special promise to answer for the debt, default or miscarriage of another person;

Guardians or Conservators

[SCPA § 1715] Statutory Excerpt or Summary

Authority of guardian to sell, lease, exchange or mortgage.

[SCPA § 1715(1)]

1. The surrogate's court of the county from which letters were issued to the guardian of the property of an infant may, in accordance with this [SCPA § 1715], authorize the guardian in the name of the infant to sell, lease, exchange or mortgage any interest of the infant in real property.

Holding Over

[RPL § 229] Statutory Excerpt or Summary

Liability of tenant holding over after giving notice of intention to quit.

If a tenant gives notice of his intention to quit the premises held by him, and does not accordingly deliver up the possession thereof, at the time specified in such notice, he or his personal representatives must, so long as he continue in possession, pay to the landlord, his heirs or assigns, double the rent which he should otherwise have paid, to be recovered at the same time, and in the same manner, as the single rent.

COMMENTARY

In negotiated commercial leases, holdover rent is often lower than the statutory double rent provided for here, at least during the first few months of holding over. The statutory double rent applies only to certain holdovers, though. The statute does not indicate whether the double rent is prorated daily or imposed on a month-to-month basis. The latter is typical in landlords' forms of commercial lease. Given recent rulings by New York courts, any commercial tenant should think carefully before holding over beyond the term of its lease. In one case, a New York court found the holdover tenant liable not only to the landlord for holdover rent but also to the new tenant for trespass damages. *See Kronish Lieb Weiner & Hellman LLP v. Tahari, Ltd.*, 35 A.D.3d 317, 829 N.Y.S.2d 7 (1st Dep't 2006). When a tenant negotiates a new lease, it should keep in mind the issues in this paragraph.

Indemnification

[GOL § 5-321] Statutory Excerpt or Summary

Agreements exempting lessors from liability for negligence void and unenforceable.

Every covenant, agreement or understanding in or in connection with or collateral to any lease of real property exempting the lessor from liability for damages for injuries to person or property caused by or resulting from the negligence of the lessor, his agents, servants or employees, in the operation or maintenance of the demised premises or the real property containing the demised premises shall be deemed to be void as against public policy and wholly unenforceable.

COMMENTARY

Even though such agreements are statutorily void, they appear in most landlords' leases, and the parties can spend time negotiating them. The statutory language sounds broad enough to invalidate routine lease provisions by which landlord and tenant mutually waive rights of recovery against each other based on the existence of waivers of subrogation by their insurance carriers, but a few reported cases suggest that this interpretation would be wrong. Also, this statute may arguably prevent a large tenant from carrying insurance (protecting the landlord) with "high deductibles" or to self-insure these risks. Apparently the risks can be shifted to an insurance company but not a tenant. The parties might try to resolve that tension with language like this, which is nonstandard and arose only in a particular transaction where the parties were very concerned about this issue:

"To the extent that Landlord suffers a loss (or incurs liability to third parties) that Tenant's insurance carrier would have covered, but for Tenant's use of a deductible in an amount exceeding \$_____ (a "High Deductible") instead of a lower deductible (a "Low Deductible"), then, Tenant shall pay the amount of such loss (or liability). The previous sentence is not intended to exempt Landlord from liability for its own negligence, or to require Tenant to indemnify Landlord against Landlord's negligence, but merely to protect Landlord from Tenant's decision to carry insurance with High Deductibles rather than Low Deductibles, and to shift from Landlord to Tenant the consequences of that decision."

If landlord's or tenant's counsel issues an enforceability opinion on the lease (which happens only very occasionally), should the opinion raise an exception for this statute?

Insurance

CROSS-REFERENCES

See “Landlord’s Duties.”

Insurance—Notice of Changes in Premium or Coverage

[No applicable statute]

COMMENTARY AND CROSS-REFERENCES

Extensive statutes and regulations address issues of this type (*see, e.g.*, ISL §§ 3426, 3427, and 3429), but any statutory or regulatory issues in this area do not commonly drive any debate, discussion, or drafting in commercial lease negotiations.

Interest

[BNK § 14-a] Statutory Excerpt or Summary

Rate of interest; banking board to adopt regulations.

1. The maximum rate of interest provided for in [GOL § 5-501] shall be [16%] per annum.
2. The rate of interest as so prescribed under this [BNK § 14-a] shall include as interest any and all amounts paid or payable, directly or indirectly, by any person, to or for the account of the lender in consideration for the making of a loan or forbearance as defined by the superintendent pursuant to [BNK § 14-a(3)].
3. The superintendent to adopt such regulations as the superintendent shall deem necessary or proper to implement the provisions of this [BNK § 14-a]. The superintendent shall make available to the public copies of all regulations adopted pursuant to this [BNK § 14-a].

5. Whenever reference is made in this [BNK ch.2] or in any other law, contract or document to the rate of interest prescribed or to be prescribed by the banking board or the superintendent [of Banks] pursuant to this [BNK § 14-a] or any

former [BNK § 14-a], such reference shall be deemed a reference to the rate of interest prescribed in [BNK § 14-a(1)].

COMMENTARY

New York's usury statutes are confusing and almost never affect substantial commercial transactions. For more on these statutes, see Joshua Stein, *New York Commercial Mortgage Transactions*, ch. 2 (2008).

[GOL § 5-501] Statutory Excerpt or Summary

Rate of interest; usury forbidden.

1. The rate of interest, as computed pursuant to this [GOL §§ 5-501 to 5-531], upon the loan or forbearance of any money, goods, or things in action, except as provided in [GOL § 5-501(5) and (6)] or as otherwise provided by law, shall be [6%] per annum unless a different rate is prescribed in [BNK § 14-a].

2. No person or corporation shall, directly or indirectly, charge, take or receive any money, goods or things in action as interest on the loan or forbearance of any money, goods or things in action at a rate exceeding the rate above prescribed. The amount charged, taken or received as interest shall include any and all amounts paid or payable, directly or indirectly, by any person, to or for the account of the lender in consideration for making the loan or forbearance as defined by the superintendent of financial services pursuant to [BNK § 14-a(3)] except such fee as may be fixed by the commissioner of taxation and finance as the cost of servicing loans made by the property and liability insurance security fund.

[GOL § 5-501(4)–(7)] Statutory Excerpt or Summary

4. Except as otherwise provided by law, interest shall not be charged, taken or received on any loan or forbearance at a rate exceeding such rate of interest as may be authorized by law at the time the loan or forbearance is made, whether or not the loan or forbearance is made pursuant to a prior contract or commitment providing for a greater rate of interest, provided, however, that no change in the rate of interest prescribed in

[BNK § 14-a] shall affect (a) the validity of a loan or forbearance made before the date such rate becomes effective or (b) the enforceability of such loan or forbearance in accordance with its terms, except that if any loan or forbearance provides for an increase in the rate of interest during the term of such loan or forbearance, the increased rate shall not exceed such rate of interest as may have been authorized by law at the time such loan or forbearance was made.

4-a. Notwithstanding the provisions of [GOL § 5-501(4)], a loan or forbearance repayable on demand may provide for changes, reflecting variations in lending rates, from time to time in the rate of interest payable on such loan or forbearance up to the rate of interest authorized by law at the time of such change and in such case the rate of interest may be so changed in accordance with the terms of the contract or loan commitment relating thereto; provided, however, that the rate of interest charged, taken or received on such a loan or forbearance shall not exceed the rate of interest authorized by law as it may subsequently be reduced from time to time; and further provided, however, that in no event shall such a loan or forbearance [be] subject to an authorized rate of interest less than that applicable at the time such loan or forbearance was made. The provisions of this [GOL § 5-501(4-a)] shall apply only to a loan or forbearance repayable on demand which has an initial principal of more than [\$5000] and which the borrower has the right to repay at any time in whole or in part, together with accrued interest on the principal so repaid, without any penalty. With respect to a loan or forbearance covered by this [GOL § 5-501(4-a)], the lender shall disclose to the borrower in writing not less often than annually the amount of interest accrued or payable as of the date of such disclosure and the manner by which such amount was computed.

5. No law regulating the maximum rate of interest which may be charged, taken or received shall apply to any loan or forbearance insured by the federal housing commissioner or for which a commitment to insure has been made by the federal housing commissioner or to any loan or forbearance insured or guaranteed pursuant to the provisions of an act of congress entitled "Servicemen's Readjustment Act of 1944."

6-a. No law regulating the maximum rate of interest which may be charged, taken or received, except [PL §§ 190.40 and 190.42], shall apply to any loan or forbearance in the amount of [\$250,000] or more, other than a loan or a forbearance secured primarily by an interest in real property improved by a one or two family residence. A loan of [\$250,000] or more which is to be advanced in installments pursuant to a written agreement by a lender shall be deemed to be a single loan for the total amount which the lender has agreed to advance pursuant to such agreement on the terms and conditions provided therein.

b. No law regulating the maximum rate of interest which may be charged, taken or received, including [PL §§ 190.40 and 190.42], shall apply to any loan or forbearance in the amount of [\$2,500,000] or more. Loans or forbearances aggregating [\$2,500,000] or more which are to be made or advanced to any one borrower in one or more installments pursuant to a written agreement by one or more lenders shall be deemed to be a single loan or forbearance for the total amount which the lender or lenders have agreed to advance or make pursuant to such agreement on the terms and conditions provided therein.

7. Except as otherwise expressly provided by law, in the event of prepayment in full of a loan, any refund of unearned interest to which the borrower may be entitled may not be computed by a sum of the balances or similar method but must be determined according to a generally accepted actuarial method.

CROSS-REFERENCES

See above for BNK § 14-a.

[GOL § 5-511] Statutory Excerpt or Summary

Usurious contracts void.

1. All bonds, bills, notes, assurances, conveyances, all other contracts or securities whatsoever, except bottomry and respondentia bonds and contracts, and all deposits of goods or other things whatsoever, whereupon or whereby there shall be reserved or taken, or secured or agreed to be reserved or taken, any greater sum, or greater value, for the loan or forbearance of

any money, goods or other things in action, than is prescribed in [GOL § 5-501], shall be void, except that the knowingly taking, receiving, reserving or charging such a greater sum or greater value by a savings bank, a savings and loan association or a federal savings and loan association shall only be held and adjudged a forfeiture of the entire interest which the loan or obligation carries with it or which has been agreed to be paid thereon. If a greater sum or greater value has been paid, the person paying the same or his legal representative may recover from the savings bank, the savings and loan association or the federal savings and loan association twice the entire amount of the interest thus paid.

2. Except as provided in [GOL § 5-511(1)], whenever it shall satisfactorily appear by the admissions of the defendant, or by proof, that any bond, bill, note, assurance, pledge, conveyance, contract, security or any evidence of debt, has been taken or received in violation of the foregoing provisions, the court shall declare the same to be void, and enjoin any prosecution thereon, and order the same to be surrendered and cancelled.

COMMENTARY

The statute provides an especially light usury penalty for savings banks and savings and loan associations, to the extent that any still exist.

[GOL § 5-513] Statutory Excerpt or Summary

Recovery of excess.

Every person who, for any such loan or forbearance, shall pay or deliver any greater sum or value than is allowed to be received pursuant to [GOL § 5-501], and his personal representatives, may recover in an action against the person who shall have taken or received the same, and his personal representatives, the amount of the money so paid or value delivered, above the rate aforesaid.

[GOL § 5-515] Statutory Excerpt or Summary

Borrower bringing an action need not offer to repay.

Whenever any borrower of money, goods or things in action, shall begin an action for the recovery of the money, goods or

things in action taken in violation of the foregoing provisions of this [GOL §§ 5-501 to 5-531], it shall not be necessary for him to pay or offer to pay any interest or principal on the sum or thing loaned; nor shall any court require or compel the payment or deposit of the principal sum or interest, or any portion thereof, as a condition of granting relief to the borrower in any case of usurious loans forbidden by the foregoing provisions of this [GOL §§ 5-501 to 5-531].

[GOL § 5-519] Statutory Excerpt or Summary

Return of excess a bar to further penalties.

Every person who shall repay or return the money, goods or other things so taken, accepted or received, or the value thereof, shall be discharged from any other or further forfeiture or penalty which he may have incurred under [GOL § 5-511 or 5-513], by taking or receiving the money, goods or other things so repaid, or returned, as aforesaid.

[GOL § 5-521] Statutory Excerpt or Summary

Corporations prohibited from interposing defense of usury.

1. No corporation shall hereafter interpose the defense of usury in any action. The term corporation, as used in this [GOL § 5-521], shall be construed to include all associations, and joint-stock companies having any of the powers and privileges of corporations not possessed by individuals or partnerships.

2. The provisions of [GOL § 5-521(1)] shall not apply to a corporation, the principal asset of which shall be the ownership of a one or two family dwelling, where it appears either that the said corporation was organized and created, or that the controlling interest therein was acquired, within a period of six months prior to the execution, by said corporation of a bond or note evidencing indebtedness, and a mortgage creating a lien for said indebtedness on the said one or two family dwelling . . .

Any provision of any contract, or any separate written instrument executed prior to, simultaneously with or within [60] days after the delivery of any moneys to any borrower in con-

nection with such indebtedness, whereby the defense of usury is waived or any such corporation is estopped from asserting it, is hereby declared to be contrary to public policy and absolutely void.

3. The provisions of [GOL § 5-521(1)] shall not apply to any action in which a corporation interposes a defense of criminal usury as described in [PL § 190.40].

COMMENTARY

If the borrower signs an estoppel certificate confirming the validity of the loan more than 60 days after closing, that may eliminate a usury defense.

[GOL § 5-527] Statutory Excerpt or Summary

Enforceability of compound interest.

[GOL § 5-527(1) and (3)]

1. A loan or other agreement providing for compound interest shall be enforceable notwithstanding the date that such loan or other agreement providing for such compound interest shall have been executed; provided, however, that such compound interest shall begin to accrue and become due and payable on the later to occur of (a) [June 24, 1989] or (b) the date that any obligation to pay such compound interest may have arisen, including, but not limited to, the date of any default or event of default under such loan or other agreement. For purposes of this [GOL § 5-527(1)], the term “compound interest” shall mean the accruing of interest upon unpaid interest irrespective of whether such unpaid interest is added to the principal debt.

3. [N]othing in this [GOL § 5-527] shall affect the maximum rate of interest which may be charged, taken or received as provided by law, or be construed to limit, impair or otherwise affect any loan or other agreement which is, or would be, enforceable without reference to this [GOL § 5-527], including but not limited to an agreement made pursuant to [BNK § 6-f].

COMMENTARY

This statute, which solved the problem that resulted from a series of unfortunate cases that made compound interest unenforceable in New York, was instigated by Martin E. Gold, former Director of Corporate Law for the NYC Law Department and now with Sidley Austin LLP in Manhattan.

[GOL § 5-1301] Statutory Excerpt or Summary

How interest calculated.

Whenever, in any statute, act, deed, written or verbal contract, or in any public or private instrument whatever, any certain rate of interest is or shall be mentioned, and no period of time is stated for which such rate is to be calculated, interest shall be calculated at the rate mentioned, by the year, in the same manner as if the words “per annum” or “by the year” had been added to such rate.

COMMENTARY

This statute corrects an occasional drafting error.

[LLC § 1104] Statutory Excerpt or Summary

Limited liability companies prohibited from interposing defense of usury.

(a) No domestic or foreign limited liability company shall hereafter interpose the defense of usury in any action.

(b) The provisions of [LLC § 1104(a)] shall not apply to a domestic or foreign limited liability company, the principal asset of which is the ownership of a one or two family dwelling, where it appears either that such limited liability company was formed, or that the controlling interest therein was acquired, within a period of six months prior to the execution by such limited liability company of a bond or note evidencing indebtedness, and a mortgage creating a lien for such indebtedness on such one or two family dwelling. Any provision of any contract, or any separate written instrument executed prior to, simultaneously with or within [60] days after the delivery of any moneys to any borrower in connection with such indebtedness, whereby the defense of usury is waived or any such lim-

ited liability company [is] estopped from asserting it, is hereby declared to be contrary to public policy and absolutely void.

The provisions of [LLC § 1104(a)] shall not apply to any action in which a limited liability company interposes a defense of criminal usury as described in [PL § 190.40].

[PL § 190.40] Statutory Excerpt or Summary

Criminal usury in the second degree.

A person is guilty of criminal usury in the second degree when, not being authorized or permitted by law to do so, he knowingly charges, takes or receives any money or other property as interest on the loan or forbearance of any money or other property, at a rate exceeding [25%] per annum or the equivalent rate for a longer or shorter period.

Criminal usury in the second degree is a class E felony.

[PL § 190.42] Statutory Excerpt or Summary

Criminal usury in the first degree.

A person is guilty of criminal usury in the first degree when, not being authorized or permitted by law to do so, he knowingly charges, takes or receives any money or other property as interest on the loan or forbearance of any money or other property, at a rate exceeding [25%] per annum or the equivalent rate for a longer or shorter period and either the actor had previously been convicted of the crime of criminal usury or of the attempt to commit such crime, or the actor's conduct was part of a scheme or business of making or collecting usurious loans.

Criminal usury in the first degree is a class C felony.

Landlord's Lien

[No applicable statute]

CROSS-REFERENCES

See "Distraint."

Landlord's Remedies

[RPAPL § 711] Statutory Excerpt or Summary

Grounds where landlord-tenant relationship exists.

A special [summary eviction] proceeding may be maintained under this [RPAPL art. 7 (§§ 701 to 767)] upon the following grounds:

1. The tenant continues in possession of any portion of the premises after the expiration of his term, without the permission of the landlord or, in a case where a new lessee is entitled to possession, without the permission of the new lessee. Acceptance of rent after commencement of the special proceeding upon this ground shall not terminate such proceeding nor effect any award of possession to the landlord or to the new lessee, as the case may be. A proceeding seeking to recover possession of real property by reason of the termination of the term fixed in the lease pursuant to a provision contained therein giving the landlord the right to terminate the time fixed for occupancy under such agreement if he deem the tenant objectionable, shall not be maintainable unless the landlord shall by competent evidence establish to the satisfaction of the court that the tenant is objectionable.

2. The tenant has defaulted in the payment of rent, pursuant to the agreement under which the premises are held, and a demand of the rent has been made, or at least three days' notice in writing requiring, in the alternative, the payment of the rent, or the possession of the premises, has been served upon him as prescribed in [RPAPL § 735]. The landlord may waive his right to proceed upon this ground only by an express consent in writing to permit the tenant to continue in possession, which consent shall be revocable at will, in which event the landlord shall be deemed to have waived his right to summary dispossession for nonpayment of rent accruing during the time said consent remains unrevoked. Any person succeeding to the landlord's interest in the premises may proceed under this [RPAPL § 711] for rent due his predecessor in interest if he has a right thereto. Where a tenant dies during the term of the lease and rent due has not been paid and no representative or person has taken possession of the premises and no administrator or

executor has been appointed, the proceeding may be commenced after three months from the date of death of the tenant by joining the surviving spouse or if there is none, then one of the surviving issue or if there is none, then any one of the distributees.

3. The tenant, in a city defaults in the payment, for [60] days after the same shall be payable, of any taxes or assessments levied on the premises which he has agreed in writing to pay pursuant to the agreement under which the premises are held, and a demand for payment has been made, or at least three days' notice in writing, requiring in the alternative the payment thereof and of any interest and penalty thereon, or the possession of the premises, has been served upon him, as prescribed in [RPAPL § 735]. An acceptance of any rent shall not be construed as a waiver of the agreement to pay taxes or assessments.

4. The tenant, under a lease for a term of three years or less, has during the term taken the benefit of an insolvency statute or has been adjudicated a bankrupt.

COMMENTARY

Many landlord's remedies appear in RPAPL Art. 7 (§§ 701–767). These extracts may not be exhaustive.

RPAPL § 711(1) allows a landlord to initiate summary dispossess proceedings (expedited eviction proceedings) when a tenant's lease has expired. What does that mean? The lease might say that if the tenant defaults, then the landlord can give a notice terminating the lease. At that point, one might think the lease has expired and therefore the landlord can commence a summary dispossess proceeding under RPAPL § 711(1). But one would be wrong. Under New York law, that sequence of events does not amount to an "expiration" of the lease sufficient to proceed under RPAPL § 711(1). Instead, the courts treat it as a volitional termination of the lease by the landlord, not an expiration of the lease by its terms. It's not good enough.

For a landlord to bring a summary dispossess proceeding, the lease needs to say that it expires, automatically, a specified amount of time after both (a) the tenant has defaulted and (b) the landlord has given a notice that the lease will terminate after the passage of some time—not merely when the

landlord has given a notice of immediate termination. If the lease provides for the passage of some time after the landlord gives a notice of termination, then the courts call the lease termination a “conditional limitation” and will allow the landlord to start a summary proceeding. In contrast, an immediate termination upon notice by landlord constitutes a “condition subsequent” and does not support a summary proceeding; in that case the landlord’s only remedy is a cumbersome action for “ejectment.” This is but one example of the hypertechnical and sometimes illogical (or perhaps goal-oriented) line-drawing that runs throughout New York landlord-tenant procedure. As a result, virtually any tenant, commercial or residential, can drag out eviction proceedings for months. In response to these judicial principles (assuming “principles” is the right word), New York landlords sometimes include language like this in their leases:

If an Event of Default¹³ exists, then without limiting Landlord’s other remedies, Landlord may serve on Tenant a written five-day¹⁴ notice of cancellation and termination of this Lease (that five-day period, the “Conditional Limitation Period”). When the Conditional Limitation expires, this Lease and the Term shall automatically and without any further action by anyone terminate, expire and come to an end, by the mere lapse of time, as fully and completely as if the last day of the Conditional Limitation Period were the Expiration Date. After the Conditional Limitation Period, Tenant’s tenancy no longer exists. Tenant shall then quit and surrender the Premises to Landlord but remain liable as this Lease provides. This paragraph establishes a conditional limitation, not a condition subsequent.

RPAPL § 711(2) provides for summary dispossess proceedings if a tenant has failed to pay rent and the landlord has met certain conditions. Tenant-oriented judges have been known to apply a rather low threshold in deciding that a landlord has waived its right to proceed under this statute. Accordingly, landlord’s counsel may wish to respond to this statute (as the courts have interpreted it) by including language like this in the lease (which is not guaranteed to work, but should not hurt):

13 The document should say, once, that an Event of Default exists only until Tenant has cured it and maybe Landlord has accepted the cure. This avoids the need to refer repeatedly to an “uncured Event of Default.”

14 Tenant will often negotiate for more than five days.

If, after Tenant's default in payment of Rent or under any notice from Landlord demanding payment of rent or possession of the Premises, Landlord accepts any Rent payment, partial or complete, that shall not constitute Landlord's "express consent in writing to permit the tenant to continue in possession" within the meaning of New York Real Property Actions and Proceedings Law § 711(2). Landlord shall not be deemed to have waived its right to commence and prosecute summary proceedings against Tenant under the real Property Actions and Proceedings Law on that basis.

As another pitfall for New York landlords under RPAPL § 711, the courts sometimes limit the period for which a landlord can claim unpaid rent under RPAPL § 711. If the landlord tries to look back too far, the courts may say that the landlord is trying to collect "stale rent" and should not be allowed to do so through a summary proceeding. This limitation does not appear in the statute but appears to be judge-made. Although the problem is more likely to arise in a residential eviction than a commercial one, a New York commercial landlord may want to try to avoid it by including in the lease language like this:

Tenant waives any right it might have to assert or claim a limit on the amount (or accrual period) of unpaid Rent that Landlord may seek to collect in a summary proceeding under Real Property Actions and Proceedings Law Article 7. If Tenant has failed to pay Rent for more than one month and believes or intends to assert that Tenant may suffer prejudice because of Landlord's failure to promptly exercise its remedies under this Lease for that nonpayment, Tenant shall Notify Landlord and ask Landlord to promptly exercise those remedies. Tenant assumes responsibility to fund appropriate reserves to prevent any surprise or prejudice that Tenant might otherwise suffer from any accumulation of unpaid Rent. Nothing in this paragraph limits Landlord's rights or remedies.

[RPAPL § 735] Statutory Excerpt or Summary

Manner of service; filing; when service complete.

1. Service of the notice of petition and petition shall be made by personally delivering them to the respondent; or by delivering to and leaving personally with a person of suitable age and discretion who resides or is employed at the property sought to

be recovered, a copy of the notice of petition and petition, if upon reasonable application admittance can be obtained and such person found who will receive it; or if admittance cannot be obtained and such person found, by affixing a copy of the notice and petition upon a conspicuous part of the property sought to be recovered or placing a copy under the entrance door of such premises; and in addition, within one day after such delivering to such suitable person or such affixing or placement, by mailing to the respondent both by registered or certified mail and by regular first class mail,

(a) if a natural person, as follows: at the property sought to be recovered, and if such property is not the place of residence of such person and if the petitioner shall have written information of the residence address of such person, at the last residence address as to which the petitioner has such information, or if the petitioner shall have no such information, but shall have written information of the place of business or employment of such person, to the last business or employment address as to which the petitioner has such information; and

(b) if a corporation, joint-stock or other unincorporated association, as follows: at the property sought to be recovered, and if the principal office or principal place of business of such corporation, joint stock or other unincorporated association is not located on the property sought to be recovered, and if the petitioner shall have written information of the principal office or principal place of business within the state, at the last place as to which petitioner has such information, or if the petitioner shall have no such information but shall have written information of any office or place of business within the state, to any such place as to which the petitioner has such information. Allegations as to such information as may affect the mailing address shall be set forth either in the petition, or in a separate affidavit and filed as part of the proof of service.

COMMENTARY

These service requirements are quite technical and specific, creating ample opportunities for mistake. The courts have traditionally applied and interpreted them in the same spirit.

[RPAPL § 747] Statutory Excerpt or Summary

Judgment.

1. The court shall direct that a final judgment be entered determining the rights of the parties. The judgment shall award to the successful party the costs of the special proceeding.
2. The judgment shall not bar an action to recover the possession of real property. The judgment shall not bar an action, proceeding or counterclaim, commenced or interposed within [60] days of entry of the judgment, for affirmative equitable relief which was not sought by counterclaim in the proceeding because of the limited jurisdiction of the court.
3. If the proceeding is founded upon an allegation of forcible entry or forcible holding out the court may award to the successful party a fixed sum as costs, not exceeding [\$50], in addition to his disbursements.
4. The judgment, including such money as it may award for rent or otherwise, may be docketed in such books as the court maintains for recording the steps in a summary proceeding; unless a rule of the court, or the court by order in a given case, otherwise provides, such judgment need not be recorded or docketed in the books, if separately maintained, in which are docketed money judgments in an action.

[RPAPL § 749] Statutory Excerpt or Summary*Warrant.*

1. Upon rendering a final judgment for petitioner, the court shall issue a warrant directed to the sheriff of the county or to any constable or marshal of the city in which the property, or a portion thereof, is situated, or, if it is not situated in a city, to any constable of any town in the county, describing the property, and commanding the officer to remove all persons, and, except where the case is within [RPAPL § 715],¹⁵ to put the petitioner into full possession.

15 RPAPL § 715 addresses the grounds and procedures to remove persons unlawfully using or occupying premises as a bawdy-house, for prostitution, or for any illegal trade, business, or manufacture.

2. The officer to whom the warrant is directed and delivered shall give at least [72] hours notice, excluding any period which occurs on a Saturday, Sunday or a public holiday, in writing and in the manner prescribed in this [RPAPL art. 7 (§§ 701 to 767)] for the service of a notice of petition, to the person or persons to be evicted or dispossessed and shall execute the warrant between the hours of sunrise and sunset.

3. The issuing of a warrant for the removal of a tenant cancels the agreement under which the person removed held the premises, and annuls the relation of landlord and tenant, but nothing contained herein shall deprive the court of the power to vacate such warrant for good cause shown prior to the execution thereof. Petitioner may recover by action any sum of money which was payable at the time when the special proceeding was commenced and the reasonable value of the use and occupation to the time when the warrant was issued, for any period of time with respect to which the agreement does not make any provision for payment of rent.

[RPAPL § 751] Statutory Excerpt or Summary

Stay upon paying rent or giving undertaking; discretionary stay outside [NYC].

The respondent [tenant being evicted] may, at any time before a warrant is issued, stay the issuing thereof and also stay an execution to collect the costs, as follows:

1. Where the lessee or tenant holds over after a default in the payment of rent, or of taxes or assessments, he may effect a stay by depositing the amount of the rent due or of such taxes or assessments, and interest and penalty, if any thereon due, and the costs of the special proceeding, with the clerk of the court, or where the office of clerk is not provided for, with the court, who shall thereupon, upon demand, pay the amount deposited to the petitioner or his duly authorized agent; or by delivering to the court or clerk his undertaking to the petitioner in such sum as the court approves to the effect that he will pay the rent, or such taxes or assessments, and interest and penalty and costs within [10] days, at the expiration of which time a warrant may issue, unless he produces to the court satisfactory evidence of the payment.

COMMENTARY

This statute means that even when a court is ready to issue a warrant of eviction—in other words, when the tenant has lost the eviction proceeding and is about to be evicted—the tenant can still obtain a final 10-day cure period, a last chance to prevent eviction. That final cure period applies, however, only if the lease terminated because the tenant did not pay rent, taxes, or assessments. The statute creates no comparable final cure period if the lease terminated because of a nonmonetary default or a default in some monetary obligation that might not be characterized as “rent, taxes, or assessments.” As a result of that gap, if a landlord has given a tenant notice of a nonmonetary default but the tenant disagrees, wants more time to cure the default, or has some other reason why the landlord should not be allowed to terminate the lease, the tenant routinely obtains a temporary restraining order (often soon converted into a preliminary injunction) to prevent the landlord from giving a notice of termination.

These actions, known as “Yellowstone” injunctions in honor of the case that spawned them,¹⁶ take landlord-tenant disputes out of landlord-tenant court and into “Supreme Court,” the general trial court of first jurisdiction in NYS, converting routine landlord-tenant disputes into full-blown emergency judicial proceedings with attendant excitement and expense. The law of “Yellowstone” injunctions is complex and quite extensive. It is designed, among other things, to let the tenant have its day in court—and let the court determine, for example, whether the tenant is or is not obligated to take particular actions under the lease—before the landlord can take the draconian step of terminating the lease. The concern is not so much that the landlord might purport to terminate the lease when the landlord had no right to do so, because any such improper termination would presumably be a nullity. Instead, the concern is that the landlord might terminate the lease rightfully but under circumstances where the tenant should have had an opportunity to let a court decide the underlying dispute between the parties, or where a court might want to give the tenant more time to cure its default.

Although the logical basis for “Yellowstone” actions (as discussed at the beginning of this paragraph) implies that they should never be available for any disputes about nonpayment (unless the amount at issue falls outside the categories of rent, taxes, and assessments), that limitation does not always apply. “Yellowstone” injunctions have been part of the New York landlord-tenant landscape for about half a century, but the Legisla-

16 *First Nat'l Stores v. Yellowstone Shopping Ctr.*, 21 N.Y.2d 630, 240 N.Y.S.2d 721 (1968).

ture has not plugged the statutory gap that drives them (i.e., the lack of a final cure period for nonmonetary and certain monetary defaults just before issuance of a warrant of eviction). Only a handful of commercial landlords have added language to their leases to mitigate the risk of these injunctions. This might be because commercial landlords: (a) regard the problem as “background noise” when they negotiate any particular lease; (b) fear (probably legitimately) that anything they try to do about the “Yellowstone” problem can and will be used against them in some other way by the landlord-tenant courts; and (c) can avoid the problem, where appropriate, by tailoring any future notice of default to disclaim any intention to terminate the lease absent a judicial determination of the landlord’s right to do so. Proposals for anti-Yellowstone language often lead to complex negotiations that verge on the philosophical, so the parties throw up their hands. If tenant has no negotiating leverage or is seeking to minimize its legal fees, landlord might include language like this in the lease:

If Tenant asserts in any action or proceeding that it has the capability to cure any default under this Lease, then as the sole means of demonstrating that capability, Tenant shall, within five days after Landlord’s demand, deposit with Landlord an amount equal to [110% of] Landlord’s reasonable estimate of the cost to cure Tenant’s default. Failure to timely make that deposit constitutes a monetary default under this Lease.

Many other variations are possible, most of them much more complicated. The New York courts seem to regard Yellowstone injunctions with the same reverence as the Constitution and grant them rather easily, so the courts may laugh at the suggested language. It should, however, do no harm.

CROSS-REFERENCES

See RPAPL § 756.

[CPLR § 2201] Statutory Excerpt or Summary

Stay.

Except where otherwise prescribed by law, the court in which an action is pending may grant a stay of proceedings in a proper case, upon such terms as may be just.

COMMENTARY

CPLR § 2201 empowers a court to stay any proceedings, including eviction proceedings. As a result, tenants can remain in possession, sometimes without paying rent, for periods that landlords consider unreasonably long. Landlords try to protect themselves by adding language such as this to their leases:

Tenant expressly waives, for itself and anyone claiming through Tenant, any rights under Civil Practice Law and Rules 2201, for any holdover proceeding or other action or proceeding on this Lease or Tenant's rights in the Premises.

See RPAPL §§ 751–767

[RPAPL § 853] Statutory Excerpt or Summary

Actions for forcible or unlawful entry or detainer; treble damages.

If a person is disseized, ejected, or put out of real property in a forcible or unlawful manner, or, after he has been put out, is held and kept out by force or by putting him in fear of personal violence or by unlawful means, he is entitled to recover treble damages in action therefor against the wrong-doer.

COMMENTARY

This statutory language incentivizes landlords not to experiment with self-help remedies in New York.

Landmarks

[NYC Admin. Code § 25-322] Statutory Excerpt or Summary

Notification; lease notification.

[NYC Admin. Code § 25-322(b)–(d)] Statutory Excerpt or Summary

b. It shall be the duty of the owner or person in charge of an improvement or property that is a [designated] landmark, interior landmark or is located on a landmark site or within an his-

toric district to ensure that every lease or sublease, or renewal thereof, between the owner or such other person in charge as lessor and a nonresidential tenant as lessee and concerning such improvement or property shall contain a notice, conspicuously set forth therein, stating that in accordance with [NYC Admin. Code §§ 25-305, 25-306, 25-309, or 25-310] the lessee must obtain a permit from the [landmarks preservation] commission before commencing any exterior or interior work on the improvement or property, except for ordinary repair and maintenance as that term is defined in [NYC Admin. Code § 25-302I]. When an improvement or property is designated a landmark, interior landmark or as part of an historic district during the term of a lease [or] sublease of all or a portion of such improvement or property, the lessor of such lease or sublease shall, within [30] days after being notified in writing of such designation by the [landmark preservation] commission or a person in charge, send a written notice as described above to all nonresidential lessees of such lessor. Such notice shall be sent by certified or registered mail, return receipt requested to all nonresidential lessees on the first two floors of the improvement or property, and shall be sent to all other nonresidential lessees by any means reasonably designed to ensure that notice is given.

c. The [landmarks preservation] commission shall promulgate such regulations as it deems necessary to comply with the provisions of this [NYC Admin. Code § 25-322I], with respect to notice requirements in all nonresidential leases for buildings under its jurisdiction.

d. Any person who violates [NYC Admin. Code § 25-322(b)], or the regulations promulgated hereunder, shall be subject to a civil penalty of not more than [\$500] per violation which shall be returnable to the environmental control board.

COMMENTARY

The NYC Landmarks Preservation Commission can designate old buildings (or components of old buildings), or even entire districts, as landmarks, thus limiting their demolition and development and often imposing on owners substantial unreimbursed costs. This process has sometimes been used as a technique (one of many) to try to block development projects. Landmark designation affects a significant percentage of

buildings in New York City, especially Manhattan. Landmark designation of the interior of a building can change the relative leverage of commercial landlords and tenants in subsequent lease renewal negotiations. For that reason, commercial landlords may want the tenant to agree not to seek or support landmark designation for the premises or any part of the building. That issue is not unique to New York.

[RCNY, tit. 63, § 10-02]Statutory Excerpt or Summary

Notice to Tenant of Landmarks Designation.

The language set forth below shall satisfy the notification requirements set forth in [NYC Admin. Code § 25-322].

“The tenant [lessee] is hereby notified that the leased premises are subject to the jurisdiction of the Landmarks Preservation Commission. In accordance with [NYC Admin. Code §§ 25-305, 25-306, 25-309 and 25-310] and the [RCNY, tit. 63, (§§ 1-01 to 13-05)] any demolition, construction, reconstruction, alteration or minor work as described in such sections and such rules may not be commenced within or at the leased premises without the prior written approval of the Landmarks Preservation Commission. Tenant is notified that such demolition, construction, reconstruction, alterations or minor work includes, but is not limited to, (a) work to the exterior of the leased premises involving windows, signs, awnings, flagpoles, banners and storefront alterations and (b) interior work to the leased premises that (i) requires a permit from the Department of Buildings or (ii) changes, destroys or affects an interior architectural feature of an interior landmark or an exterior architectural feature of an improvement that is a landmark or located on a landmark site or in a historic district.”

COMMENTARY

This statute recognizes that once a lease has been signed, a landlord has no unilateral power to modify the lease or to require the tenant to do anything. Any future leases must contain the required disclosure notice, though.

[RCNY, tit. 63, § 10-03]Statutory Excerpt or Excerpt

Notification.

(a) Lease notification: Any nonresidential lease or sublease (including any renewal thereof) executed after December 13, 1996 for property or an improvement that is a landmark, interior landmark or located on a landmark site or in a historic district shall include the notice set forth in [RCNY, tit. 63, § 10-02] above. Such notification shall be highlighted in bold or underscored or otherwise highlighted so that it is conspicuously set forth.

(b) Letter notification: If an improvement or property is designated as a landmark or an interior landmark or included as part of a landmark site or historic district during the term of a nonresidential lease or a sublease of all or a portion of such improvement or property, the lessor of such lease or sublease shall within 30 days after being notified of such designation by the Landmarks Preservation Commission or person in charge, send the written notice set forth in [RCNY, tit. 63, § 10-02] to the nonresidential lessee or sublessee. Such notice shall be highlighted in bold or underscored or otherwise highlighted so that it is conspicuously set forth. Such notice shall be sent by certified or registered mail, return receipt requested to all nonresidential lessees on the first two floors (excluding the basement or cellar) and shall be sent to all other nonresidential lessees by any means reasonably designed to ensure that notice is given.

Landowner's Duties—Maintenance of Property

[New York City Admin. Code § 7-210] Statutory Excerpt or Summary

Liability of real property owner for failure to maintain sidewalk in a reasonably safe condition.

- a. It shall be the duty of the owner of real property abutting any sidewalk, including, but not limited to, the intersection quadrant for corner property, to maintain such sidewalk in a reasonably safe condition.
- b. Notwithstanding any other provision of law, the owner of real property abutting any sidewalk, including, but not limited to, the intersection quadrant for corner property, shall be liable for any injury to property or personal injury, including death,

proximately caused by the failure of such owner to maintain such sidewalk in a reasonably safe condition. Failure to maintain such sidewalk in a reasonably safe condition shall include, but not be limited to, the negligent failure to install, construct, reconstruct, repave, repair or replace defective sidewalk flags and the negligent failure to remove snow, ice, dirt or other material from the sidewalk. This [NYC Admin. Code § 7-210(b)] shall not apply to one-, two- or three-family residential real property that is (i) in whole or in part, owner occupied, and (ii) used exclusively for residential purposes.

c. Notwithstanding any other provision of law, the city shall not be liable for any injury to property or personal injury, including death, proximately caused by the failure to maintain sidewalks (other than sidewalks abutting one-, two- or three-family residential real property that is (i) in whole or in part, owner occupied, and (ii) used exclusively for residential purposes) in a reasonably safe condition. This [NYC Admin. Code § 7-210I] shall not be construed to apply to the liability of the city as a property owner pursuant to [NYC Admin. Code § 7-210 (b)].

d. Nothing in this [NYC Admin. Code § 7-210] shall in any way affect the provisions of this [NYC Admin. Code tit. 7, ch. 2 (§§ 7-201–7-209)] or of any other law or rule governing the manner in which an action or proceeding against the city is commenced, including any provisions requiring prior notice to the city of defective conditions.

COMMENTARY

The NYC Admin. Code makes property owners responsible for sidewalks by their property. If a commercial lease otherwise makes a tenant responsible for adjacent sidewalks (e.g., a ground floor retail lease), the landlord may want to shift to the tenant the Administrative Code obligations on sidewalk maintenance and liability. The lease could include language like this:

For any sidewalk this Lease requires Tenant to maintain or repair, Tenant shall perform Landlord's obligations (and shall Indemnify Landlord against any liability) under New York City Administrative Code §§ 7-210 and 7-211. Tenant shall

maintain all insurance the cited sections require, naming Landlord as an additional insured.

The preceding language assumes the lease has already defined the word “Indemnify” somewhere once, so one does not need to repeat the usual long paragraph of standard language.

See “Actions Against Landowner by Invitees, Licensees, and Trespassers.”

[NYC Admin. Code § 7-211] Statutory Excerpt or Summary

Personal injury and property damage liability insurance.

An owner of real property, other than a public corporation as defined in [General Construction Law § 66] or a state or federal agency or instrumentality, to which [NYC Admin. Code § 7-210(b)] applies, shall be required to have a policy of personal injury and property damage liability insurance for such property for liability for any injury to property or personal injury, including death, proximately caused by the failure of such owner to maintain the sidewalk abutting such property in a reasonably safe condition. The city shall not be liable for any injury to property or personal injury, including death, as a result of the failure of an owner to comply with this [NYC Admin. Code § 7-211].

[BNK § 235] Statutory Excerpt or Summary

Investment of funds.

[BNK § 235(6)(i)]

(6)(i) A mortgage loan upon a leasehold estate shall not be made unless such leasehold estate shall have an unexpired term of not less than [21] years, which term may include the term provided by an option of renewal enforceable at the exclusive discretion of the savings bank. No mortgage loan upon a leasehold estate shall be made or acquired by a savings bank unless the terms thereof shall provide, regardless of the period of the loan, for payments to be made by the borrower on the principal thereof at least once in each year in amounts which would be sufficient to completely amortize a loan whose period extended for [4/5] of the unexpired term of the lease, which

term may include the term provided by an option of renewal enforceable at the exclusive discretion of the savings bank; or, in the case of a mortgage loan upon a leasehold estate in real property upon which there is a building in process of construction, such payments of principal need not be required during the period of construction or the first three years of the mortgage, whichever is shorter. The provisions of [BNK § 235(6)]I, (d), I, (f), (g), and (h) shall be applicable to loans made upon leasehold estates.

Leasehold Mortgages

[ISL § 1404] Statutory Excerpt or Summary

Types of reserve investments permitted for non-life insurers.

(a) In addition to the investments specified in [ISL § 1404(b)], but excluding any investment prohibited by the provisions of [ISL § 1407(a)(1), (3), (4), (6), (8), (9) or (10)],¹⁷ the reserve investments of a domestic insurer authorized to make investments under the authority of [ISL § 1404] shall consist of the following:

[ISL § 1404(a)(4)(A)]

(4) Loans secured by real property. (A) Loans secured by first or second mortgages which are liens on improved real property in the United States (including leasehold estates having an unexpired term of not less than [20] years, inclusive of the term or terms which may be provided by enforceable terms of renewal) meeting the following requirements:

(i) Priority of mortgages. The mortgaged property shall be subject to no prior lien, except a first mortgage and liens for non-delinquent ground rents, taxes, assessments and similar charges. There shall be no condition or right of re-entry or forfeiture not insured against under which the mortgage can be cut off, subordinated or otherwise disturbed. No loan secured by a second mortgage shall be made if the principal amount

¹⁷ These sections describe various prohibited investments for property/casualty and certain other insurers.

secured by a prior first mortgage can be increased without the insurer's consent unless the amount of increase is applied to reduce the second mortgage.

(ii) Leaseholds. If the mortgaged property is a leasehold:

(I) the lease shall provide for a term of at least [21] years,

(II) the property underlying the leasehold shall be subject to no prior lien except for liens for non-delinquent ground rents, taxes, assessments and similar charges and there shall be no condition or right of re-entry or forfeiture not insured against under which the insurer is unable to continue the lease in force for the duration of the loan, and

(III) the loan shall provide for such payments that at any time during the period of the loan the aggregate payments of principal to be made will be sufficient to repay the loan within the lesser of [40] years or a period equal to [80%] of the term of the lease, through payments of interest only for five years and equal payments applicable first to interest and then to principal at the end of each year thereafter. "Term," as used in [ISL § 1404(a)(4)(A)]¹⁸ with reference to a lease, means its unexpired term at the date of the loan, plus any term which may be provided by options of the lessee to renew.

COMMENTARY

Other types of lender (beyond those reflected here) may face statutory restrictions on leasehold mortgages.

Leases—Nature and Requirements

[BCL § 909] **Statutory Excerpt or Summary**

Sale, lease, exchange or other disposition of assets.

[BCL § 909(a)]

¹⁸ The actual language of the statute refers to "paragraph 6." This appears to be a mistake or a vestige. The reference should probably instead be to paragraph (A), i.e., ISL § 1404(a)(4)(A).

(a) A sale, lease, exchange or other disposition of all or substantially all the assets of a corporation, if not made in the usual or regular course of the business actually conducted by such corporation, shall be authorized only in accordance with the following procedure:

(1) The board shall authorize the proposed sale, lease, exchange or other disposition and direct its submission to a vote of shareholders.

(2) Notice of meeting shall be given to each shareholder of record, whether or not entitled to vote.

(3) The shareholders shall approve such sale, lease, exchange or other disposition and may fix, or may authorize the board to fix, any of the terms and conditions thereof and the consideration to be received by the corporation therefor, which may consist in whole or in part of cash or other property, real or personal, including shares, bonds or other securities of any other domestic or foreign corporation or corporations, by vote at a meeting of shareholders of (A) for corporations in existence on [September 1, 1965],¹⁹ the certificate of incorporation of which expressly provides such or corporations incorporated after [September 1, 1965],²⁰ a majority of the votes of all outstanding shares entitled to vote thereon or (B) for other corporations in existence on [September 1, 1965],²¹ [2/3] of the votes of all outstanding shares entitled to vote thereon.

COMMENTARY AND CROSS-REFERENCES

This requirement applies where a NY corporation enters into certain transactions. If the corporation is just a partner or member of the transacting party, or was formed in another state, then the statute does not apply.

The statutes collected here requiring certain approvals for certain leases should not be relied upon as being an exhaustive collection of all such statutes. *See, e.g.*, “Government Leases.”

[BNK § 98] Statutory Excerpt or Summary

¹⁹ This date is the effective date of BCL § 909(a)(3).

²⁰ *Id.*

²¹ *Id.*

Power to take and hold real estate; restrictions.

[BNK § 98(1)(a)–(d)]

1. A bank or trust company may purchase, hold, lease and convey real property as follows:

(a) A plot whereon there is or may be erected a building suitable for the convenient transaction of its business, from portions of which not required for its own use a revenue may be derived, and a plot whereon parking accommodations are, or are to be, provided, with or without charge, primarily for its customers or employees or both, and a building or a portion or portions thereof for use by the bank or trust company in its business, provided that the aggregate of all investments of any bank or trust company in such plots and buildings and in a leased building or a portion or portions thereof or in the stock, debentures or other obligations of any corporation holding such plots or buildings and of all loans to or upon the security of the stock of any such corporation shall not exceed [40%] of the aggregate of the capital stock, surplus fund and undivided profits of such bank or trust company, except with the approval of the superintendent. . . .

(b) Such as shall be conveyed to it in satisfaction of debts previously contracted in the course of its business.

(c) Such as it shall purchase at sales under judgments, decrees or mortgages held by it.

(d) Such purchase, lease, conveyance or other acquisition or sale of real property which is located outside the United States, its territories and possessions, and which is used principally as the residence of one or more directors, officers or employees of the bank or trust company as may be specifically approved by the superintendent.

[ECL § 27-2401]

Definitions.

As used in this [ECL §§ 27-2401–27-2405]:

1. “Owner” shall mean any person or persons who owns a dwelling unit or commercial space located on real property.
2. “Real property” shall mean lands, tenements and hereditaments.

[ECL § 27-2403]*Notification requirements.*

1. A person identified as a responsible party pursuant to [ECL §§ 27-1301–27-1323] or a participant as defined in [ECL § 27-1405(1)(a)] shall provide within [30] days of validation of any test undertaken pursuant to this [ECL art. 27 (§§ 0101–2713)] or [Navigation Law art. 12 (§§ 170–197)] the results of any such test to any identifiable owner of real property that has been tested. In the event that such a test is undertaken by the [DEC], the [DEC] shall provide, within [30] days of validation of such test, the results of such test to any identifiable owner of real property that has been tested.
2. Such person identified as a responsible party pursuant to [ECL §§ 27-1301–27-1323] or a participant as defined in [ECL § 27-1405(1)(a)] knowingly failing to provide test results as required in [ECL § 27-2403(1)] shall be considered a violation of any order on consent or a breach of any agreement entered into with the [DEC].

[RCO § 12] Statutory Excerpt or Summary*Sale, mortgage and lease of real property of religious corporations.*

1. A religious corporation shall not sell, mortgage or lease for a term exceeding five years any of its real property without applying for and obtaining leave of the court therefor pursuant to [NPC § 511] as that section is modified by [RCO § 2-b (1)(d-1)] . . .

8. Except as otherwise provided in this [RCO § 12] in respect to a religious corporation of a specified denomination, any solvent religious corporation may, by order of the court, obtained

as above provided in proceedings to sell, mortgage or lease real property, convey the whole or any part of its real property to another religious corporation, or to a membership, educational, municipal or other nonprofit [corporation, for] a consideration of [\$1.00] or other nominal consideration, and for the purpose of applying the provisions of [BCL art. 1 (§§ 101–112)], a proposed conveyance for such consideration shall be treated as a sale, but it shall not be necessary to show, in the petition or otherwise, nor for the court to find that the pecuniary or proprietary interest of the grantor corporation will be promoted thereby; and the interests of such grantor shall be deemed to be promoted if it appears that religious or charitable objects generally are conserved by such conveyance, provided, however, that such an order shall not be made if tending to impair the claim or remedy of any creditor.

9. If a sale, mortgage or lease for a term exceeding five years of any real property of any such religious corporation has been heretofore or shall be hereafter made and a conveyance or mortgage executed and delivered without the authority of a court of competent jurisdiction, obtained as required by law, or not in accordance with its directions, the court may, thereafter, upon the application of the corporation, or of the grantee or mortgagee in any such conveyance or mortgage or of any person claiming through or under any such grantee or mortgagee upon such notice to such corporation, or its successor, and such other person or persons as may be interested in such property, as the court may prescribe, confirm said previously executed conveyance or mortgage, and order and direct the execution and delivery of a confirmatory deed or mortgage, or the recording of such confirmatory order in the office where deeds and mortgages are recorded in the county in which the property is located; and upon compliance with the said order such original conveyance or mortgage shall be as valid and of the same force and effect as if it had been executed and delivered after due proceedings had in accordance with the statute and the direction of the court. But no confirmatory order may be granted unless the consents required in [RCO § 12(1)] for a Protestant Episcopal, Roman Catholic, Presbyterian church or an incorporated African Methodist Episcopal Zion church or an incorporated United Methodist church have first been given by the

prescribed authority thereof, either upon the original application or upon the application for the confirmatory order.

COMMENTARY

The statutes quoted here often arise in transactions with certain entity types. Other entity types not addressed here may face similar limitations. Seven categories of Christian church must also, by statute, satisfy certain internal approval procedures within the particular church. They are, in turn, exempted from requirements to notify the Attorney General of any proposed transaction. Because the editor is not an expert in constitutional law or the meaning of the First Amendment, he expresses no view on whether it is appropriate for New York statutes to establish different rules for different religious groups.

[EDL § 2853] Statutory Excerpt or Summary

Charter school organization; oversight; facilities.

[EDL § 2853(3)(a) and 4(c)]

3. Facilities.

(a) A charter school may be located in part of an existing public school building, in space provided on a private work site, in a public building or in any other suitable location. Provided, however, before a charter school may be located in part of an existing public school building, the charter entity shall provide notice to the parents or guardians of the students then enrolled in the existing school building and shall hold a public hearing for purposes of discussing the location of the charter school. A charter school may own, lease or rent its space.

4. Public and private assistance to charter schools.

(c) A charter school may contract with a school district or the governing body of a public college or university for the use of a school building and grounds, the operation and maintenance

thereof. Any such contract shall provide such services or facilities at cost.

COMMENTARY

Any consideration of statutes that appear favorable to charter schools in NYC must take into account the political environment in NYC since the 2014 mayoral election, in which the voter selected as mayor an opponent of charter schools and friend of the public school teachers' unions. This has led to efforts, large and small, to thwart the charter schools in NYC.

[NPC § 509] Statutory Excerpt or Summary

Purchase, sale, mortgage and lease of real property.

(a) No corporation shall purchase real property unless such purchase is authorized by the vote of a majority of directors of the board or of a majority of a committee authorized by the board, provided that if such property would, upon purchase thereof, constitute all, or substantially all, of the assets of the corporation, then the vote of two-thirds of the entire board shall be required, or if there are twenty-one or more directors, the vote of a majority of the entire board shall be sufficient.

(b) No corporation shall sell, mortgage, lease, exchange or otherwise dispose of its real property unless authorized by the vote of a majority of directors of the board or of a majority of a committee authorized by the board; provided that if such property constitutes all, or substantially all, of the assets of the corporation, then the vote of two-thirds of the entire board shall be required, or, if there are twenty-one or more directors, the vote of a majority of the entire board shall be sufficient.

(c) If a corporation authorizes a committee to act pursuant to paragraphs (a) and (b) of this section, the committee shall promptly report any actions taken to the board, and in no event after the next regularly scheduled meeting of the board.

[SFL § 41] Statutory Excerpt or Summary

Indebtedness not to be contracted without appropriation.

No state officer, employee, board, department or commission shall contract indebtedness on behalf of the state, nor assume

to bind the state, in an amount in excess of money appropriated or otherwise lawfully available. This [SFL § 41] shall not apply to a case where a statute expressly authorizes the making of a contract or contracts for a stated maximum amount which exceeds the money [appropriated] or otherwise available for payments thereon.

[NYC Admin. Code § 6-101] Statutory Excerpt or Summary

Contracts; certificate of comptroller.

[NYC Admin. Code § 6-101(a) and (c)]

a. Any contract, except as otherwise provided in [N.Y.C. Admin. Code § 6-101], shall not be binding or of any force, unless the comptroller shall indorse thereon the comptroller's certificate that there remains unexpended and unapplied a balance of the appropriation or fund applicable thereto, sufficient to pay the estimated expense of executing such contract, as certified by the officer making the same.

c. It shall be the duty of the comptroller to make such indorsement upon every contract so presented to him or her, if there remains unapplied and unexpended the amount so specified by the officer making the contract, and thereafter to hold and retain such sum to pay the expense incurred until such contract shall be fully performed. Such indorsement shall be sufficient evidence of such appropriation or fund in any action.

[ABC Law § 105] Statutory Excerpt or Summary

Provisions governing licensees to sell at retail for consumption off the premises.

[ABC Law § 105(1)–(3)(b), (6) and (7)]

1. No retail license to sell liquors and/or wines for consumption off the premises shall be granted for any premises, unless

the applicant shall be the owner thereof, or shall be in possession of said premises under a lease, management agreement or other agreement giving the applicant control over the food and beverage service at the premises, in writing, for a term not less than the license period except, however, that such license may thereafter be renewed without the requirement of a lease, management agreement or other agreement giving the applicant control over the food and beverage service at the premises, as herein provided. This [ABC Law § 105(1)] shall not apply to premises leased from government agencies, as defined under [ABC Law § 3(12-c)]; provided, however, that the appropriate administrator of such government agency provides some form of written documentation regarding the terms of occupancy under which the applicant is leasing said premises from the government agency for presentation to the state liquor authority at the time of the license application. Such documentation shall include the terms of occupancy between the applicant and the government agency, including, but not limited to, any short-term leasing agreements or written occupancy agreements.

2. No premises shall be licensed to sell liquors and/or wines at retail for off premises consumption, unless said premises shall be located in a store, the principal entrance to which shall be from the street level and located on a public thoroughfare in premises which may be occupied, operated or conducted for business, trade or industry or on an arcade or sub-surface thoroughfare leading to a railroad terminal. There may be not more than one additional entrance which shall be from the street level and located on and giving access to and from a public or private parking lot or parking area having space for not less than five automobiles.

3(a). No retail license to sell liquor and/or wine for off-premises consumption shall be granted for any premises which shall be located on the same street or avenue, and within [200] feet of a building occupied exclusively as a school, church, synagogue or other place of worship; the measurements to be taken in a straight line from the center of the nearest entrance to the building used for such school, church, synagogue or other place of worship to the center of the nearest entrance of the premises to be licensed; except, however, that no license shall

be denied to any premises at which a license under this [ABC Law § 105] has been in existence continuously from a date prior to the date when a building on the same street or avenue and within [200] feet of said premises has been occupied exclusively as a school, church, synagogue or other place of worship.

(b) Within the context of this [ABC Law § 105(3)], the word “entrance” shall mean a door of a school, of a house of worship, or of the premises sought to be licensed, regularly used to give ingress to students of the school, to the general public attending the place of worship, and to patrons or guests of the premises proposed to be licensed, except that where a school or house of worship is set back from a public thoroughfare, the walkway or stairs leading to any such door shall be deemed an entrance; and the measurement shall be taken to the center of the walkway or stairs at the point where it meets the building line or public thoroughfare. A door which has no exterior hardware, or which is used solely as an emergency or fire exit, or for maintenance purposes, or which leads directly to a part of a building not regularly used by the general public or patrons, is not deemed an “entrance.”

COMMENTARY

In addition to these statutory requirements, if a landlord will receive a percentage of a tenant’s sales proceeds from alcoholic beverages, then the State Liquor Authority may require the tenant’s liquor license application to cover the landlord as if the landlord were a partner of the licensed entity. This may entail a background check, fingerprinting, and subjecting the landlord to “tied house” restrictions—extensive SLA rules designed to protect society from the terrifying possibility that a retail licensee may also own an interest in a manufacturer or distributor of alcoholic beverages.

Maintenance of Property

[LAB § 202] **Statutory Excerpt or Summary**

Protection of the public and of persons engaged at window cleaning and cleaning of exterior surfaces of buildings.

The owner, lessee, agent and manager of every public building and every contractor involved shall provide such safe means for the cleaning of the windows and of exterior surfaces of such building as may be required and approved by the [Industrial Board of Appeals]. The owner, lessee, agent, manager or superintendent of any such public building and every contractor involved shall not require, permit, suffer or allow any window or exterior surface of such building to be cleaned unless such means are provided to enable such work to be done in a safe manner for the prevention of accidents and for the protection of the public and of persons engaged in such work in conformity with the requirements of this [LAB §§ 1 to 1200] and the rules of the [Industrial Board of Appeals]. A person engaged at cleaning windows or exterior surfaces of a public building shall use the safety devices provided for his protection. Every employer and contractor involved shall comply with this [LAB § 202] and the rules of the board and shall require his employee, while engaged in cleaning any window or exterior surface of a public building, to use the equipment and safety devices required by this [LAB §§ 1–1200] and rules of the [Industrial Board of Appeals].

The provisions of this [LAB § 202] shall not apply to (1) multiple dwellings six stories or less in height located anywhere in this state; nor to (2) any building three stories or less in height in cities, towns or villages having a population of less than [40,000]; nor to (3) the windows or exterior surfaces of any building which may be exempted under any rule adopted by the [Industrial Board of Appeals].

The [Industrial Board of Appeals] may grant variations pursuant to [LAB § 30]. All existing variations heretofore made by the board relating to the cleaning of windows are hereby validated and continued in full force and effect until amended or terminated by the board.

[Industrial Board of Appeals] may make rules to effectuate the purposes of this [LAB § 202].

Notwithstanding any other law or regulation, local or general, the provisions of this [LAB § 202] and the rules issued thereunder shall be applicable exclusively throughout the state and

the commissioner shall have exclusive authority to enforce this [LAB § 202] and the rules issued thereunder.

COMMENTARY

Every commercial lease already requires the tenant to comply with all applicable law. Nevertheless, as a result of LAB § 202, most New York commercial leases include a covenant like this:

Tenant shall not clean, nor require, permit, suffer, or allow anyone else to clean, any window from the outside in violation of Law.

New York also has numerous other health and safety statutes and regulations that could affect commercial leases and tenants, but for some reason LAB § 202 has achieved special prominence in lease documents.

[RPAPL § 881] Statutory Excerpt or Summary

Access to adjoining property to make improvements or repairs.

When an owner or lessee seeks to make improvements or repairs to real property so situated that such improvements or repairs cannot be made by the owner or lessee without entering the premises of an adjoining owner or his lessee, and permission so to enter has been refused, the owner or lessee seeking to make such improvements or repairs may commence a special proceeding for a license so to enter pursuant to [CPLR art. 4 (§§ 401 to Rule 411)]. The petition and affidavits, if any, shall state the facts making such entry necessary and the date or dates on which entry is sought. Such license shall be granted by the court in an appropriate case upon such terms as justice requires. The licensee shall be liable to the adjoining owner or his lessee for actual damages occurring as a result of the entry.

COMMENTARY

To respond to the quoted statute, a commercial lease may include language like this:

Tenant shall comply with any Law on access to the Premises for any excavation on adjacent land. Any such excavation shall not give Tenant any claim against Landlord for damages, indemnity, or abatement, diminution, reduction, or suspension

of Rent. Any payment for any such excavation shall belong to Landlord.

[LAB § 240] Statutory Excerpt or Summary

Scaffolding and other devices for use of employees.

1. All contractors and owners and their agents, except owners of one and two-family dwellings who contract for but do not direct or control the work, in the erection, demolition, repairing, altering, painting, cleaning or pointing of a building or structure shall furnish or erect, or cause to be furnished or erected for the performance of such labor, scaffolding, hoists, stays, ladders, slings, hangers, blocks, pulleys, braces, irons, ropes, and other devices which shall be so constructed, placed and operated as to give proper protection to a person so employed.

COMMENTARY

NYS's notorious (and unique or almost unique to NYS) "scaffold law" establishes strict liability if a worker falls from a height – sometimes as low as 16 inches – without regard to whether the worker is contributorily negligent or even drunk. Among other things, this law is said to produce very high insurance rates for New York construction projects.

Mechanic's Lien

[LIE § 2] Statutory Excerpt or Summary

Definitions.

[LIE § 2(3)]

Owner.

The term "owner," when used in this chapter, includes the owner in fee of real property, or of a [lesser] estate therein, [or] a lessee for a term of years.

COMMENTARY

These extracts from LIE cannot possibly do justice to this statute, whose intricacies complicate every construction loan closing and potentially enable lien claimants to torment landlords, tenants, and parties to other commercial real estate transactions in the state. A prominent construction lawyer once said he could, if asked, always figure out a way that every construction lender had violated the LIE and hence lost priority to mechanics' liens. Lien claimants and their advocates, on the other hand, regard the LIE as woefully inadequate. For more on mechanics' liens, see Joshua Stein, *Stein on New York Commercial Mortgage Transactions*, Ch. 5 (2008).

[LIE § 2(4)]

Improvement.

The term “improvement,” when used in this [LIE §§ 1–251], includes . . . the performance of real estate brokerage services in obtaining a lessee for a term of more than three years of all or any part of real property to be used for other than residential purposes pursuant to a written contract of brokerage employment or compensation.

COMMENTARY

A real estate broker can claim a mechanic's lien for negotiating certain commercial leases. The broker's engagement must be in writing. Compare RPL § 294-b(1), which allows a broker to file an affidavit claiming a commission based on an oral or written contract. *See* “Real Estate Brokers—Lien.” In other contexts, NYS generally allows oral agreements with licensed brokers. Real estate brokers of an institutional caliber rarely assert mechanics' liens, because they hope to obtain future business from their landlord clients.

[LIE § 3]

Mechanic's lien on real property.

A contractor, subcontractor, laborer, materialman, landscape gardener, nurseryman or person or corporation selling fruit or ornamental trees, roses, shrubbery, vines and small fruits, who performs labor or furnishes materials for the improvement of real property with the consent or at the request of the owner thereof, or of his agent, contractor or subcontractor, and any trust fund to which benefits and wage supplements are due or

payable for the benefit of such laborers, shall have a lien for the principal and interest, of the value, or the agreed price, of such labor, including benefits and wage supplements due or payable for the benefit of any laborer, or materials upon the real property improved or to be improved and upon such improvement, from the time of filing a notice of such lien as prescribed in this [LIE §§ 1–251]....Within the meaning of the provisions of this [LIE §§ 1–251], materials actually manufactured for but not delivered to the real property, shall also be deemed to be materials furnished.

COMMENTARY

Many words used in this and other sections of the LIE are the subject of complex statutory definitions that have spawned extensive (and sometimes rather odd) state-specific jurisprudence but do not merit reprinting here. The reference to “consent” by the owner to a tenant’s work can sometimes make the owner’s interest in the property subject to liens from that work, though consent usually requires something more than mere lease language allowing alterations. Instead, there needs to be some kind of contractual relationship between the owner and the lien claimant, although courts can infer that relationship. Landlords sometimes worry about this statute. New York provides no statutory mechanism (of the type available in, for example, California) for a landlord to disclaim responsibility for liens arising from its tenants’ construction projects.

Landlords sometimes try to protect themselves by including language in their leases saying that nothing in the lease constitutes the landlord’s consent to any lienable work. Of course, the typical lien claimant will never see any such provisions. The lien claimant will argue that any such self-serving (and undisclosed) provisions cannot possibly affect the lien claimant’s right to assert a lien against the fee estate. The landlord might argue that the lien claimant has some implied obligation to search title, see that he is not dealing with the fee owner, and ask to see the lease. The theory sounds good but may bear no relation to reality. Does the landlord improve its position by including the same language in a recorded memorandum of lease? Conceivably, maybe. And it should do no harm except perhaps by creating an unwarranted sense of comfort and safety. Here is a sample of language a landlord might use in a lease and in a memorandum of lease:

Nothing in this Lease constitutes Landlord’s consent or request, express or implied, by inference or otherwise: (a) to

any contractor, subcontractor, laborer, or material supplier to perform any labor or furnish any materials for any improvement, alteration or repair of the Premises; or (b) to subject Landlord's property to any mechanic's lien.

No assurance can be provided that this language will work. Landlords often use ALL CAPITAL LETTERS for language of this type.

[LIE § 10] Statutory Excerpt or Summary

Filing of notice of lien.

[LIE § 10(1)]

1. Notice of lien may be filed at any time during the progress of the work and the furnishing of the materials, or, within eight months after the completion of the contract, or the final performance of the work, or the final furnishing of the materials, dating from the last item of work performed or materials furnished; provided, however, . . . that in the case of a lien by a real estate broker, the notice of lien may be filed only after the performance of the brokerage services and execution of lease by both lessor and lessee and only if a copy of the alleged written agreement of employment or compensation is annexed to the notice of lien, provided that where the payment pursuant to the written agreement of employment or compensation is to be made in installments, then a notice of lien may be filed within eight months after the final payment is due, but in no event later than a date five years after the first payment was made. . . . The notice of lien must be filed in the clerk's office of the county where the property is situated.

COMMENTARY AND CROSS-REFERENCES

The LIE allows commercial leasing brokers to file liens if their efforts led to the mutual signing of a lease. *See* LIE § 2(4), above. *See* LIE § 3 for comments on liens arising from tenant work. Shorter filing deadlines apply to residential construction projects.

[LIE § 13] Statutory Excerpt or Summary

Priority of liens.

[LIE § 13(1)]

(1) A lien for materials furnished or labor performed in the improvement of real property shall have priority over a conveyance, mortgage, judgment or other claim against such property not recorded, docketed or filed at the time of the filing of the notice of such lien, except as hereinafter in this [LIE §§ 1 to 251] provided; over advances made upon any mortgage or other encumbrance thereon after such filing, except as hereinafter in this [LIE art. 2 (§§ 3 to 39-c)] provided; and over the claim of a creditor who has not furnished materials or performed labor upon such property, if such property has been assigned by the owner by a general assignment for the benefit of creditors, within [30] days before the filing of either of such notices; and also over an attachment hereafter issued or a money judgment hereafter recovered upon a claim, which, in whole or in part, was not for materials furnished, labor performed or moneys advanced for the improvement of such real property; and over any claim or lien acquired in any proceedings upon such judgment. Such liens shall also have priority over advances made upon a contract by an owner for an improvement of real property which contains an option to the contractor, his successor or assigns to purchase the property, if such advances were made after the time when the labor began or the first item of material was furnished, as stated in the notice of lien. If several buildings are demolished, erected, altered or repaired, or several pieces or parcels of real property are improved, under one contract, and there are conflicting liens thereon, each lienor shall have priority upon the particular part of the real property or upon the particular building or premises where his labor is performed or his materials are used. Persons shall have no priority on account of the time of filing their respective notices of liens, but all liens shall be on a parity except as hereinafter in [LIE §56] provided; and except that in all cases laborers for daily or weekly wages shall have preference over all other claimants under this [LIE art. 2 (§§ 3 to 39-c)].

COMMENTARY

Displaying the same elegance and transparency as the rest of the LIE, this section clearly states that all liens from the same construction job have the same priority, probably relating back only to the date when the first such lien was filed.

[LIE § 34] Statutory Excerpt or Summary

Waiver of lien.

Notwithstanding the provisions of any other law, any contract, agreement or understanding whereby the right to file or enforce any lien created under [LIE art.2 (§§ 3 to 39-c)] is waived, shall be void as against public policy and wholly unenforceable. This [LIE § 34] shall not preclude a requirement for a written waiver of the right to file a mechanic's lien executed and delivered by a contractor, subcontractor, material supplier or laborer simultaneously with or after payment for the labor performed or the materials furnished has been made to such contractor, subcontractor, material man or laborer nor shall this [LIE § 34] be applicable to a written agreement to subordinate, release or satisfy all or part of such a lien made after a notice of lien has been filed.

COMMENTARY

Progress lien waivers are enforceable only to the extent of payments made. They are often required in New York practice. To the extent that they are not justified by actual payment, they are generally thought to run afoul of LIE § 34. Recent cases suggest that courts will stretch to find a basis to set aside (or make meaningless) even progress lien waivers delivered in exchange for payments made.

[GBL § 756] Statutory Excerpt or Summary

Definitions

[GBL § 756(1) and (3)]

As used in this [GBL art. 35-E (§§ 756–758)]:

1. “Construction contract” means a written or oral agreement for the construction, reconstruction, alteration, maintenance, moving or demolition of any building, structure or improvement, or relating to the excavation of or other development or

improvement to land, and where the aggregate cost of the construction project including all labor, services, materials and equipment to be furnished, equals or exceeds [\$150,000]. For the purposes of this [GBL art. 35-E (§§ 756 to 758)] a construction contract shall not include any such contract made and awarded by the state, any public department, any public benefit corporation, any public corporation or official thereof, or a municipal corporation or official thereof for construction, reconstruction, alteration, repair, maintenance, moving or demolition of any public works project nor any contract with a contractor or subcontractor which is part of such project . . .

3. “Owner” means any person, firm, partnership, corporation, company, association or other organization or other entity, or a combination of any thereof, (with an ownership interest, whether the interest or estate is in fee, as vendee under a contract to purchase, as lessee or another interest or estate less than fee) that causes a building, structure or improvement, new or existing, to be constructed, altered, repaired, maintained, moved or demolished or that causes land to be excavated or otherwise developed or improved.

[GBL § 756-a] Statutory Excerpt or Summary

Obligations.

It is the policy and purpose of this [GBL art. 35-E (§§ 756–758)] to expedite payment of all monies owed to those who perform contracting services pursuant to construction contracts. Except as otherwise provided in this [GBL art. 35-E (§§ 756–758)], the terms and conditions of a construction contract shall supersede the provisions of this [GBL art. 35-E (§§ 756–758)] and govern the conduct of the parties thereto.

3. Payment. (a) The owner’s payment of a contractor’s interim and final invoices shall be made on the basis of a duly approved invoice of work performed and the material supplied during the billing cycle.

(i) Unless the provisions of this [GBL art. 35-E (§§ 756–758)] provide otherwise, the owner shall pay the contractor strictly in accordance with the terms of the construction contract.

(ii) Payment of an interim or final invoice shall be due from the owner not later than [30] days after approval of the invoice.

(iii) If payment by the owner is contingent upon lender approval, payment of a contractor’s interim or final invoice or the amount of loan proceeds disbursed by the lender for payment of the contractor’s interim or final invoice shall be due from the owner seven days after receipt by the owner of good funds except where the provisions of [GBL § 756-d] applies.

(iv) An owner may withhold from an interim payment only an amount that is sufficient to pay the costs and expenses the owner reasonably expects to incur in order to cure the defect or correct any items set forth in writing pursuant to [GBL § 756-a(2)(a)(i)] or in the alternative, to withhold an amount not to exceed the line item amount appearing in the agreed schedule of values together with any change orders, additions and/or deletions, if such schedule has been previously submitted, and/or an amount sufficient to cover liquidated damages as established in an agreed upon schedule in the construction contract.

COMMENTARY

GBL art. 35E, known as the “Prompt Payment” law, is an exceedingly long statute that attempts to teach owners and contractors how to behave. Only a small part is reprinted here. The single most important provision appears in the introductory paragraph to § 756-a, which confirms parties remain free to contract around almost everything in the statute. Any construction lender should require a borrower to do just that. A diligent landlord or tenant should have the same agenda, to avoid being stuck with the somewhat arcane and unrealistic provisions of the Prompt Payment law.

[GBL § 757] Statutory Excerpt or Summary

Void Provisions.

The following provisions of construction contracts shall be void and unenforceable:

1. A provision, covenant, clause or understanding in, collateral to or affecting a construction contract, with the exception of a contract with a material supplier, that makes the contract subject to the laws of another state or that requires any litigation, arbitration or other dispute resolution proceeding arising from the contract to be conducted in another state.
2. A provision, covenant, clause or understanding in, collateral to or affecting a construction contract stating that a party to the contract cannot suspend performance under the contract if another party to the contract fails to make prompt payments under the contract.
3. A provision, covenant, clause or understanding in, collateral to or affecting a construction contract stating that expedited arbitration as expressly provided for and in the manner established by [GBL § 756-b] of this [GBL art. 35-E (§§ 756–758)] is unavailable to one or both parties.
4. A provision, covenant, clause or understanding in, collateral to or affecting a construction contract establishing payment provisions which differ from those established in [GBL § 756-a(3)] and [GBL § 756-b] as applicable.

COMMENTARY

Except as listed here, it seems the parties can contract around all provisions of the law. They will often want to do that. Section 756(2) invalidates common provisions that would obligate contractors to keep working notwithstanding a payment dispute. Section 756(4) invalidates any payment provisions that vary from Sections 756-a(3) and 756-b.

[GOL § 5-322.1] Statutory Excerpt or Summary

Agreements exempting owners and contractors from liability for negligence void and unenforceable; certain cases.

[GOL § 5-322.1(1) and (2)]

1. A covenant, promise, agreement or understanding in, or in connection with or collateral to a contract or agreement rela-

tive to the construction, alteration, repair or maintenance of a building, structure, appurtenances and appliances including moving, demolition and excavating connected therewith, purporting to indemnify or hold harmless the promisee against liability for damage arising out of bodily injury to persons or damage to property contributed to, caused by or resulting from the negligence of the promisee, his agents or employees, or indemnitee, whether such negligence be in whole or in part, is against public policy and is void and unenforceable; provided that this [GOL § 5-322.1] shall not affect the validity of any insurance contract, workers' compensation agreement or other agreement issued by an admitted insurer. This [GOL § 5-322.1(1)] shall not preclude a promisee requiring indemnification for damages arising out of bodily injury to persons or damage to property caused by or resulting from the negligence of a party other than the promisee, whether or not the promisor is partially negligent.

2. A covenant, promise, agreement or understanding in, or in connection with or collateral to a contract or agreement relative to the construction, alteration, repair or maintenance of a building, structure, appurtenances and appliances including moving, demolition and excavating connected therewith, purporting to condition a subcontractor's or materialman's right to file a claim and/or commence an action on a payment bond on exhaustion of another legal remedy is against public policy and is void and unenforceable; provided that this [GOL § 5-322.1(2)] shall not affect the validity of any insurance contract, workers' compensation agreement or other agreement issued by an admitted insurer.

COMMENTARY

Like many other states, New York, as a matter of public policy, disfavors contracts that seek to limit or indemnify one party against the other for negligence. The legislature enacted GOL § 5-322.1 specifically to prevent owners (and contractors) from requiring subcontractors, as a prerequisite to being awarded the work, to assume liability for negligence of others.

[GOL § 5-322.2] Statutory Excerpt or Summary

Contents of certain construction contracts.

[GOL § 5-322.2(1) and (4)]

1. Every written contract or agreement executed by an owner providing for the building, construction, repair or renovation of buildings, structures, or improvements upon real property owned by him other than contracts involving public improvements as defined in [LIE] and contracts involving residential property with housing accommodations for less than five families, shall contain a clause requiring such owner to set forth in said contract the following information:

(a) the full name and address of the owner or owners;

(b) the full name and address of the owner of the land and the owner of the building or improvements if the owner of the land and the owner of the building or improvements shall be different persons or entities; and

(c) a description by street address; or section, block, and lot numbers; or reference to a deed book and page number;

In the event the names required to be set forth as hereinabove provided shall be changed after the execution of any such contract or agreement and during the period of such construction, the owner shall within five days notify the contractor of such change in writing sent to the contractor by certified mail to the address of the contractor as set forth in said contract.

4. Any failure to comply with the provisions of this [GOL § 5-322.2] shall not render any agreement or contract hereof, enumerated in [GOL § 5-322.2(1)], void or voidable nor shall it otherwise impair any obligations or rights under any such agreement or contract.

COMMENTARY

GOL § 5-322.2 requires a tenant to include in any construction contract the property owner's name and contact information. If the property owner changes during construction, the tenant is supposed to tell the contractor within five days. Will the tenant always know about any such transfer,

particularly within five days? If a tenant has delivered a security deposit, then GOL § 7-105 already requires owners to notify tenants of a transfer. See “Security Deposits.” But some tenants don’t deliver security deposits and some landlords don’t perform all their obligations regarding security deposits. For that and other reasons, any tenant may want their landlord to agree to notify them immediately of any change in the property’s ownership. Will the landlord remember?

Why would contractors need to know about a change of ownership of the fee estate? Presumably to help them file mechanics’ liens against the fee estate.

[GOL § 5-322.3]

Payment bonds to be filed.

A copy of any payment bond executed in connection with a contract for the improvement of real property other than a contract for a public improvement, shall be filed within [30] days of such execution by the owner of the improvement in the office of the county clerk in the county in which the improvement is to be undertaken; provided, however, that such filing shall be required only where the contract for the improvement of real property is for an amount in excess of [\$100,000]. Any owner failing to file such payment bond as provided herein shall be liable for the reasonable attorney's fees, as determined by the court, of any claimant successfully bringing an action or proceeding on the bond.

Memorandum of Lease

[RPL § 291-c] Statutory Excerpt or Summary

Recording memoranda of leases.

In lieu of the recording of a lease for a term exceeding three years, pursuant to [RPL §291], there may be recorded with like effect a memorandum of such lease, executed by all persons who are parties to the lease, and acknowledged or proved, and certified, in the manner to entitle a conveyance to be recorded. A memorandum of lease thus entitled to be recorded shall contain at least the following information with respect to the lease: the name of the lessor and the name of the lessee and the

addresses, if any, set forth in the lease as addresses of such parties; a reference to the lease, with its date of execution; a description of the leased premises in the form contained in the lease; the term of the lease, with the date of commencement and the date of termination of such term, and if there is a right of extension or renewal, the maximum period for which or date to which the lease may be extended or the number of times or date to which it may be renewed, and the date or dates on which such rights of extension or renewal are exercisable.

Whenever a memorandum of lease is presented for recording, the lease shall also be submitted to the recording officer for the purpose of examination to determine whether or not such memorandum of lease is subject to the tax on mortgages provided by [TAX art. 11 (§§ 250–267)].

COMMENTARY

In addition to the items listed in the statute, the parties may wish to mention in any memorandum of lease: any restrictions that affect the landlord's property other than the demised premises (e.g., expansion options, exclusive uses, construction restrictions, other use restrictions); landlord's disclaimer (or at least purported disclaimer) of responsibility for mechanics' liens; and transfer restrictions. The last sentence of this statute offers a brief glimpse of the state's weird and wonderful mortgage recording tax, which inflicts endless layers of complexity on real estate finance transactions that would be routine anywhere else. That tax is otherwise outside the scope of this work. See Joshua Stein, *Stein on New York Commercial Mortgage Transactions*, ch. 6-9 (2008). When the parties record a memorandum of lease, the recording office will collect the applicable transfer taxes, as more fully described elsewhere in this chapter. The taxes are, however, triggered in the first instance as soon as the parties enter into certain leases or lease-related transactions. Recording a memorandum of such a transaction does not trigger the tax. It just alerts the tax collectors.

[RPL § 291-cc]

Recording modifications of leases.

1. Where a lease or memorandum of such lease has been recorded, an unrecorded agreement modifying such lease or memorandum is void as against a subsequent purchaser in good faith and for a valuable consideration, and the possession

of the tenant shall not be deemed notice of the modification, unless the agreement of modification or a memorandum thereof is recorded prior to the recording of the instrument by which the subsequent purchaser acquires his estate or interest.

2. A memorandum of an agreement modifying a lease shall contain at least the following information with respect to the agreement: the names of the parties and the addresses, if any, set forth in the agreement; a reference to the agreement with its date of execution; a brief description of the leased premises in form sufficient to identify the same; any changes made by the agreement in the term of the lease and the date of the termination of the lease as modified[;] and any changes in the provisions of the lease as to the rights of extension or renewal.

3. For the purpose of this [RPL § 291-cc] the word “purchaser” includes a person who purchases or acquires by exchange or contracts to purchase or acquire by exchange the leased premises or the real property of which the leased premises are part or any estate or interest therein, or acquires by assignment the rent to accrue from tenancies or subtenancies thereof in existence at the time of the assignment.

COMMENTARY

Under New York law, if the parties record a memorandum of lease they must record an amendment of it whenever they amend their lease, even if the amendment affects nothing disclosed in the memorandum. The requirement seems burdensome but actually makes some sense. To avoid the need to comply with it, the parties might agree that once Tenant is in possession they will terminate the memorandum of lease, so Tenant's possession will give the world constructive notice of Tenant's rights. This is a nonstandard approach and creates certain risks (e.g., what happens if Tenant temporarily moves out). It may, however, make sense in some cases.

See “Recording.”

Mitigation of Damages

No applicable statute.

COMMENTARY

New York remains in the minority of states that do not require a commercial landlord to mitigate damages. The courts seem to show no sign of any interest in changing that rule, or maybe they display a healthy inclination to leave legislation to legislators. On the other hand, it is sometimes suggested that if a lease is silent on the issue, New York courts may infer an obligation to mitigate. Therefore it might help, and it can't hurt, for landlord's counsel to negate expressly any obligation to mitigate. If landlord sues for a single award of damages for breach of the lease, the ordinary formula in any lease gives tenant credit for the fair market rental value of the leased premises, which indirectly incentivizes landlord to re-rent at market and could be considered something like an obligation to mitigate damages. When leasing lawyers debate mitigation of damages, they often forget that dynamic.

Notarial Acts—Uniform Law on Notarial Acts

[No applicable statute]

COMMENTARY

New York has not adopted the Uniform Law on Notarial Acts. *See* “Formalities of Execution.”

Options

[GOL § 5-334]

Option or right to acquire interest in property.

1. An option or right to acquire an equity or other ownership interest in property or in a partnership, corporation, trust or other entity that owns property shall not be unenforceable because the owner of such interest grants such option or right to the holder of a mortgage which is a lien on such property or to the holder of a security interest in such property, simultaneously with or in connection with any loan or forbearance of money secured by such mortgage or security interest, if (a) the power to exercise such option or right is not dependent upon the occurrence of a default with respect to such loan, forbearance, mortgage or security interest, and (b) such loan or forbearance is for the principal sum of [\$2,500,000] or more when the option or right is granted. Loans or forbearances aggregating [\$2,500,000] or more which are to be made or advanced to any one borrower in one or more installments pur-

suant to a written agreement by one or more lenders shall be deemed a single loan or forbearance for the total amount which the lender or lenders have agreed to make or advance pursuant to such agreement.

2. This [GOL § 5-334] shall not be construed to limit, impair or otherwise affect the power of the holder of any option or right to acquire an equity or other ownership interest in property or in a partnership, corporation, trust or other entity that owns property, if such option or right is or would be enforceable without reference to this [GOL § 5-334].

3. This [GOL § 5-334] shall apply to all options or rights which are exercised on or after [June 11, 1985],²² notwithstanding the date when such options or rights were granted.

COMMENTARY AND CROSS-REFERENCES

See “Recording.” If the mortgagee obtained an option to acquire 100 percent of the borrower's equity for \$1 as of any time on or after a specified date that happened to be one week after the scheduled maturity date of the loan, would this statute validate that arrangement?

Possession of Tenant

[No applicable statute]

CROSS-REFERENCE

But see “Adverse Possession.”

Power of Attorney

[GOL § 5-1501C] Statutory Excerpt or Summary

Powers of attorney excluded from this title.

The provisions of this [GOL §§ 5-1501–5-1512] shall not apply to the following powers of attorney:

1. a power of attorney given primarily for a business or commercial purpose, including without limitation:

²² This date is the effective date of GOL § 5-334.

- (a) a power to the extent it is coupled with an interest in the subject of the power;
 - (b) a power given to or for the benefit of a creditor in connection with a loan or other credit transaction;
 - (c) a power given to facilitate transfer or disposition of one or more specific stocks, bonds or other assets, whether real, personal, tangible or intangible;
2. a proxy or other delegation to exercise voting rights or management rights with respect to an entity;
 3. a power created on a form prescribed by a government or governmental subdivision, agency or instrumentality for a governmental purpose;
 4. a power authorizing a third party to prepare, execute, deliver, submit and/or file a document or instrument with a government or governmental subdivision, agency or instrumentality or other third party;
 5. a power authorizing a financial institution or employee of a financial institution to take action relating to an account in which the financial institution holds cash, securities, commodities or other financial assets on behalf of the person giving the power;
 6. a power given by an individual who is or is seeking to become a director, officer, shareholder, employee, partner, limited partner, member, unit owner or manager of a corporation, partnership, limited liability company, condominium or other legal or commercial entity in his or her capacity as such;
 7. a power contained in a partnership agreement, limited liability company operating agreement, declaration of trust, declaration of condominium, condominium bylaws, condominium offering plan or other agreement or instrument governing the internal affairs of an entity authorizing a director, officer, shareholder, employee, partner, limited partner, member, unit owner, manager or other person to take lawful action relating to such entity;

8. a power given to a condominium managing agent to take action in connection with the use, management and operation of a condominium unit;

9. a power given to a licensed real estate broker to take action in connection with a listing of real property, mortgage loan, lease or management agreement;

10. a power authorizing acceptance of service of process on behalf of the principal; and

11. a power created pursuant to authorization provided by a federal or state statute, other than this [GOL §§ 5-1501 to 5-1512], that specifically contemplates creation of the power, including without limitation a power to make health care decisions or decisions involving the disposition of remains.

Nothing in this [GOL § 5-1501C] shall be deemed to prohibit use of a statutory short form power of attorney or a non-statutory power of attorney in connection with any of the transactions described in this [GOL § 5-1501C].

COMMENTARY

In September 1, 2009, the Legislature rewrote New York's power of attorney statute, GOL § 5-1501, in response to perceived abuses involving powers of attorney that elderly property owners granted to their relatives. As an unintended consequence of that statute—which was longer than the United States Constitution—it became temporarily infeasible to grant any power of attorney in New York for commercial transactions. The Legislature took a year to recognize the practical needs of commercial transactions and to repair the statute, which remains extraordinarily long and complex. For commercial transactions, the only part that matters is the exceptions quoted here. As a result, for most commercial transactions New York law seems to impose no state-specific requirements for the form of a power of attorney. Any power that will affect real property should, in any event, be acknowledged in recordable form, recorded and circulated for review and sign-off well before closing.

Property Affidavit

[No applicable statute]

COMMENTARY

Although NYS has no specific statute on affidavits, they commonly appear in New York transactions, particularly in the machinations required to mitigate the mortgage recording tax.

See “Recording.”

Real Estate Brokers

[RPL § 440] Statutory Excerpt or Summary

Definitions.

[RPL § 440(1)]

1. Whenever used in this [RPL art. 12-A (§§ 440–443-a)] “real estate broker” means any person, firm, limited liability company or corporation, who, for another and for a fee, commission or other valuable consideration, lists for sale, sells, at auction or otherwise, exchanges, buys or rents, or offers or attempts to negotiate a sale, at auction or otherwise, exchange, purchase or rental of an estate or interest in real estate, or collects or offers or attempts to collect rent for the use of real estate, or negotiates or offers or attempts to negotiate, a loan secured or to be secured by a mortgage, other than a residential mortgage loan, as defined in [BNK § 590], or other incumbrance upon or transfer of real estate, or is engaged in the business of a tenant relocater, or who, notwithstanding any other provision of law, performs any of the above stated functions with respect to the resale of condominium property originally sold pursuant to the provisions of [GBL §§ 352–359-h]. In the sale of lots pursuant to the provisions of [RPL art. 9-A (§§ 337–339-c)], the term “real estate broker” shall also include any person, partnership, association or corporation employed by or on behalf of the owner or owners of lots or other parcels of real estate, at a stated salary, or upon a commission, or upon a salary and commission, or otherwise, to sell such real estate, or any parts thereof, in lots or other parcels, and who shall sell or exchange, or offer or attempt or agree to negotiate the sale or exchange, of any such lot or parcel of real estate. For purposes of this [RPL §440(1)], the term “interest in real estate” shall include the sale of a business wherein the value of the real

estate transferred as part of the business is not merely incidental to the transaction, and shall not include the assignment of a lease, and further, the transaction itself is not otherwise subject to regulation under state or federal laws governing the sale of securities. In connection with the sale of a business[,], the term “real estate broker” shall not include a person, firm or corporation registered pursuant to the provisions of [GBL §§ 352–359-h)] or federal securities laws.

[RPL § 440(3)]

3. “Real estate salesman” means a person associated with a licensed real estate broker to list for sale, sell or offer for sale, at auction or otherwise, to buy or offer to buy or to negotiate the purchase or sale or exchange of real estate, or to negotiate a loan on real estate other than a mortgage loan as defined in [BNK § 590], or to lease or rent or offer to lease, rent or place for rent any real estate, or collects or offers or attempts to collect rent for the use of real estate for or in behalf of such real estate broker, or who, notwithstanding any other provision of law, performs any of the above stated functions with respect to the resale of a condominium property originally sold pursuant to the provisions of the [GBL §§ 352-e–352-h].

COMMENTARY

The reference to anyone who “collects or attempts to collect rent for the use of real estate” would cover most property managers, even if affiliated with the owner. RPL § 440-a (see below) expressly excludes certain “white knight” property managers from New York’s brokerage/licensing requirements.

[RPL § 440-a] Statutory Excerpt or Summary

License required for real estate brokers and salesmen.

No person, co-partnership, limited liability company or corporation shall engage in or follow the business or occupation of, or hold himself or itself out or act temporarily or otherwise as a real estate broker or real estate salesman in this state without first procuring a license therefor as provided in this [RPL art. 12-A (§§ 440–443-a)]. No person shall be entitled to a license

as a real estate broker under this [RPL art. 12-A (§§ 440–443-a)], either as an individual or as a member of a co-partnership, or as a member or manager of a limited liability company or as an officer of a corporation, unless he or she is [20] years of age or over, a citizen of the United States or an alien lawfully admitted for permanent residence in the United States. No person shall be entitled to a license as a real estate salesman under this [RPL art. 12-A (§§ 440–443-a)] unless he or she is over the age of [18] years. No person shall be entitled to a license as a real estate broker or real estate salesman under this [RPL art. 12-A (§§ 440–443-a)] who has been convicted in this state or elsewhere of a felony, of a sex offense, as defined in [Correction Law § 168-a] or any offense committed outside of this state which would constitute a sex offense, or a sexually violent offense, as defined in [Correction Law § 168-a] or any offense committed outside this state which would constitute a sexually violent offense, and who has not subsequent to such conviction received executive pardon therefor or a certificate of relief from disabilities or a certificate of good conduct pursuant to [Correction Law art. 23 (§§ 700–706)], to remove the disability under this [RPL § 440-a] because of such conviction. No person shall be entitled to a license as a real estate broker or real estate salesman under this [RPL art. 12-A (§§ 440–443-a)] who does not meet the requirements of [GOL § 3-503].

Notwithstanding the above, tenant associations, and not-for-profit corporations authorized in writing by the [Commissioner of the NYC Department] charged with enforcement of the housing maintenance code of such city to manage residential property owned by such city or appointed by a court of competent jurisdiction to manage residential property owned by such city shall be exempt from the licensing provisions of this [RPL § 440-a] with respect to the properties so managed.

[RPL § 442] Statutory Excerpt or Summary

Splitting commissions.

1. No real estate broker shall pay any part of a fee, commission or other compensation received by the broker to any person for any service, help or aid rendered in any place in which this article is applicable, by such person to the broker in buying, selling, exchanging, leasing, renting or negotiating a loan upon

any real estate including the resale of a condominium unless such a person be a duly licensed real estate salesman regularly associated with such broker or a duly licensed real estate broker or a person regularly engaged in the real estate brokerage business in a state outside of New York; provided, however, that notwithstanding any other provision of this [RPL § 442], it shall be permissible for a real estate broker to pay any part of a fee, commission, or other compensation received to an unlicensed corporation or an unlicensed limited liability company if each of its shareholders or members, respectively, is associated as an individual with the broker as a duly licensed associate broker or salesman.

2. Furthermore, notwithstanding any other provision of law, it shall be permissible for a broker properly registered pursuant to the provisions of [GBL 352–359-h] who earns a commission on the original sale of a cooperative or homeowners association interest in real estate, including condominium units to pay any part of a fee, commission or other compensation received for bringing about such sale to a person whose principal business is not the sale or offering of cooperatives or homeowners association interests in real property, including condominium units in this state but who is either: (i) a real estate salesman duly licensed under this [RPL art. 12-A (§§ 440–443-a)] who is regularly associated with such broker; (ii) a broker duly licensed under this [RPL art. 12-A (§§ 440–443-a)]; or [(iii)] a person regularly engaged in the real estate brokerage business in a state outside of New York.

Except when permitted pursuant to the foregoing provisions of this [RPL §442], no real estate broker shall pay or agree to pay any part of a fee, commission, or other compensation received by the broker, or due, or to become due to the broker to any person, firm or corporation who or which is or is to be a party to the transaction in which such fee, commission or other compensation shall be or become due to the broker; provided, however, that nothing in this section shall prohibit a real estate broker from offering any part of a fee, commission, or other compensation received by the broker to the seller, buyer, landlord or tenant who is buying, selling, exchanging, leasing, renting or negotiating a loan upon any real estate including the resale of a condominium or cooperative apartment. Such fee,

commission, or other compensation must not be made to the seller, buyer, landlord or tenant for performing any activity requiring a license under this article.

COMMENTARY

The proviso in the second half of the last paragraph was added relatively recently. It confirms brokers can “split” part of their commission with their clients, but only if the clients don’t do any work that requires a real estate license. This conforms to the informal position previously expressed by the Department of State, which regulates brokers. The change should now make it impossible for brokers to assert (as they previously often did) that any such fee-sharing is illegal.

Real Estate Brokers—Requirements

CROSS-REFERENCE

See “Real Estate Brokers.”

Real Estate Brokers—Lien

[RPL § 294-b] Statutory Excerpt or Summary

COMMENTARY

RPL § 294-b allows only residential brokers to record or file affidavits claiming an entitlement to a commission. Commercial leasing brokers can claim mechanics’ liens for unpaid brokerage commissions, but they must have been engaged under a written (not oral) contract. This technique does more than create nuisance value. *See* “Mechanic’s Liens” (LIE § 2(4)). Licensed brokers can claim commissions even without written agreements. *See* “Statute of Frauds” (GOL § 5-701).

Recording

[RPL § 290] Statutory Excerpt or Summary

Definitions; effect of article.

1. The term “real property,” as used in this [RPL art. 9 (§§ 290–336)], includes lands, tenements and hereditaments and chattels real, except a lease for a term not exceeding three years.

2. The term “purchaser” includes every person to whom any estate or interest in real property is conveyed for a valuable consideration, and every assignee of a mortgage, lease or other conditional estate.

3. The term “conveyance” includes every written instrument, by which any estate or interest in real property is created, transferred, mortgaged or assigned, or by which the title to any real property may be affected, including an instrument in execution of a power, although the power be one of revocation only, and an instrument postponing or subordinating a mortgage lien; except a will, a lease for a term not exceeding three years, an executory contract for the sale or purchase of lands, and an instrument containing a power to convey real property as the agent or attorney for the owner of such property.

4. The term “recording officer” means the county clerk of the county, except in a county having a register, where it means the register of the county.

5. “Recording” or “recorded” means the entry, at length, upon the pages of the proper record books in a plain and legible hand writing, or in print or in symbols of drawing or by photographic process or partly in writing, partly in printing, partly in symbols of drawing or partly by photographic process or by any combination of writing, printing, drawing or photography or either or any two of them, or by an electronic process by which a record or instrument affecting real property, after delivery is incorporated into the public record.. “Recording” or “recorded” also means the reproduction of instruments by microphotography or other photographic process on film, which is kept in appropriate files.

6. This [RPL art. 9 (§§ 290–336)] does not apply to leases for life or lives, or for years, heretofore made, of lands in any of the counties of Albany, Ulster, Sullivan, Herkimer, Dutchess, Columbia, Delaware or Schenectady.

COMMENTARY AND CROSS-REFERENCES

Rules on the form of conveyancing instruments, or instruments that otherwise affect estates in real property, can be counterintuitive. For example, in one case the parties used a “fence line affidavit” to resolve minor ques-

tions about the proper location of a fence and a property boundary. This approach tracked local practice (“everyone does it this way”). A court later decided, though, that if the signer of the “fence line affidavit” had as a matter of law already acquired title by adverse possession to the strip of land at issue, then a “fence line affidavit” could not divest such title, only a deed. Although many question the result, after this decision real estate lawyers may hesitate to use a “fence line affidavit” ever again. Decisions like these drive the ever increasing complexity and paper-intensity of New York closings, as well as the popularity of the New York courts for creative claims of all types.

See “Memorandum of Lease.”

See “Taxation—Transfer Tax” regarding leases, the fees imposed, and exemptions. In addition, the recording offices impose nominal fees and occasional extra fees to record documents. *See, e.g.*, RPL § 316-a(10) (extra fee of \$1.00 for every additional town after the first where the affected real property is located).

[RPL § 291] Statutory Excerpt or Summary

Recording of conveyances.

A conveyance of real property, within the state, on being duly acknowledged by the person executing the same, or proved as required by this [RPL §§ 1 to 602], and such acknowledgment or proof duly certified when required by this [RPL §§ 1 to 602] may be recorded in the office of the clerk of the county where such real property is situated, and such county clerk shall, upon the request of any party, on tender of the lawful fees therefor, record the same in his said office. Every such conveyance not so recorded is void as against any person who subsequently purchases or acquires by exchange or contracts to purchase or acquire by exchange, the same real property or any portion thereof, or acquires by assignment the rent to accrue therefrom as provided in [RPL § 294-a], in good faith and for a valuable consideration, from the same vendor or assignor, his distributees or devisees, and whose conveyance, contract or assignment is first duly recorded, and is void as against the lien upon the same real property or any portion thereof arising from payments made upon the execution of or pursuant to the terms of a contract with the same vendor, his distributees or devisees, if such contract is made in good faith and is first duly recorded.

Notwithstanding the foregoing, any increase in the principal balance of a mortgage lien by virtue of the addition thereto of unpaid interest in accordance with the terms of the mortgage shall retain the priority of the original mortgage lien as so increased provided that any such mortgage instrument sets forth its terms of repayment.

COMMENTARY

Recording of a document in New York entails preparing and submitting a variety of tax returns and sometimes affidavits, depending on what is being recorded. *See, e.g.*, RPL § 333. In some cases, New York law imposes a fee for the privilege of filing one of these tax returns. If a memorandum of lease is recorded, then notice of any future amendment must be recorded. For these and other reasons, the parties do not always record memoranda of leases, especially for leases affecting smaller premises or shorter terms, or where the tenant takes possession immediately. Failure to record does not eliminate any transfer tax that would otherwise apply, though.) For more, *see* “Memorandum of Lease.”

[RPL § 291-i] Statutory Excerpt or Summary

Validity of electronic recording.

1. Notwithstanding any law to the contrary,

(a) where a law, rule or regulation requires, as a condition for recording, that an instrument affecting real property be an original, be on paper or another tangible medium or be in writing, the requirement is satisfied by a digitized paper document or an electronic record of such instrument;

(b) where a law, rule or regulation requires, as a condition for recording, that an instrument affecting real property be signed, the requirement is satisfied, where the instrument exists as a digitized paper document, if the digitized image of a wet signature of the person executing such instrument appears on such digitized paper document or, where the instrument exists as an electronic record, if the instrument is signed by use of an electronic signature;

(c) where a law, rule or regulation requires, as a condition of recording, that an instrument affecting real property or a signature associated with such an instrument be notarized, acknowl-

edged, verified, witnessed or made under oath, the signature requirement is satisfied if: (i) the digitized image of a wet signature of the person authorized to perform that act and any stamp, impression or seal required by law to be included, appears on a digitized paper document of such instrument; or (ii) the electronic signature of the person authorized to perform that act, and all other information required to be included, is attached to or logically associated with an electronic record of such instrument, provided, however that no physical or electronic image of a stamp, impression or seal shall be required to accompany such electronic signature.

(d) where a law, rule or regulation requires, as a condition of recording an instrument affecting real property, that any accompanying document be filed therewith, the requirement is satisfied if, in the case of recording by electronic means, a digitized paper document or electronic record of any such accompanying document is presented to the recording officer at the same time as such instrument is recorded by electronic means; provided that each such document or record shall be presented to the recording officer as a separate digitized paper document or electronic record unto itself.

2. A digitized paper document or documents shall be created using a software application or other electronic process which stores an image of the original paper document or documents, and which does not permit additions, deletions or other changes to the digitized image, or if additions, deletions or changes are permitted, a media trail exists which creates an electronic record which makes it possible to identify these changes.

3. Nothing in this section or any other provision of law shall be construed to require the recording by electronic means of instruments affecting real property. The decision by each county clerk to participate in electronic recording is discretionary. Once a county clerk permits electronic recording, the county shall accept such electronic recordings.

4. Where any recording officer permits instruments affecting real property and any accompanying documents to be presented for recording or filing as digitized paper documents or electronic records pursuant to this section, such recording by

electronic means shall be in accordance with the rules and regulations established by the electronic facilitator pursuant to subdivision five of this section.

5. In order to ensure consistency in the standards and practices of, and the technology used by recording officers in the state, the electronic facilitator, as described in section three hundred three of the state technology law, shall, consistent with the provisions of article three of the state technology law, promulgate rules and regulations, and amendments thereto, as appropriate governing the use and acceptance of digitized paper documents, electronic records and electronic signatures under this article. Such authority shall address and be limited to standards requiring adequate information security protection to ensure that electronic records of instruments affecting real property documents are accurate, authentic, adequately preserved for long-term electronic storage and resistant to tampering. When promulgating rules and regulations, the electronic facilitator may take into consideration: (a) the most recent standards promulgated by national standard-setting bodies such as, without limitation, the property records industry association; (b) the views of interested persons and governmental officials and entities, including but not limited to recording officers and representatives of the state title, legal and banking industries; and (c) the needs of counties of varying size, population, and resources.

6. Nothing contained in this section shall be construed to authorize a recording officer to furnish digitized paper documents of the reports required by section five hundred seventy-four of the real property tax law. Such reports shall be furnished as paper documents with the requisite notations thereon, except where the state board of real property services has agreed to accept data submissions in lieu thereof or has provided for the electronic transmission of such data pursuant to law.

[RPL § 294] Statutory Excerpt or Summary

Recording executory contracts and powers of attorney.

1. An executory contract for the sale, purchase or exchange of real property, or an instrument canceling such a contract, or an

instrument containing a power to convey real property, as the agent or attorney for the owner of the property, acknowledged or proved, and certified, in the manner to entitle a conveyance to be recorded, may be recorded in the office of the recording officer of any county in which any of the real property to which it relates is situated, and such recording officer shall, upon the request of any party, on tender of the lawful fees therefor, record the same in his said office.

2. In lieu of the recording of an executory contract, there may be recorded a memorandum thereof, executed by the parties, and acknowledged or proved, and certified, in the manner to entitle a conveyance to be recorded, containing at least the following information with respect to the contract: the names of the parties to the contract, the time fixed by the contract for the conveyance of title, and a description of the property. The executory contract shall be deemed duly recorded upon the recording of a memorandum in conformity with this [RPL § 294(2)].

If the purchaser is entitled to possession of the property under the terms of the contract, the memorandum must so state. The provisions of [TAX art. 11 (§§ 250 to 267)] shall not be applicable to an executory contract for the sale, purchase or exchange of real property, or memorandum thereof, unless the contract provides that the purchaser is entitled to possession of the property.

3. Every executory contract for the sale, purchase or exchange of real property not recorded as provided in this [RPL § 294] shall be void as against any person who subsequently purchases or acquires by exchange or contracts to purchase or acquire by exchange, the same real property or any portion thereof, or acquires by assignment the rent to accrue therefrom as provided in [RPL § 294-a], in good faith and for a valuable consideration, from the same vendor or assignor, his distributees or devisees, and whose conveyance, contract or assignment is first duly recorded, and shall be void as against the lien upon the same real property or any portion thereof arising from payments made upon the execution of or pursuant to the terms of a contract with the same vendor, his distributees or devisees, if such contract is made in good faith and is first duly recorded.

4. (a) Where an executory contract is duly recorded as provided in this [RPL § 294] the right of the purchaser to performance of the contract is enforceable against a person who, subsequent to the recording and while the recording is effective as provided in this [RPL § 294], purchases or acquires by exchange the same real property or any part thereof, from the same vendor, his distributees or devisees.

(b) If the recorded contract provides for payments made or to be made by the purchaser before conveyance of title, including payments made at the execution of the contract, or if the recorded memorandum states that the contract so provides, the lien of the purchaser arising from any such payments actually made is enforceable against any such person described in [RPL § 294(4)(a),] to the extent of such payments, not exceeding the total amount specified in the recorded contract or memorandum, and is so enforceable without regard to any notice of the estate or interest of such person.

5. The recording of the executory contract or memorandum shall be effective for the purposes of [RPL § 294(4)] up to and including the [30th] day after the day fixed by the contract for the conveyance of title. An agreement extending the time for the conveyance of title, acknowledged or proved, and certified, in the manner to entitle a conveyance to be recorded, may be recorded, and the recording shall be effective up to and including the [30th] day after the day fixed by such agreement for the conveyance of title.

6. An executory contract or memorandum thereof shall not be deemed recorded as provided in this [RPL § 294] if it is recorded more than one year previous to the date on which the vendor acquired title to the real property to which the contract relates. An executory contract recorded before the date when the vendor acquired title shall not be deemed recorded as provided in this [RPL § 294] as against a person to whom the real property is conveyed or contracted to be sold or exchanged, by a conveyance or contract which is part of the transaction in which the vendor acquired title.

7. An option to purchase or lease real property shall be deemed an executory contract within the meaning of this [RPL § 294], except that the recording of the option agreement shall be

effective only up to and including the [30th] day after the last day fixed by the agreement for the exercise of the option. If the option is exercised in accordance with the terms of the option agreement, the optionee may extend the effectiveness of the recording of the option agreement to and including the [30th] day after the day fixed pursuant to the option agreement for the conveyance of title or the execution and delivery of the lease, as the case may be, by recording, within [30] days after the last day fixed by the option agreement for the exercise of the option, a written declaration executed by the optionor and the optionee, or by the optionee alone, and acknowledged or proved and certified in the manner to entitle a conveyance to be recorded, stating that the said option has been duly exercised and setting forth the day fixed pursuant to the option agreement for the conveyance of title or the execution and delivery of the lease, as the case may be. In the event that such declaration is executed by the optionee alone, it shall be verified by the optionee and shall also set forth the time and manner in which such option was exercised and, if the last day for the conveyance of title or the execution and delivery of the lease is not specified in the option agreement, the extension of the effectiveness of the recording of the option agreement shall in no event exceed [90] days from the date of the recording of such declaration.

8. (a) After the recording of an executory contract or memorandum has ceased to be effective as provided in [RPL § 294(5)] or the recording of an option to purchase or lease real property has ceased to be effective as provided in [RPL § 294(7)], such executory contract, memorandum or option shall be (1) void as against a subsequent purchaser in good faith and for a valuable consideration, who has no other notice of an estate or interest of the contract vendee or optionee in the premises to which such contract, memorandum or option refers, or of any claim thereof, and (2) ineffective to give notice to such subsequent purchaser of any estate or interest of the contract vendee or optionee in such premises, or of any claim thereof, or to create any duty of inquiry with respect thereto.

(b) For the purposes of this [RPL § 294(8)(b)], “purchaser” includes a person who purchases or acquires by exchange or

contracts to purchase or acquire by exchange the same premises or any portion thereof or estate or interest therein, or acquires by assignment the rent to accrue from tenancies or subtenancies thereof in existence at the time of the assignment.

COMMENTARY

If the parties record a contract (or memorandum thereof), this does not change its “executory” character for bankruptcy purposes.

A memorandum of contract will typically not mention the vendee's lien for the down payment, for fear of attracting a mortgage recording tax.

Although the statute says a memorandum of contract (or option) remains effective for a stated period, attorneys sometimes worry that a court might extend its effectiveness. Thus, property owners sometimes hesitate to use this mechanism.

Redemption

[RPAPL § 761] Statutory Excerpt or Summary

Redemption by lessee.

Where the special [summary eviction] proceeding is founded upon an allegation that a lessee holds over after a default in the payment of rent, and the unexpired term of the lease under which the premises are held exceeds five years at the time when the warrant is issued the lessee, his executor, administrator or assignee, at any time within one year after the execution of the warrant, unless by the terms of the lease such lessee shall have waived his right to redeem, or such lessee, executor, administrator or assignee shall have subsequently waived the right to redeem by a written instrument filed and recorded in the office in which the lease is recorded, or if not so recorded, in the office in which deeds are required to be recorded of the county in which the leased premises are located, may pay or tender to the petitioner, his heir, executor, administrator or assignee, or if, within five days before the expiration of the year he cannot be found with reasonable diligence within the city or town wherein the property or a portion thereof is situated, then to the court which issued the warrant, all rent in arrears at the time of the payment or tender with interest thereupon and the costs and charges incurred by the petitioner.

Thereupon the person making the payment or tender shall be entitled to the possession of the demised premises under the lease and may hold and enjoy the same according to the terms of the original demise, except as otherwise prescribed in [RPAPL § 765].

COMMENTARY

Any New York commercial lease typically includes a waiver of the tenant's right of redemption. Without such a waiver, the tenant's redemption right can extend for one year. In addition to a generic waiver of any right of redemption the tenant might have, landlord's counsel may want to include in a New York commercial lease language like this:

Tenant waives any right of redemption under Real Property Actions and Proceedings Law § 761.

Subsequent sections of RPAPL flesh out the redemption process. These sections say, among other things, that a leasehold mortgagee can also exercise the lessee's redemption right—but must do so by 2 p.m. on the day after the lessee's redemption right expires, excluding Sundays and public holidays. *See* RPAPL § 763.

Renewal

[GOL § 5-905]

Certain provisions of leases to be inoperative unless express notice thereof is given to tenant.

No provision of a lease of any real property or premises which states that the term thereof shall be deemed renewed for a specified additional period of time unless the tenant gives notice to the lessor of his intention to quit the premises at the expiration of such term shall be operative unless the lessor, at least [15] days and not more than [30] days previous to the time specified for the furnishing of such notice to him, shall give to the tenant written notice, served personally or by registered or certified mail, calling the attention of the tenant to the existence of such provision in the lease.

The Legislature has determined that consenting adults who enter into leases (including commercial leases) in NYS should never reliably be able to negotiate and enforce lease provisions

that say the lease renews automatically, unless the tenant gives notice to the contrary. On the other hand, the requirement that landlord remind tenant of the automatic renewal is not bizarre or burdensome— especially if one assumes an average typical commercial landlord is better-equipped than an average typical commercial tenant to maintain reliable long-term calendaring systems for leases. What happens if the landlord forgets (or deliberately fails) to send the reminder notice? Does the tenant become a tenant at will? What if the tenant didn't want to be protected from the automatic renewal? If one were arguing against the adoption of this statute, one would argue that unanswered questions like these would open the floodgates of litigation. In fact, the statute has produced relatively little reported litigation, yielding somewhat inconsistent answers to the questions just asked. If landlord's or tenant's counsel issues an opinion on the enforceability of lease with automatic renewals, the opinion should perhaps mention this statute. Landlords and tenants concerned about this statute may be able to restructure their transaction as a long-term lease with early cancellation options, which may be a more transparent and appropriate way to reach the same result.

Rent

[No applicable statute]

COMMENTARY

Most of the statutes collected here affect or relate to rent in some way, direct or indirect.

Rent Control

[No applicable statute]

COMMENTARY

Although NYC suffers the consequences of 50 years of residential rent control, occasional efforts to extend those rules to commercial leases always fail. After the 2014 NYC elections, some observers expected new efforts to enact commercial rent control. It didn't happen. As of early 2017, retail rents in Manhattan are declining, after having experienced dramatic increases since the Financial Crisis. Markets adjust.

Rule Against Perpetuities

[EPTL § 9-1.1]

Rule against perpetuities.

(a)(1) The absolute power of alienation is suspended when there are no persons in being by whom an absolute fee or estate in possession can be conveyed or transferred.

(2) Every present or future estate shall be void in its creation which shall suspend the absolute power of alienation by any limitation or condition for a longer period than lives in being at the creation of the estate and a term of not more than [21] years. Lives in being shall include a child conceived before the creation of the estate but born thereafter. In no case shall the lives measuring the permissible period be so designated or so numerous as to make proof of their end unreasonably difficult.

(b) No estate in property shall be valid unless it must vest, if at all, not later than [21] years after one or more lives in being at the creation of the estate and any period of gestation involved. In no case shall lives measuring the permissible period of vesting be so designated or so numerous as to make proof of their end unreasonably difficult.

[EPTL § 9-1.2]

Reduction of age contingency.

Where an estate would, except for this [EPTL § 9-1.2], be invalid because made to depend, for its vesting or its duration, upon any person attaining or failing to attain an age in excess of [21] years, the age contingency shall be reduced to [21] years as to any or all persons subject to such contingency.

[EPTL § 9-1.3]

Rules of construction.

(a) Unless a contrary intention appears, the rules of construction provided in [EPTL § 9-1.3] govern with respect to any matter affecting the rule against perpetuities.

(b) It shall be presumed that the creator intended the estate to be valid.

(c) Where an estate would, except for this [EPTL § 9-1.3(c)], be invalid because of the possibility that the person to whom it is given or limited may be a person not in being at the time of the creation of the estate, and such person is referred to in the instrument creating such estate as the spouse of another without other identification, it shall be presumed that such reference is to a person in being on the effective date of the instrument.

(d) Where the duration or vesting of an estate is contingent upon the probate of a will, the appointment of a fiduciary, the location of a distributee, the payment of debts, the sale of assets, the settlement of an estate, the determination of questions relating to an estate or transfer tax or the occurrence of any specified contingency, it shall be presumed that the creator of such estate intended such contingency to occur, if at all, within [21] years from the effective date of the instrument creating such estate.

(e)(1) Where the validity of a disposition depends upon the ability of a person to have a child at some future time, it shall be presumed, subject to [EPTL § 9-1.3(e)(2)], that a male can have a child at [14] years of age or over, but not under that age, and that a female can have a child at [12] years of age or over, but not under that age or over the age of [55] years.

(2) In the case of a living person, evidence may be given to establish whether he or she is able to have a child at the time in question.

(3) Where the validity of a disposition depends upon the ability of a person to have a child at some future time, the possibility that such person may have a child by adoption shall be disregarded.

(4) The provisions of [EPTL § 9-1.3(e)(1), (e)(2), and (e)(3)] shall not apply for any purpose other than that of determining the validity of a disposition under the rule against perpetuities where such validity depends on the ability of a person to have a child at some future time. A determination of validity or inva-

lidity of a disposition under the rule against perpetuities by the application of [EPTL § 9-1.3(e)(1), (e)(2), or (e)(3)] shall not be affected by the later occurrence of facts in contradiction to the facts presumed or determined or the possibility of adoption disregarded under [EPTL § 9-1.3(e)(1), (e)(2), or (e)(3)].

COMMENTARY

New York's rule against perpetuities is chronically the subject of proposals for reform. In one recent case, the courts used the rule against perpetuities to invalidate a purchase option in a lease. The option structure had been created in favor of a commercial lessee so a private developer could benefit from the tax exemption of a community-based not-for-profit performance hall. If the court had let the developer exercise the option, the performance hall might have been rendered homeless. The Rule Against Perpetuities resurfaced in *Bleecker St. Tenants Corp. v. Bleecker Jones, LLC*, 16 N.Y.3d 272 (2011). There, a 14-year lease had nine nine renewal options, each for ten years. Based on a very technical interpretation of prior law, an intermediate appellate court decided most of these options violated the Rule and unreasonably restrained alienation. (Here, the beneficiary of the decision was a residential cooperative corporation rather than a community-based not-for-profit performance hall.) The Court of Appeals, the state's highest court, reversed, holding that the Rule does not apply to options to renew a lease. Despite the reversal, the case reminds New York real estate lawyers that the Rule remains alive and well, potentially waiting to frustrate the parties' expectations for any long-term transaction.

[RPAPL § 1901] Statutory Excerpt or Summary

Release of rents reserved by leases in perpetuity.

1. Any person interested in lands held under a lease in perpetuity, upon which no rent has been paid for at least [20] years, may present his petition to the courts mentioned in this section asking that it be declared that the rents and reversion have been released to the owner of the fee. Such petition shall be verified, shall describe the lease and allege that the rents and reversion have been released, and shall state such facts as the petitioner can ascertain relative to the execution of a release and the identity of the persons who would otherwise be the present owners of the rents and reversion and the last known owner thereof.

2. Such petition may be presented to the supreme court or to the county court of the county where the lands are situated. The court may thereupon order all persons interested to show cause at a certain time and place why the rents and reversion should not be declared to have been released. A description of the lease and lands affected thereby and the name of the last known owner of the rents and reversion shall be specified in such order, and the order shall be published in such newspaper or newspapers and for such time as the court shall direct. The court may also direct the order to be personally served upon such persons as it shall designate.

3. The court may issue commissions to take the testimony of witnesses and may refer the petition to a referee to take and report proofs of the facts stated in the petition. Upon being satisfied that the matters alleged in the petition are true, the court may make an order declaring that the rents and reversion have been released to the owner of the fee. The nonpayment of rent under any such lease for [20] years shall be presumptive evidence of such a release.

4. The entry of such order in the office of the clerk of the county where such lands are situated shall have the same effect as a release of such rents and reversion to such owner then duly executed and recorded. The county clerk shall note on the margin of the record of the original lease a minute of the entry of such order.

COMMENTARY

RPAPL § 1901 in effect allows fee owners under dormant perpetual leases to extinguish the interests of third parties in the rents and reversions. Limited research disclosed no reported cases on this statute.

Rules Against Perpetuities—Uniform Statutory Rule Against Perpetuities

[No applicable statute]

COMMENTARY

New York has not adopted the Uniform Statutory Rule Against Perpetuities and has instead adopted the language in EPTL § 9-1.1. *See* “Rule Against Perpetuities.”

Rules of Construction

COMMENTARY

Nothing specific to commercial leases.

Security Deposits

[GOL § 7-103]

Money deposited or advanced for use or rental of real property; waiver void; administration expenses.

1. Whenever money shall be deposited or advanced on a contract or license agreement for the use or rental of real property as security for performance of the contract or agreement or to be applied to payments upon such contract or agreement when due, such money, with interest accruing thereon, if any, until repaid or so applied, shall continue to be the money of the person making such deposit or advance and shall be held in trust by the person with whom such deposit or advance shall be made and shall not be mingled with the personal moneys or become an asset of the person receiving the same, but may be disposed of as provided in [GOL § 7-105].

2. Whenever the person receiving money so deposited or advanced shall deposit such money in a banking organization, such person shall thereupon notify in writing each of the persons making such security deposit or advance, giving the name and address of the banking organization in which the deposit of security money is made, and the amount of such deposit. Deposits in a banking organization pursuant to the provisions of this [GOL § 7-103(2)] shall be made in a banking organization having a place of business within the state. If the person depositing such security money in a banking organization shall deposit same in an interest bearing account, he shall be entitled to receive, as administration expenses, a sum equivalent to [1%] per annum upon the security money so deposited, which shall be in lieu of all other administrative and custodial expenses. The balance of the interest paid by the banking organization shall be the money of the person making the deposit or advance and shall either be held in trust by the person with whom such deposit or advance shall be made, until repaid or

applied for the use or rental of the leased premises, or annually paid to the person making the deposit of security money.

2-a. Whenever the money so deposited or advanced is for the rental of property containing six or more family dwelling units, the person receiving such money shall, subject to the provisions of this [GOL § 7-103], deposit it in an interest bearing account in a banking organization within the state which account shall earn interest at a rate which shall be the prevailing rate earned by other such deposits made with banking organizations in such area.

2-b. In the event that a lease terminates other than at the time that a banking organization in such area regularly pays interest, the person depositing such security money shall pay over to his tenant such interest as he is able to collect at the date of such lease termination.

3. Any provision of such a contract or agreement whereby a person who so deposits or advances money waives any provision of this [GOL § 7-103] is absolutely void.

4. The term “real property” as used in this [GOL § 7-103] is co-extensive in meaning with lands, tenements and hereditaments.

COMMENTARY

The state’s general statute on security deposits requires the landlord to maintain security deposits separately from other funds, but does not (except in the case of apartment buildings with six or more units) otherwise obligate the landlord to do anything in particular with security deposits. Perhaps the commercial landlord can keep the security deposits in a mattress as long as it is a separate mattress. If the landlord deposits such funds in a “banking organization,” which almost all landlords do, then certain consequences follow. Among other things, the landlord must “thereupon notify” the tenant of the name and address of the bank and the amount of the security deposit. Landlords should take care to satisfy the notice provisions of GOL § 7-103, a statute strictly construed in favor of tenants. Notification in the lease of the depository bank may not suffice. Instead, to satisfy the statutory notice provisions, a landlord must notify the tenant of the depository bank name and address, and the amount of the deposit, after making the deposit. (The statute says the landlord must

deposit the funds and “thereupon” notify the tenant. That's what it says. And the courts tend to interpret landlord-tenant statutes strictly against the landlord.) Although “improper” (i.e., early) notice will not by itself necessarily cause a court to require the landlord to “disgorge” the deposit, it does create an adverse inference of commingling and conversion that the landlord must affirmatively rebut. *See McMaster v. Pearse*, 804 N.Y.S.2d 640 (Civ. Ct. 2005). New York landlords should and typically do take the statutory requirements quite seriously. In New York, landlords cannot use security deposits as “found money” to avoid the need to borrow elsewhere—a financing technique that is a cornerstone for some major real estate investment trusts whose leases are not generally governed by New York law.

A landlord may want to include the following language in a lease, which may not satisfy the statute for the reasons stated earlier. This paragraph just restates New York law, so it doesn't seem strictly necessary, but many tenants ask for it and it's a good reminder for landlords:

To the extent General Obligations Law § 7-103 requires: (a) Landlord shall deposit the Security in an account at a bank with a place of business in the State; (b) if the Building contains six or more family dwelling units, then that account shall earn interest at the prevailing rate earned by similar deposits with banks in the State; (c) Tenant acknowledges that Landlord has Notified²³ Tenant that Landlord shall deposit the Security at _____ Bank located at _____; (d) if the Security is deposited in an interest-bearing account, then Landlord shall be entitled to receive, as administration expenses, 1% per annum of the Security; and (e) any other interest paid by the bank shall belong to Tenant and Landlord shall hold it in trust until repaid, applied to Rent, or annually paid to Tenant.

In today's interest rate environment, interest earnings rarely exceed the landlord's 1% administrative fee. Most landlords keep the interest earnings and call it a day.

[GOL § 7-105] Statutory Excerpt or Summary

23 The statute may require Landlord to give this Notice only after the Security has been deposited. If so, Landlord must remember to give a separate Notice after the fact. N.Y. Gen. Oblig. Law § 7-103 (McKinney 2016).

Landlord failing to turn over deposits made by tenants or licensees and to notify tenants or licensees thereof in certain cases.

1. Any person, firm or corporation and the employers, officers or agents thereof, whether the owner or lessee of the property leased, who or which has or hereafter shall have received from a tenant or licensee a sum of money or any other thing of value as a deposit or advance of rental as security for the full performance by such tenant or licensee of the terms of his lease or license agreement, or who or which has or shall have received the same from a former owner or lessee, shall, upon conveying such property or assigning his or its lease to another, or upon the judicial appointment and qualifying of a receiver in an action to foreclose a mortgage or other lien of record affecting the property leased, or upon the conveyance of such property to another person, firm or corporation by a referee in an action to foreclose a mortgage or other lien of record affecting the property leased if a receiver shall not have been appointed and qualified in such action, at the time of the delivery of the deed or instrument or assignment or within five days thereafter, or within five days after the receiver shall have qualified, deal with the security deposit as follows: Turn over to his or its grantee or assignee, or to the receiver in the foreclosure action, or to the purchaser at the foreclosure sale if a receiver shall not have been appointed and qualified the sum so deposited, and notify the tenant or licensee by registered or certified mail of such turning over and the name and address of such grantee, assignee, purchaser or receiver.

2. Any owner or lessee turning over to his or its grantee, assignee, to a purchaser of the leased premises at a foreclosure sale, or to the receiver in the foreclosure action the amount of such security deposit is hereby relieved of and from liability to the tenant or licensee for the repayment thereof; and the transferee of such security deposit is hereby made responsible for the return thereof to the tenant or licensee, unless he or it shall thereafter and before the expiration of the term of the tenant's lease or licensee's agreement, transfer such security deposit to another, pursuant to [GOL § 7-105(1)] and give the requisite notice in connection therewith as provided thereby. A receiver shall hold the security subject to such disposition thereof as

shall be provided in an order of the court to be made and entered in the foreclosure action. The provisions of this [GOL § 7-105] shall not apply if the agreement between the landlord and tenant or licensee is inconsistent herewith.

3. Any failure to comply with this [GOL § 7-105] is a misdemeanor.

COMMENTARY

This statute obligates a landlord to turn over security deposits to the new owner of the property, including a receiver or a foreclosure sale purchaser, upon theoretical threat of criminal prosecution. GOL § 7-105(1) requires the transferor to give prompt notice to the tenant of the disposition of the security deposit, whereupon the transferor is relieved of liability. The statute does not expressly excuse the grantee from any liability if the grantee failed to receive the security deposit from the grantor, but such a result can reasonably be inferred. No available reported case confirms that result. If that inference is correct, then foreclosing lenders are already protected against liability for security deposits they did not actually receive, and hence (arguably) it may be duplicative to address the issue in nondisturbance agreements. Different rules apply for residential leases, depending on whether the tenant is protected by New York's rent regulation schemes. *See* GOL §§ 7-107 and 7-108.

Security Interests in Rents

[No applicable statute]

COMMENTARY

As in most other states, New York commercial mortgage lenders obtain and record an "assignment of rents" in addition to a mortgage. *See* "Assignment of Rents."

Statute of Frauds

[GOL § 5-701]

Agreements required to be in writing.

[GOL § 5-701(a)(1) and (a)(10)]

a. Every agreement, promise or undertaking is void, unless it or some note or memorandum thereof be in writing, and subscribed by the party to be charged therewith, or by his lawful agent, if such agreement, promise or undertaking:

1. By its terms is not to be performed within one year from the making thereof or the performance of which is not to be completed before the end of a lifetime;

10. Is a contract to pay compensation for services rendered in negotiating a loan, or in negotiating the purchase, sale, exchange, renting or leasing of any real estate or interest therein, or of a business opportunity, business, its good will, inventory, fixtures or an interest therein, including a majority of the voting stock interest in a corporation and including the creating of a partnership interest. "Negotiating" includes procuring an introduction to a party to the transaction or assisting in the negotiation or consummation of the transaction. This [GOL § 5-701(a)(10)] shall apply to a contract implied in fact or in law to pay reasonable compensation but shall not apply to a contract to pay compensation to an auctioneer, an attorney at law, or a duly licensed real estate broker or real estate salesman.

[GOL § 5-701(b)(4)]

4. For purposes of this subdivision,²⁴ the tangible, written text produced by telex, telefacsimile, computer retrieval or other process by which electronic signals are transmitted by telephone or otherwise shall constitute a writing and any symbol executed or adopted by a party with the present intention to authenticate a writing shall constitute a signing. The confirmation and notice of objection referred to in subparagraph (b) of paragraph three of this subdivision may be communicated by means of telex, telefacsimile, computer or other similar process by which electronic signals are transmitted by telephone or otherwise, provided that a party claiming to have communicated in such a manner shall, unless the parties have otherwise agreed in writing, have the burden of establishing actual or

24 See Commentary below for meaning of "subdivision."

constructive receipt by the other party as set forth in subparagraph (b) of paragraph three of this subdivision.

COMMENTARY

Under this statute, licensed real estate brokers—and attorneys (who generally do not need a brokerage license to perform brokerage services)—can claim compensation without a written agreement. *See* “Guaranty—Statute of Frauds.”

GOL § 701(b)(4) by its terms seems to refer only to GOL § 701(b), which relates to “qualified financial contracts.” For better or worse, at least one appellate court seems to have applied GOL § 701(b)(4) to real estate brokerage contracts. *Newmark & Co. Real Estate Inc. v. 2615 East 17 St. Realty LLC*, 914 N.Y.S.2d 162, 80 A.D.3d 476 (N.Y. App. Div. 2011). Even if such application was incorrect, GOL § 701(b)(4) does set out reasonable principles, which a court might well follow as a matter of common law or judicial discretion.

As in other states, anyone considering the statute of frauds should also consider the effect of recent state and federal legislation on electronic signatures.

[GOL § 5-703] Statutory Excerpt or Summary

Conveyances and contracts concerning real property required to be in writing.

1. An estate or interest in real property, other than a lease for a term not exceeding one year, or any trust or power, over or concerning real property, or in any manner relating thereto, cannot be created, granted, assigned, surrendered or declared, unless by act or operation of law, or by a deed or conveyance in writing, subscribed by the person creating, granting, assigning, surrendering or declaring the same, or by his lawful agent, thereunto authorized by writing. But this [GOL § 5-703(1)] does not affect the power of a testator in the disposition of his real property by will; nor prevent any trust from arising or being extinguished by implication or operation of law, nor any declaration of trust from being proved by a writing subscribed by the person declaring the same.

2. A contract for the leasing for a longer period than one year, or for the sale, of any real property, or an interest therein, is

void unless the contract or some note or memorandum thereof, expressing the consideration, is in writing, subscribed by the party to be charged, or by his lawful agent thereunto authorized by writing.

3. A contract to devise real property or establish a trust of real property, or any interest therein or right with reference thereto, is void unless the contract or some note or memorandum thereof is in writing and subscribed by the party to be charged therewith, or by his lawfully authorized agent.

4. Nothing contained in this [GOL § 5-703] abridges the powers of courts of equity to compel the specific performance of agreements in cases of part performance.

[GOL § 5-1103] Statutory Excerpt or Summary

Written agreement for modification or discharge. An agreement, promise or undertaking to change or modify, or to discharge in whole or in part, any contract, obligation, or lease, or any mortgage or other security interest in personal or real property, shall not be invalid because of the absence of consideration, provided that the agreement, promise or undertaking changing, modifying, or discharging such contract, obligation, lease, mortgage or security interest, shall be in writing and signed by the party against whom it is sought to enforce the change, modification or discharge, or by his agent.

COMMENTARY

Notwithstanding this statute, the parties usually recite delivery of consideration for any written modification of a contract.

[GOL § 5-1111] Statutory Excerpt or Summary

Execution by agent in real property transactions; written authorization required.

If executed by an agent, any agreement, promise, undertaking, assignment or offer required by [GOL § 5-1103]...to be in writing, which affects or relates to real property or an interest therein in any manner stated in [GOL § 5-703(1) or (2)], shall be void unless such agent was thereunto authorized in writing.

[GOL § 15-301] Statutory Excerpt or Summary

When written agreement or other instrument cannot be changed by oral executory agreement, or discharged or terminated by oral executory agreement or oral consent or by oral notice.

1. A written agreement or other written instrument which contains a provision to the effect that it cannot be changed orally, cannot be changed by an executory agreement unless such executory agreement is in writing and signed by the party against whom enforcement of the change is sought or by his agent.

2. A written agreement or other written instrument which contains a provision to the effect that it cannot be terminated orally, cannot be discharged by an executory agreement unless such executory agreement is in writing and signed by the party against whom enforcement of the discharge is sought, or by his agent, and cannot be terminated by mutual consent unless such termination is effected by an executed accord and satisfaction other than the substitution of one executory contract for another, or is evidenced by a writing signed by the party against whom is sought to enforce the termination, or by his agent.

3. a. A discharge or partial discharge of obligations under a written agreement or other written instrument is a change of the agreement or instrument for the purpose of [GOL § 15-301(1)] and is not a discharge or termination for the purpose of [GOL § 15-301(2)], unless all executory obligations under the agreement or instrument are discharged or terminated.

b. A discharge or termination of all executory obligations under a written agreement or other written instrument is a discharge or termination for the purpose of [GOL § 15-301(2)] even though accrued obligations remaining unperformed at the date of the discharge or termination are not affected by it.

c. If a written agreement or other written instrument containing a provision that it cannot be terminated orally also provides for termination or discharge on notice by one or either party, both [GOL § 15-301(2) and (4)] apply whether or not the agreement

or other instrument states specifically that the notice must be in writing.

4. If a written agreement or other written instrument contains a provision for termination or discharge on written notice by one or either party, the requirement that such notice be in writing cannot be waived except by a writing signed by the party against whom enforcement of the waiver is sought or by his agent.

5. If executed by an agent, any agreement, evidence of termination, notice of termination or waiver, required by this [GOL § 15-301] to be in writing, which affects or relates to real property or an interest therein as defined in [GOL § 5-101] in any manner stated in [GOL § 5-703(1) or (2)] shall be void unless such agent was thereunto authorized in writing.

6. As used in this [GOL § 15-301], the term “agreement” includes promise and undertaking.

COMMENTARY

Notwithstanding GOL § 15-301, New York courts sometimes recognize oral or implied waivers.

Statutes of Limitation

[CPLR § 212]

Actions to be commenced within [10] years.

[CPLR § 212(a) and (c)]

(a) Possession necessary to recover real property. An action to recover real property or its possession cannot be commenced unless the plaintiff, or his predecessor in interest, was seized or possessed of the premises within [10] years before the commencement of the action.

(c) To redeem from a mortgage. An action to redeem real property from a mortgage with or without an account of rents and profits may be commenced by the mortgagor or his successors in interest, against the mortgagee in possession, or against the purchaser of the mortgaged premises at a foreclosure sale in an action in which the mortgagor or his successors in interest were not excluded from their interest in the mortgaged premises, or against a successor in interest of either, unless the mortgagee, purchaser or successor was continuously possessed of the premises for [10] years after the breach or non-fulfillment of a condition or covenant of the mortgage, or the date of recording of the deed of the premises to the purchaser.

[CPLR § 213] Statutory Excerpt or Summary

Actions to be commenced within six years: where not otherwise provided for; on contract;

The following actions must be commenced within six years:

[CPLR § 213(1) and (2)]

1. an action for which no limitation is specifically prescribed by law;
2. an action upon a contractual obligation or liability, express or implied, except as provided in [CPLR § 213(a)], [Uniform Commercial Code art. 2 (§§ 2-701–2-725)], or [GBL §§ 777–777-b];

Subdivisions

[GML § 239-1] Statutory Excerpt or Summary

Coordination of certain municipal zoning and planning actions; legislative intent and policy.

[GML § 239-1(a)–(c)]Statutory Excerpt or Summary

2. Intent. The purposes of [GML §§ 239-l, 239-m, and 239-n] shall be to bring pertinent inter-community and county-wide planning, zoning, site plan and subdivision considerations to the attention of neighboring municipalities and agencies having jurisdiction. Such review may include inter-community and county-wide considerations in respect to the following:

- (a) compatibility of various land uses with one another;
- (b) traffic generating characteristics of various land uses in relation to the effect of such traffic on other land uses and to the adequacy of existing and proposed thoroughfare facilities;
- (c) impact of proposed land uses on existing and proposed county or state institutional or other uses;

COMMENTARY

Other statutes and municipal ordinances also deal with subdivision approvals, but there is no single integrated statewide subdivision procedure of the type that has become, in California, a massive body of law in its own right. *See, e.g.*, Public Health Law §§ 1115 et seq. (approval of water supply); General Municipal Law §§ 239-f and 239-g (approval of subdivision plats by municipal bodies); and ECL §§ 17-1501–17-1515 (approval of sewage systems). The state environmental quality review act (ECL §§ 8-0101–8-0117) and city uniform land use review procedure (*see* NYC Charter § 197-c) may also apply. Regardless of which subdivision law, if any, applies, the process of breaking one tax lot into multiple tax lots will entail multiple interactions with the municipal authorities. In NYC, the recording office will not accept a deed conveying any partial tax lot.

[GML § 239-m] Statutory Excerpt or Summary

Referral of certain proposed city, town and village planning and zoning actions to the county planning agency or regional planning council; report thereon; final action.

[GML § 239-m(4)(a)]

4. County planning agency or regional planning council review of proposed actions; recommendation, report.

(a) The county planning agency or regional planning council shall review any proposed action referred for inter-community or countywide considerations, including but not limited to those considerations identified in [GML § 239-1]. Such county planning agency or regional planning council shall recommend approval, modification, or disapproval, of the proposed action, or report that the proposed action has no significant county-wide or inter-community impact.

[Town Law§ 276]

Subdivision review; approval of plats; development of filed plats.

[Town Law§ 276(1) and (4)(a)]

1. Purpose. For the purpose of providing for the future growth and development of the town and affording adequate facilities for the housing, transportation, distribution, comfort, convenience, safety, health and welfare of its population, the town board may, by resolution, authorize and empower the planning board to approve preliminary and final plats of subdivisions showing lots, blocks or sites, with or without streets or highways, within that part of the town outside the limits of any incorporated village.

4. Definitions. When used in this [Town Law art. 16 (§§ 261 to 285)] the following terms shall have the respective meanings set forth herein except where the context shows otherwise:

(a) “Subdivision” means the division of any parcel of land into a number of lots, blocks or sites as specified in a local ordinance, law, rule or regulation, with or without streets or highways, for the purpose of sale, transfer of ownership, or development. The term “subdivision” may include any alteration of lot lines or dimensions of any lots or sites shown on a plat previously approved and filed in the office of the county clerk or register of the county in which such plat is located. Subdivisions may be defined and delineated by local regula-

tion, as either “major” or “minor,” with the review procedures and criteria for each set forth in such local regulations.

[Village Law § 7-728] Statutory Excerpt or Summary

Subdivision review; approval of plats; development of filed plats.

[Village Law § 7-728(1) and (4)(a)]

1. Purpose. For the purpose of providing for the future growth and development of the village and affording adequate facilities for the housing, transportation, distribution, comfort, convenience, safety, health and welfare of its population, the village board of trustees, may by resolution, authorize and empower the planning board to approve preliminary and final plats of subdivisions showing lots, blocks or sites, with or without streets or highways.

4. Definitions. When used in this article the following terms shall have the respective meanings set forth herein except where the context shows otherwise:

(a) “Subdivision” means the division of any parcel of land into a number of lots, blocks or sites as specified in a law, rule or regulation, with or without streets or highways, for the purpose of sale, transfer of ownership, or development. The term “subdivision” may include any alteration of lot lines or dimensions of any lots or sites shown on a plat previously approved and filed in the office of the county clerk or register of the county in which such plat is located. Subdivisions may be defined and delineated by local regulation, as either “major” or “minor,” with the review procedures and criteria for each set forth in such local regulations.

[RPL § 337-b] Statutory Excerpt or Summary

Offering statement; contents; prohibitions.

1. Contents. The offering statement shall contain (a) the names, addresses, business background of the subdivider, and if such subdivider is a partnership or corporation, the names, addresses and business background of each of the partners, officers and principal stockholders, the nature of their fiduciary relationship and their financial relationship, past, present and future, to the subdivider; (b) a duly certified financial statement of the assets and liabilities of the subdivider, as of a date not more than three months prior to the date of the filing, in such detail as the Department [of State] may require; (c) a description of the subdivision and each unit or lot into which it has or will be divided, in such detail as the Department [of State] may require; (d) the material terms of any encumbrances, liens and restrictions upon the subdivision and each such unit or lot; (e) data and information concerning improvements, including streets, water supply and sewerage disposal facilities, in existence on the subdivision, and the estimated cost, date of completion and responsibility for construction of improvements to be made which are referred to in connection with the sale or lease or offering for sale or lease of the subdivision or any unit or lot thereon; (f) each of the terms and conditions under which each such unit or lot is offered for sale; and (g) such additional data and information as the Department [of State] may require as being necessary or appropriate in the public interest or for the protection of purchasers or lessees.

2. There may be omitted from any offering statement any of the information required under [RPL § 337-b(1)] which the Department [of State] may by rules and regulations designate as not being necessary or appropriate in the public interest or for the protection of purchasers.

3. Limitations. No offer to sell or lease subdivided lands by means of advertisements in periodicals or newspapers, or on television or radio, or by motion picture or otherwise shall be made unless each such advertisement contains reference to the fact that an offering statement has been filed with the Department [of State] and that a copy of such statement is available, upon request, from the subdivider.

4. Except as provided in [RPL § 337-b(3)], no offer of sale or lease of subdivided lands shall be made unless such offer is accompanied by a copy of the current offering statement filed pursuant to this [RPL art. 9-A (§§ 337–339-c)].

[RPL § 337-b(6)] Statutory Excerpt or Summary

6. No sale or lease of subdivided lands shall be made unless accompanied or preceded by the delivery to the prospective purchaser of an offering statement complying with the provisions of this [RPL § 337-b].

[RPL § 337-b(9)]

9. The offering statement shall include the following statement in easily readable capital letters of not less than nine-point type: “THE OFFEROR HAS FILED ADDITIONAL INFORMATION ON THIS LAND OFFERING WITH THE DEPARTMENT OF STATE PURSUANT TO SECTION 337-A OF THE REAL PROPERTY LAW. THIS INFORMATION INCLUDES A DESCRIPTION AND MAPS OF THE PROPERTIES BEING OFFERED; A CERTIFICATE STATING IN DETAIL ALL LIENS, ENCUMBRANCES OR CLOUDS UPON THE TITLE TO THE LAND; AND STATEMENTS OF ANY PRIOR CRIMINAL CONVICTIONS OF THE PRINCIPALS MAKING THIS OFFERING WHICH INVOLVED THE SALE OR OFFERING FOR SALE OF SUBDIVIDED LANDS. INFORMATION FILED PURSUANT TO SECTION 337-A OF THE REAL PROPERTY LAW IS AVAILABLE PURSUANT TO THE FREEDOM OF INFORMATION LAW FROM THE DEPARTMENT OF STATE AT THE FOLLOWING ADDRESS: THE DEPARTMENT OF STATE, SUBDIVIDED LANDS SECTION, ALBANY, NEW YORK 12231-0001.”

COMMENTARY

Use at least 10-point type.

[RPL § 337-c] Statutory Excerpt or Summary

Right to cancel.

Every contract or agreement for the sale or lease of subdivided lands shall expressly grant to the purchaser or lessee the absolute right to cancel the contract or agreement within seven days following the signing of the contract or agreement, by giving the subdivider notice of cancellation at the address listed in the offering statement filed by the subdivider, by registered or certified mail return receipt requested. Within [10] days of receipt of such a notice of cancellation the subdivider shall return to the purchaser or lessee all consideration paid or delivered on account of such contract or agreement.

Subdivision—Application to Leased Lands

[No applicable statute]

COMMENTARY

“Subdivisions” typically do not include the leasing of part of a legal lot, even on a very long term and triple-net basis.

Taxation

[RPT § 499-c]

[RPT § 499-C(5)] Statutory Excerpt or Summary

Eligibility Requirements.

[RPTL § 499-C(5)]

5. The lease for the eligible premises shall contain the following provisions:

- (a) a statement of the tenant’s percentage share;
- (b) a statement informing the tenant in at least [12]-point type that:
 - (1) an application for abatement of real property taxes pursuant to this [RPTL §§ 499-A to 499-H] will be made for the premises;

(2) the rent, including amounts payable by the tenant for real property taxes, will accurately reflect any abatement of real property taxes granted pursuant to this [RPTL §§ 499-A to 499-H] for the premises;

(3) at least [\$10] per square foot or [\$35] per square foot must be spent on improvements to the premises and the common areas, the amount being dependent upon the length of the lease and whether it is a new or a renewal lease, provided, however, that with respect to a lease commencing on or after [April 1, 1997], if, by the [60th] day following the rent commencement date, the tenant employs [125] or fewer employees in the relevant premises, at least [\$5] per square foot must be spent on improvements to the premises and the common areas; and

(4) all abatements granted with respect to a building pursuant to this [RPTL §§ 499-A to 499-H] will be revoked if, during the benefit period, real estate taxes or water or sewer charges or other lienable charges are unpaid for more than one year, unless such delinquent amounts are paid as provided in [RPT § 499-F(4)].

COMMENTARY

New York's real property tax law contains a variety of tax abatements intended to motivate owners to undertake certain forms of development or redevelopment, which it is thought would not otherwise be feasible given New York's high taxes. Real property tax law provisions starting with Section 499-A award these benefits for redevelopment of certain properties in Lower Manhattan. Unlike most tax abatements, this particular tax abatement requires property owners to "pass through" to tenants any real estate tax savings and to include certain language in leases. Owners remain free to negotiate all other elements of the tenant's rent. A cynic would argue that the net effect of these abatements merely places money in the property owner's pocket and increases the importance of knowing how to file successful abatement applications as a means of creating incremental land value in any area where the tax benefits were available. And anyone who owns a developable site in that area will ultimately price the value of these benefits into the selling price when a developer comes along. So ultimately the value of the benefits gets "baked into" land values—which may be a good thing if it incentivizes owners of development sites to sell for development. The city could achieve the same goal more directly by increasing real estate taxes on underutilized land. to avoid

problems with present and future tax abatement filings, a landlord may want to include language like this in a commercial lease:

Tenant shall cooperate as Landlord reasonably requests, including by providing any information in Tenant's possession that Landlord must submit, to enable Landlord to qualify for any otherwise available tax incentive, abatement, deferral, subsidy, or other benefit program.

The tenant may request reciprocal language to accommodate any tax benefits the tenant may be able to claim.

[NYC Admin. Code § 11-208.1] Statutory Excerpt or Summary

Income and expense statements.

a. Where real property is income-producing property, the owner shall be required to submit annually to the department [of finance] not later than [September 1], a statement of all income derived from and all expenses attributable to the operation of such property as follows:

(1) Where the owner's books and records reflecting the operation of the property are maintained on a calendar year basis, the statement shall be for the calendar year preceding the date the statement shall be filed.

(2) Where the owner's books and records reflecting the operation of the property are maintained on a fiscal year basis for federal income tax purposes, the statement shall be for the last fiscal year concluded as of the [August 1] preceding the date the statement shall be filed.

(3) Notwithstanding the provision[s] of [NYC Admin. Code § 11-208.1(1) and (2)], where the owner of the property has not operated the property and is without knowledge of the income and expenses of the operation of the property for a consecutive [12] month period concluded as of the [August 1] preceding the date the statement shall be filed, then the statement shall be for the period of ownership.

(4) The commissioner may for good cause shown extend the time for filing an income and expense statement by a period not to exceed [30] days.

[NYC Admin. Code § 11-208.1(e)]

e. As used in this [NYC Admin. Code § 11-208], the term “income-producing property” means property owned for the purpose of securing an income from the property itself, but shall not include property with an assessed value of [\$40,000] or less, or residential property containing [10] or fewer dwelling units or property classified in class one or class two as defined in [RPTL art. 18 (§§ 1801 to 1806)] containing six or fewer dwelling units and one retail store.

COMMENTARY

For some categories of real property, real estate tax assessments depend on income and expenses., so real estate taxes become a roundabout form of additional income taxes. For multifamily rental property, NYC tries to collect real estate taxes equal to 25% to 33% of gross revenue. These are extraordinary numbers. They allow NYC to impose unusually low real estate taxes on single-family residences, occupied by voters. Tenants also vote, but they don’t feel the direct pain of real estate taxes. For NYC to administer this system, it needs to collect income and expense information ever year from landlords, much like another income tax filing. In recent years, NYC has become more aggressive about fining landlords who fail to file. This becomes an issue upon sale of the property.

[NYC Admin. Code § 11-701]Statutory Excerpt or Summary*Definitions.*

[NYC Admin. Code § 11-701(5)–(7)]

5. “Taxable premises.” Any premises in the city occupied, used or intended to be occupied or used for the purpose of carrying on or exercising any trade, business, profession, vocation or commercial activity, including any premises so used even though it is used solely for the purpose of renting, or granting the right to occupy or use, the same premises in whole or in part to tenants;

6. "Rent." The consideration paid or required to be paid by a tenant for the use or occupancy of premises, valued in money, whether received in money or otherwise, including all credits and property or services of any kind and including any payment required to be made by a tenant on behalf of his or her landlord for real estate taxes, water rents or charges, sewer rents or any other expenses (including insurance) normally payable by a landlord who owns the realty other than expenses for the improvement, repair or maintenance of the tenant's premises.

7. "Base rent." The rent paid for each taxable premises by a tenant to his or her landlord for a period, less the amounts received by or due such tenant for the same period from any tenant of any part of such premises:

(i) as rent for premises which constitute taxable premises of such tenant except where such tenant is exempt from tax thereon pursuant to [NYC Admin. Code § 11-704(b) or (c)(6)]; provided, however, that for tax periods beginning on and after [June 1, 1985], rent received or due from a tenant exempt from tax thereon pursuant to [NYC Admin. Code § 11-704(b)(2)], as such [paragraph] was in effect immediately prior to its amendment by [Local Law 57 of 1993], may be deducted if such tenant occupies or uses the premises pursuant to a written agreement made prior to [June 1, 1984], the terms and conditions of which have not been changed or amended; and provided, further, that for tax periods beginning on and after [June 1, 1985], with respect to a tenant exempt from tax pursuant to [NYC Admin. Code § 11-704(b)(2)] as such [paragraph] was in effect immediately prior to its amendment by [Local Law 57 of 1993], because of the reduction in base rent provided for in [NYC Admin. Code § 11-704(h)], rent received or due from such tenant may be deducted if such tenant occupies or uses the premises pursuant to a written agreement made prior to [June 1, 1985], the terms and conditions of which have not been changed or amended; and provided, further, that for tax periods beginning on and after [June 1, 1994], with respect to a tenant exempt from tax pursuant to [NYC Admin. Code § 11-704(b)(2)] as a result of the amendment of such [paragraph] [by] Local Law 57 of 1993], whether or not such exemption is due to the reduction in base rent provided for in [NYC Admin.

Code § 11-704(h)], rent received or due from such tenant may be deducted if such tenant occupies or uses the premises pursuant to a written agreement made prior to [June 1, 1993], the terms and conditions of which have not been changed or amended; and provided, further, that for tax periods beginning on and after [July 29, 1987], with respect to a tenant exempt from tax pursuant to [NYC Admin. Code § 11-704(b)(2)] because of the reduction in base rent provided for in [NYC Admin. Code § 11-704(f)], rent received or due from such tenant may be deducted; and provided, further, that, notwithstanding anything in [N.Y.C. Admin. Code § 11-701(7)(i)] to the contrary, for tax periods beginning on and after [June 1, 1995], with respect to a tenant exempt from tax pursuant to [NYC Admin. Code § 11-704(b)(2)], rents received or due from such tenant may be deducted;

(ii) as rent for premises which do not constitute taxable premises and which are used by such tenant as lodging or residential premises (including such residential premises in hotels, apartment hotels or lodging houses as defined in former title V of chapter [46] of the code);

(iii) who is exempt from tax under [NYC Admin. Code § 11-704(a)];

(iv) as rent for premises which do not constitute taxable premises where such rent is, or to the extent that such rent is, deductible from the base rent of such tenant by reason of [NYC Admin. Code § 11-704(c)(5)]; and

(v) as rent for premises which do not constitute taxable premises, pursuant to a common law relationship of landlord and tenant (notwithstanding the definition given to those terms by [NYC Admin. Code § 11-701(2) and (3)]) except where it is received as rent, whether or not such landlord-tenant relationship exists, for premises which are occupied as or constitute:

(a) a locker, safe deposit box or beach cabana;

(b) storage space in part of a warehouse or in part of any other structure or area in which goods are stored;

(c) garage space or parking space in any part of a garage, of a parking lot or of a parking area where the entire garage, entire parking lot or entire parking area [accommodates] more than two motor vehicles;

(d) an occupancy of the type which customarily has not been the subject of such a common law relationship of landlord and tenant.

Nothing contained in this [NYC Admin. Code §§ 11-701 to 11-718] shall be construed to permit a tenant to deduct the same rent from his or her base rent more than once.

COMMENTARY

The commercial rent tax is one of several taxes unique or almost unique to NYC or NYS. The extracts set forth here represent only the highlights (lowlights?) of this tax. The commercial rent tax statute includes a municipal “bulk sales” notification requirement (see NYC Admin. Code § 11-712(c)), piled on top of the state’s sales tax enforcement bulk sales requirements (TAX §§ 1141(c) et seq.).²⁵ The definition of rent is quite broad. This statute is often amended, such as to change the tax rate or to broaden or the scope of exemptions, usually based on the location of the leased premises. At this time, the tax applies only in parts of Manhattan. The city imposes this tax on the tenant rather than the landlord but (perhaps surprisingly) does not obligate the landlord to collect the tax from tenants on the city’s behalf. Landlords must, however, maintain certain records and make them available “at any time upon demand” to the taxing authorities. In calculating City transfer tax on the creation of long-term ground leases, the City disregards any rent that would be subject to the commercial rent tax, even if that tax does not actually apply, given the location of the property.

[NYC Admin. Code § 11-702]Statutory Excerpt or Summary

Imposition of tax.

[NYC Admin. Code § 11-702(a)(2)–(b)]

²⁵ In contrast, New York amended its version of the UCC to eliminate art. 6, which covered bulk sales as a matter of private debtor-creditor law.

a. (2) For each tax year commencing on or after, [June 1, 1970], every tenant shall pay a tax at the rates shown in the following tables:

When the annual rent is:	But not more than:	The rate shall be:
0	\$2,499	2 ½ %
\$2,500 or over	\$4,999	5 %
\$5,000 or over	\$7,999	6 ¼ %
\$8,000 or over	\$10,999	7 %
\$11,000 and over		7 ½ %

For tax years beginning after [May 31, 1981], the tax shall be imposed at rates equal to [80%] of the rates shown in the foregoing table.

Where the rent is for a period of less than one year, the rate shall be determined by assuming that the rent is on an equivalent basis for the entire year.

b. Nothing contained in this [NYC Admin. Code §§ 11-701 to 11-718] shall be deemed to require payment of a double or multiple tax pursuant to this [NYC Admin. Code §§ 11-701 to 11-718] on any part of any taxable premises.

[NYC Admin. Code § 11-702(e)]

e. Nothing contained in this [NYC Admin. Code § 11-702] shall be construed as permitting base rent of a tenant for one taxable premises to be reduced by deducting rents received by him or her for another taxable premises of which he or she is also a tenant.

[NYC Admin. Code § 11-703]Statutory Excerpt or Summary

Presumption and burden of proof.

[NYC Admin. Code § 11-703(a)]

a. For the purpose of the proper administration of this [NYC Admin. Code §§ 11-701–11-718] and to prevent evasion of the tax hereby imposed[,] it shall be presumed that all premises are taxable premises and that all rent paid or required to be paid by a tenant is base rent until the contrary is established, and the burden of proving that such presumptive base rent or any portion thereof is not included in the measure of the tax imposed by this [NYC Admin. Code §§ 11-701–11-718] shall be on the tenant.

[NYC Admin. Code § 11-704]Statutory Excerpt or Summary

Exemptions and deductions from base rent.

[NYC Admin. Code § 11-704(a) and (b)]

a. The following shall be exempt from the payment of the tax imposed by this [NYC Admin. Code §§ 11-701–11-718]:

1. The [NYS], or any public corporation (including a public corporation created pursuant to agreement or compact with another state or the Dominion of Canada), improvement district or other political subdivision of the state;

2. The United States of America, insofar as it is immune from taxation;

3. The United Nations or other world-wide international organizations of which the United States of America is a member;

4. Any corporation, or association, or trust, or community chest, fund or foundation, organized and operated exclusively for religious, charitable, or educational purposes, or for the prevention of cruelty to children or animals, and no part of the net earnings of which inures to the benefit of any private shareholder or individual and no substantial part of the activities of which is carrying on propaganda, or otherwise attempting to influence legislation; provided, however, that nothing in this [NYC Admin. Code § 11-704(a)(4)] shall include an organization operated for the primary purpose of carrying on a trade or business for profit, whether or not all of its profits are payable

to one or more organizations described in this [NYC Admin. Code § 11-704(a)(4)]; and

5. Any tenant who would be subject to taxes under this [NYC Admin. Code §§ 11-701–11-718] aggregating not more than [\$1.00] for a tax year with respect to all taxable premises used by the tenant; and

6. Any tenant located in the “World Trade Center Area,” . . .

b.²⁶ (1) A tenant who uses premises for no more than [14] days in a tax year whether or not consecutive, where his or her agreement with his or her landlord does not require him or her to pay rent for a longer period shall be exempt from the payment of the tax imposed by this [NYC Admin. Code §§ 11-701 to 11-718] in respect to the rent paid by him or her for such premises.

(2) . . . for tax years beginning on or after [June 1, 2001] is not in excess of [\$249,999]²⁷ per year, calculated without regard to any reduction in base rent allowed by [NYC Admin. Code § 11-704(h)(2)] shall be exempt from the payment of the tax imposed by this [NYC Admin. Code §§ 11-701 to 11-718] with respect to such rent, provided, however, that where the base rent of such tenant is for a period of less than one year, such base rent shall, for purposes of this [NYC Admin. Code § 11-704(b)(2)], be determined as if it had been on an equivalent basis for the entire year . . .

[NYC Admin. Code § 11-704(d)]

d. A tenant who uses taxable premises for renting to others for residential purposes to the extent of [75%] or more of the rentable floor space shall be exempt from the tax imposed by this [NYC Admin. Code § 11-704] in respect to the rent paid for such premises from the time that construction thereof commences, provided, however, that this [NYC Admin. Code § 11-704(d)] shall not be applicable to hotels, apartment hotels or

26 The numbering of this section conforms to the statute

27 This was recently raised from \$99,999.

lodging houses as defined in former title V of chapter forty-six of the code.

[NYC Admin. Code § 11-704(h)]

h. (1) In the case of any taxable premises located in the borough of Manhattan north of the center line of [96th] street or in the boroughs of the Bronx, Brooklyn, Queens and Staten Island,...a tenant of taxable premises...shall be exempt from the payment of the tax imposed by this chapter with respect to the rent for such taxable premises.

(2) In the case of any taxable premises located in the borough of Manhattan south of the center line of [96th] street, the base rent for such premises shall be reduced by...[35%]... such reduction to be made after all other exemptions and deductions authorized by this [NYC Admin. Code §§ 11-701 to 11-718] have been taken.

[NYC Admin. Code § 11-704.3]

Tax credit.

[NYC Admin. Code § 11-704.3(a)(6) and (b)(1)]

(6) For each tax year beginning on or after [June 1, 2001] a credit shall be allowed against the tax imposed by this [NYC Admin. Code §§ 11-701–11-718] as follows: a tenant whose base rent is at least [\$250,000] but not more than [\$300,000] shall be allowed a credit in an amount determined by multiplying [3.9%] of base rent by a fraction the numerator of which is [\$300,000] minus the amount of base rent and the denominator of which is [\$50,000]. If the tenant's base rent is over [\$300,000] no credit shall be allowed under this [NYC Admin. Code § 11.704.3(a)(6)]. For purposes of this [NYC Admin. Code § 11-704.3(a)(6)], 'base rent' shall be calculated without regard to any reduction in base rent allowed by [NYC Admin. Code § 11-704(h)(2)].

(b)(1) Where the base rent of a tenant is for a period of less than one year, such base rent shall, for purposes of this [NYC Admin. Code § 11-704.3], be determined as if it had been on an equivalent basis for the entire year . . .

COMMENTARY

Does this credit create an incentive for tenants to enter into many small leases instead of a single large one?

[NYC Admin. Code § 11-705]Statutory Excerpt or Summary

Returns.

[NYC Admin. Code § 11-705(a) and (b)]

a. Every tenant subject to tax under this [NYC Admin. Code §§ 11-701–11-718] shall file with the commissioner of finance a return with respect to the taxes payable for the three month periods ending on [August 31], [November 31] and [February 28] of each year and a final return with respect to the taxes payable for the tax year ending on [May 31] of each year. Such returns shall be filed within [20] days from the expiration of the period covered thereby.... For tax years beginning on or after [June 1, 2001], no such final return shall be required from such exempt tenant with respect to any taxable premises if (1) the tenant's rent for such premises, determined without regard to any deduction from or reduction in rent or base rent allowed by this [NYC Admin. Code §§ 11-701–11-718], does not exceed [\$200,000] for the tax year and (2) the amount of rent received or due from any subtenant of such exempt tenant with respect to such premises does not exceed [\$200,000] for the tax year. Notwithstanding anything in this subdivision to the contrary... no return shall be required pursuant to this [NYC Admin. Code § 11-705(a)] with respect to any taxable premises located in that part of the city specified in [NYC Admin. Code § 11-704(h)(1)] and no such taxable premises shall be taken into account for purposes of clause two of the preceding sentence. The commissioner of finance may permit or require returns (including final returns) to be made for other periods and upon such dates as the commissioner may specify and if he

or she deems it necessary in order to insure the payment of the tax imposed by this [NYC Admin. Code §§ 11-701 to 11-718], the commissioner may require such returns to be made for shorter periods than those prescribed by the foregoing provisions of this [NYC Admin. Code § 11-705], and upon such dates as he or she may specify.

b. The commissioner of finance may by regulation require the filing of information returns and supplemental information returns by landlords and by tenants of taxable premises, whether or not they are required to pay the tax imposed by this chapter, upon such dates or at such times as the commissioner may specify if he or she deems the filing of such information returns necessary for proper administration of this [NYC Admin. Code §§ 11-701–11-718].

[NYC Admin. Code § 11-706] Statutory Excerpt or Summary

Payment of tax.

[NYC Admin. Code § 11-706(a)]

a. The tax imposed by this chapter shall be due and payable on or before the [20th] day of the calendar month following the end of each tax period and shall be paid to the commissioner of finance, as follows: The tax to be paid at such time shall be based on the base rent for such tax period and the rate of tax shall be the one which would be applicable if the base rent for such period were the same for each tax period during the tax year, except that the payment required to be made together with the final return or at the time that the final return should be filed shall be the amount by which the actual tax for the tax year exceeds the amounts previously paid for the tax year.

[NYC Admin. Code § 11-707]

Records to be kept.

Every landlord of taxable premises and every tenant of taxable premises shall keep records of rent paid and received by him or her in such form as the commissioner of finance may by regulation require, all leases or agreements which fix the rents or

rights of tenants of taxable premises, and such other records, receipts and other papers relevant to the ascertainment of the tax due under this [NYC Admin. Code §§ 11-701 to 11-718] as the commissioner of finance may by regulation require. Such records shall be offered for inspection and examination at any time upon demand by the commissioner of finance. Such records, unless the commissioner of finance consents to a sooner destruction or requires that they be kept for a longer time, shall be preserved for a period of three years except that leases or agreements which fix the rents or rights of a tenant shall be kept for a period of three years after the expiration of the tenancy thereunder.

[NYC Admin. Code § 11-709]Statutory Excerpt or Summary

Refunds.

[NYC Admin. Code § 11-709(a)]

a. In the manner provided in this [NYC Admin. Code § 11-709], the commissioner of finance shall refund or credit, without interest, any tax, penalty or interest erroneously, illegally or unconstitutionally collected or paid, if written application to the commissioner of finance for such refund shall be made within [18] months from the date fixed by this [NYC Admin. Code §§ 11-701–11-718] for filing the return on which such payment was based or within six months of the payment thereof, whichever of such periods expire the later. Whenever a refund or credit is made or denied, the commissioner of finance shall state his or her reason therefor and give notice thereof to the taxpayer in writing. The commissioner of finance may, in lieu of any refund required to be made, allow credit therefore on payments due from the applicant.

[NYC Admin. Code § 11-712]Statutory Excerpt or Summary

Proceedings to recover tax.

[NYC Admin. Code § 11-712(c)]

(c) Whenever there is made a sale, transfer or assignment in bulk of any part or the whole of a stock of merchandise or of fixtures, or merchandise and of fixtures pertaining to the conducting of the business of the seller, transferor or assignor, otherwise than in the ordinary course of trade and in the regular prosecution of said business, the purchaser, transferee or assignee shall at least [10] days before taking possession of such merchandise, fixtures, or merchandise and fixtures, or paying therefor, [notify] the commissioner of finance by registered mail of the proposed sale and of the price, terms and conditions thereof whether or not the seller, transferor or assignor, has represented to, or informed the purchaser, transferee or assignee that it owes any tax pursuant to this chapter and whether or not the purchaser, transferee or assignee has the knowledge that such taxes are owing, and whether any such taxes are in fact owing.

Whenever the purchaser, transferee or assignee shall fail to give notice to the commissioner of finance..., or whenever the commissioner of finance shall inform the purchaser, transferee or assignee that a possible claim for such tax or taxes exists, any sums of money, property or choses in action, or other consideration, which the purchaser, transferee or assignee is required to transfer over to the seller, transferor or assignor shall be subject to a first priority right and lien for any such taxes theretofore or thereafter determined to be due from the seller, transferor or assignor to the city, and the purchaser, transferee or assignee is forbidden to transfer to the seller, transferor or assignor any such sums of money, property or choses in action to the extent of the amount of the city's claim. For failure to comply with the provisions of this [NYC Admin. Code § 11-712(c)], the purchaser, transferee or assignee, ... shall be personally liable for the payment to the city of any such taxes theretofore or thereafter determined to be due to the city from the seller, transferor or assignor, and such liability may be assessed and enforced in the same manner as the liability for tax under this [NYC Admin. Code §§ 11-701 to 11-718].

[NYC Admin. Code § 11-715]Statutory Excerpt or Summary

Interest and penalties.

[NYC Admin. Code § 11-715(a) and (b)]

(a) Interest on underpayment; quarterly return. If any amount of tax required to be paid together with a return, other than the final return for a tax year, is not paid on or before the last date prescribed for payment (without regard to any extension of time granted for payment), interest on such amount at the rate set by the commissioner of finance pursuant to [NYC Admin. Code § 11-715(h)], or, if no rate is set, at the rate of [7.5%] per annum, shall be paid for the period from such last date until [20] days after the end of the tax year during which such payments were due or until such prior time as the tax paid for the tax year equals [75%] of the full tax required to be paid for the tax year. Such interest shall be paid with the final return for the tax year to which it relates. In computing the amount of interest to be paid, such interest shall be compounded daily. Interest under this [NYC Admin. Code § 11-715(a)] shall not be paid if the amount thereof is less than [\$1.00].

(b) Interest on underpayment; final return. If any amount of tax required to be paid together with the final return for a tax year is not paid on or before the last day prescribed for payment (without regard to any extension of time granted for payment), interest on such amount at the rate set by the commissioner of finance pursuant to [NYC Admin. Code § 11-715(h)], or, if no rate is set, at the rate of [7.5%] per annum, shall be paid for the period from such last date to the date of payment. In computing the amount of interest to be paid, such interest shall be compounded daily. Interest under this [NYC Admin. Code § 11-715(b)] shall not be paid if the amount thereof is less than [\$1.00].

[NYC Admin. Code § 11-715(h)]

(h)(1) Authority to set interest rates. The commissioner of finance shall set the rate of interest to be paid pursuant to [NYC Admin. Code § 11-715(a) and (b)], but if no such rate of

interest is set, such rate shall be deemed to be set at [7.5%] per annum. Such rate shall be the same for [NYC Admin. Code § 11-715(a) and (b)] and shall be the rate prescribed in [NYC Admin. Code § 11-715(h)(2)] but shall not be less than [7.5%] per annum. Any such rate set by the commissioner of finance shall apply to taxes, or any portion thereof, which remain or become due on or after the date on which such rate becomes effective and shall apply only with respect to interest computed or computable for periods or portions of periods [occurring] in the period in which such rate is in effect.

(2) General rule. The rate of interest set under this [N.Y.C. Admin. Code § 11-715(h)(2)] shall be the sum of (i) the federal short-term rate as provided under [NYC Admin. Code § 11-715(h)(3)], plus (ii) [7%].

(3) Federal short-term rate. For purposes of this [NYC Admin. Code § 11-715(h)]:

(A) The federal short-term rate for any month shall be the federal short-term rate determined by the United States secretary of the treasury during such month in accordance with [Internal Revenue Code § 1274(d)] for use in connection with [Internal Revenue Code § 6621]. Any such rate shall be rounded to the nearest full percent (or, if a multiple of [1/2] of [1%], such rate shall be increased to the next highest full percent).²⁸

(B) Period during which rate applies.

i) In general...[T]he federal short-term rate for the first month in each calendar quarter shall apply during the first calendar quarter beginning after such month.

(4) Publication of interest rate. The commissioner of finance shall cause to be published in the city record, and give other appropriate general notice of, the interest rate to be set under this [NYC Admin. Code § 11-715(h)] no later than [20] days preceding the first day of the calendar quarter during which such interest rate applies....

²⁸ The reference to “a multiple of” 1/2 of 1% presumably means only an “odd” multiple. Otherwise, 3% (which is an even multiple of 1/2%, i.e., 6 times 1/2% would be converted to 4%.

[NYC Admin. Code § 11-717]Statutory Excerpt or Summary

Notices and limitation of time.

[NYC Admin. Code § 11-717(b)]

b. The provisions of the [CPLR] or any other law relative to limitations of time for the enforcement of a civil remedy shall not apply to any [proceeding] or action taken by the city to levy, appraise, assess, determine or enforce the collection of any tax or penalty provided by this [NYC Admin. Code §§ 11-701–718]. However, except in the case of a willfully false or fraudulent return with intent to evade the tax, no assessment of additional tax shall be made after the expiration of more than three years from the date of the final return for the tax year to which the assessment relates; provided, however, that where no return has been made as provided by law, the tax may be assessed at any time.

[TAX § 1105(b)]

Imposition of sales tax.

On and after [June 1, 1971], there is hereby imposed and there shall be paid a tax of [4%] upon:

(b)

(1) The receipts from every sale, other than sales for resale, of the following: (A) gas, electricity, refrigeration and steam, and gas, electric, refrigeration and steam service of whatever nature; [and] (B) telephony and telegraphy and telephone and telegraph service of whatever nature except interstate and international telephony and telegraphy and telephone and telegraph service and except any [mobile] telecommunications service . . .

COMMENTARY

New York's sales and other taxes have a very broad scope, matched only by the creativity and aggressiveness of the tax collectors. This often produces surprises. Provisions beyond those quoted here could also apply.

[TAX § 1141(c)] Statutory Excerpt or Summary

Proceedings to Recover Tax.

[TAX 1141(c)]

(c) Whenever a person required to collect tax shall make a sale, transfer, or assignment in bulk of any part or the whole of his business assets, otherwise than in the ordinary course of business, the purchaser, transferee or assignee shall at least [10] days before taking possession of the subject of said sale, transfer or assignment, or paying therefor, notify the [Tax Commission] by registered mail of the proposed sale and of the price, terms and conditions thereof whether or not the seller, transferor or assignor, has represented to, or informed the purchaser, transferee or assignee that he owes any tax pursuant to this [TAX art. 28 (§§ 1101 to 1150)] and whether or not the purchaser, transferee, or assignee has knowledge that such taxes are owing, and whether any such taxes are in fact owing.

COMMENTARY

This statute is commonly referred to as New York's bulk sales law, a bulky provision too long to quote in its entirety here. Recent cases have made clear that the bulk sales law counterintuitively applies to transfers of property other than inventory, equipment, and other business property, e.g., it applies to the assignment of a lease. Assignees should comply with the statute or face personal liability for their assignor's sales taxes. As a practical matter, many contracts dispense with bulk sales compliance, partly because the bulk sales filing requires the parties to submit a copy of their contract to the tax authorities. Instead, the buyer requires an indemnity from the seller, sometimes without rigorously considering creditworthiness.

[TAX § 19] Statutory Excerpt or Summary

Green building credit.

[TAX § 19(a)(1)]

(a) Allowance of credit.

(1) General.

(A) Green building credit. A taxpayer subject to tax under [TAX article 9, 9-A, 22, 32, or 33] shall be allowed a green building credit against such tax, pursuant to the provisions referenced in [TAX § 19(f)]. Provided, however, no credit shall be allowed under this [TAX § 19] unless the taxpayer has complied with the applicable requirements of [TAX § 19(d)(2)] (relating to reports to DEC). The amount of the credit shall be the sum of the credit components specified in [TAX § 19(a)2 through (7)]. Provided, however, the amount of each such credit component shall not exceed the limit set forth in the initial credit component certificate obtained pursuant to [TAX § 19(c)]. In the determination of such credit components, no cost paid or incurred by the taxpayer shall be the basis for more than one such component.

(B) Credit to successor owner. If a credit is allowed to a building owner pursuant to this [TAX § 19(a)] with respect to property, and such property (or an interest therein) is sold, the credit for the period after the sale which would have been allowable under this [TAX § 19(a)] to the prior owner had the property not been sold shall be allowable to the new owner. Credit for the year of sale shall be allocated between the parties on the basis of the number of days during such year that the property or interest was held by each.

(C) Credit to successor tenant. If a credit is allowed to a tenant pursuant to this [TAX § 19(a)] with respect to property, and if such tenancy is terminated but such property remains in use in the building by a successor tenant, the credit for the period after such termination which would have been allowable under this [TAX § 19(a)] to the prior tenant had the tenancy not been terminated shall be allowable to the successor tenant. Credit for the year of termination shall be allocated between the parties on the basis of the number of days during such year that the property was used by each.

(D) Notwithstanding any other provision of law to the contrary, in the case of allowance of credit under this [TAX § 19] to a successor owner or tenant, as provided in [TAX § 19(a)(1)(B) or (C)], the commissioner shall have the authority to reveal to the successor owner or tenant any information, with respect to the credit of the prior owner or tenant, which is the basis for the denial in whole or in part of the credit claimed by such successor owner or tenant.

[TAX § 19(b)]

(b) Definitions. As used in this section, the following terms shall have the following meanings:

(1) “Allowable costs” means amounts properly chargeable to capital account (other than for land), which are paid or incurred on or after [June 1, 1999], for: construction or rehabilitation; commissioning costs; interest paid or incurred during the construction or rehabilitation period; legal, architectural, engineering and other professional fees allocable to construction or rehabilitation; closing costs for construction, rehabilitation or mortgage loans; recording taxes and filing fees incurred with respect to construction or rehabilitation; site costs (such as temporary electric wiring, scaffolding, demolition costs, and fencing and security facilities); and costs of furniture, carpeting, partitions, walls and wall coverings, ceilings, drapes, blinds, lighting, plumbing, electrical wiring and ventilation; provided that such costs shall not include the cost of telephone systems and computers (other than electrical wiring costs) and shall not include the cost of fuel cells or photovoltaic modules (including installation) or the cost of new air conditioning equipment using an EPA-approved non-ozone depleting refrigerant or other EPA-approved refrigerant approved by the commissioner of environmental conservation (excluding installation).

(2) “Base building” means all areas of a building not intended for occupancy by a tenant or owner . . .

(2-a) “Credit allowance year” means the later of (a) the taxable year during which the property, construction, completion or

rehabilitation referred to [TAX § 19(a)(2) through (7)] has been placed in service or has received a final certificate of occupancy or (b) the first taxable year with respect to which the credit may be claimed pursuant to the initial credit component certificate issued pursuant to [TAX § 19(c)].

(3) “Commissioning” means the testing and fine-tuning of heat, ventilating and air conditioning and other systems to assure proper functioning and adherence to design criteria and the preparation of system operation manuals and instruction of maintenance personnel.

(5) “Economic development area” means an area which is designated (A) an empire zone pursuant to [GML Art. 18B (§§ 955 to 969)] or (B) an empowerment zone or enterprise community pursuant to [Internal Revenue Code § 1391].

(6) “Eligible building” means a building located in this state which is:

(A) classified B2, B3, B4, C1, C2, C5, or C6 for purposes of the [NYS] uniform fire prevention and building code or similarly classified under any subsequent code; provided that any such building contains at least [20,000] square feet of interior space, or

(B) a residential multi-family building with at least twelve dwelling units that contain at least [20,000] square feet of interior space, or

(C) one or more residential multi-family buildings with at least two dwelling units that are part of a single or phased construction project that contains, in the aggregate, at least [20,000] square feet of interior space; provided that in any single phase of such project at least [10,000] square feet of interior space is under construction or rehabilitation, or

(D) any combination of buildings described in [TAX § 19(b)(6)(A), (B), (C)], and

(E) is not a building located on freshwater wetlands or tidal wetlands the construction of which requires a permit under

[ECL § 24-0701 or § 25-0403], respectively, of the [ECL], or on wetlands such that the construction thereof requires a permit pursuant to [Federal Clean Water Act § 404] (33 U.S.C. § 1344).

(7) “Energy Code” means the [NYS] Energy Conservation Construction Code.

(8) “Fuel cell” means a device that produces electricity directly from hydrogen or hydrocarbon fuel through a non-combustive electro-chemical process.

(9) “Green base building” means a base building which is part of an eligible building and which meets the following standards:

(A) Energy and energy efficiency.

(i) Energy use is no more than [65%] (in the case of new construction of a base building) or [75%] (in the case of rehabilitation of a base building) of the use permitted under the energy code or, in the event such standard is revised or superseded, energy use shall meet such other energy efficiency standards that DEC, in consultation with NYSERDA, shall establish in regulations promulgated pursuant to [TAX § 19(e)(1)], in effect at the time the base building or rehabilitation thereof is placed in service.

(ii) All appliances and any heating, cooling and water heating equipment used in the base building and subject to the regulations promulgated by DEC, in consultation with NYSERDA, pursuant to [Tax Law § 19(e)(1)], shall meet the standards established by such regulations in effect at the time the base building or rehabilitation thereof is placed in service.

(B) Zoning, indoor air quality, building materials, finishes and furnishings.

(i) The base building shall comply with all applicable zoning, land use and erosion control requirements, stormwater management ordinances, building code requirements and environmental regulations. In the case of the rehabilitation of an existing building, all existing environmental hazards shall be

identified and managed in accordance with applicable laws, regulations and industry guidelines.

(ii) Buildings classified B2, B3, B4, C1, C2, C5, or C6, for purposes of the [NYS] Uniform Fire Prevention and Building Code, or similarly classified under any subsequent code, shall meet the following indoor air quality requirements:

(I) ventilation and exchange of indoor/outdoor air shall meet the standards established by regulations promulgated by DEC, in consultation with DOH and NYSERDA, pursuant to [TAX § 19(e)(2)];

(II) if smoking is permitted in specific areas of the building, separate air ventilation and circulation shall be provided for smoking and non-smoking areas;

(III) the ventilation system shall include an air purging system that is capable of replacing [100%] of the air on any floor, on a minimum of two floors at a time. The air shall be purged for a period of one week on every floor immediately prior to initial occupancy and on any floor that undergoes renovation immediately prior to re-occupancy; provided that, if a taxpayer obtains certification from a licensed architect, engineer, certified industrial hygienist, or other licensed or certified professional whom the commissioner of environmental conservation shall approve, pursuant to regulations, verifying that off-gassing and any other contamination can be reduced to comparable levels in less than one week, the period of purging may be shortened. The taxpayer shall maintain a copy of such certification in accordance with the provisions of [TAX § 19(d)].

(C) Building fresh air intake shall be located a minimum of [25] feet away from loading areas, building exhaust fans, cooling towers and other point sources of contamination.

(D) During construction or rehabilitation, the ventilation system components and pathways shall be protected from contamination in accordance with an indoor air quality management plan for the construction or rehabilitation process that meets the standards established in regulations promulgated by DEC, in consultation with DOH and NYSERDA, pursuant to [TAX § 19(e)(2)]. In the event that such areas are not protected from

contamination in accordance with such standards, they shall be cleaned prior to occupancy.

(E) A licensed engineer, certified industrial hygienist, or other licensed or certified professional whom the commissioner of environmental conservation shall approve, pursuant to regulations, shall conduct indoor air quality testing with respect to the entire building immediately following occupancy, if any, and on an annual basis, to monitor supply and return air and ambient air for carbon monoxide, carbon dioxide, total volatile organic compounds, radon, and particulate matter. Provided, however, once radon measurements have been found to be satisfactory, subsequent annual testing is not required. The taxpayer shall record baseline readings immediately following occupancy, if any, and annually thereafter. In the event that the taxpayer does not establish that during a taxable year during which any part of the building is occupied, indoor air quality met the standards established in regulations promulgated by DEC, in consultation with DOH and NYSERDA, pursuant [TAX § 19(e)(2)], the base building shall not constitute a green base building.

(F) The mechanical plant of the building shall be commissioned in accordance with the standards established in regulations promulgated by DEC, in consultation with NYSERDA, pursuant to [TAX § 19(e)(1)(D)], which standards shall be informed by documents such as ASHRAE G-1 and the United States General Services Administration “Model Commissioning Plan and Guide Specifications]. For purposes of [TAX § 19(b)(9)(F)] the term “ASHRAE” means the American Society of Heating, Refrigerating and Air Conditioning Engineers.

(G) Separate waste disposal chutes or a carousel compactor system for recyclable materials shall be provided for the recycling of waste by occupants, or recycling shall be otherwise facilitated by, at a minimum, providing a readily accessible designated collection area or areas with sufficient space to store recyclable materials separately between collection dates.

(H) All plumbing fixtures in the public areas of the building shall meet the plumbing fixture requirements of the energy policy act of 1992 or any successor provision in effect at the time the building or rehabilitation is placed in service.

(I) Prior to initial occupancy and upon request, the owner of the building shall provide each tenant with (1) written notification of the opportunity to apply for a tax credit pursuant to [TAX § 19] and (2) written guidelines regarding opportunities to improve the energy efficiency and air quality of tenant space and to reduce and recycle waste streams.

(J) All building materials, finishes and furnishings used in the base building and subject to the regulations promulgated by DEC, in consultation with NYSERDA, pursuant to [TAX § 19(e)(3)(A)], shall meet the standards established by such regulations in effect at the time the building or rehabilitation is placed in service; provided further that with respect to furnishings, this requirement shall apply only to newly purchased items.

(K) All tenant space in the building occupied by the owner must be green tenant space.

(10) “Green building” means a building wherein the base building is a green base building and all tenant space is green tenant space.

(11) “Green tenant space” means tenant space in a building if such building is an eligible building and if such tenant space complies with the following requirements: ...

COMMENTARY

The green tenant space requirements have been omitted because for the most part they conform to the “green base building” standards. *See* TAX § 19(b)(9).

(B) Code requirements, indoor air quality, building materials, finishes and furnishings.

(i) The tenant space shall comply with all applicable building code requirements and environmental regulations and, with respect to projects other than new construction, all existing environmental hazards shall be identified and managed in accordance with applicable laws, regulations and industry guidelines.

(12) “Incremental cost of building-integrated photovoltaic modules” means:

(A) the cost of building-integrated photovoltaic modules and any associated inverter, additional wiring or other electrical equipment or additional mounting or structural materials, less the cost of spandrel glass or other building material that would have been used in the event that building-integrated photovoltaic modules were not installed,

(B) incremental labor costs properly allocable to on-site preparation, assembly and original installation of photovoltaic modules, and

(C) incremental architectural and engineering services and designs and plans directly related to the construction or installation of photovoltaic modules.

(13) “NYSERDA” means the [NYS] Energy Research and Development Authority.

(14) “Qualifying alternate energy sources” means building-integrated and non-building-integrated photovoltaic modules and fuel cells installed to serve the base building or tenant space which have the capability to monitor their ac output, and which are validated upon installation, and annually thereafter, to ensure that such systems meet their design specifications.

(15) “Tenant improvements” means improvements which are necessary or appropriate to support or conduct the business of a tenant or occupying owner.

(16) “Tenant space” means the portion of a building intended for occupancy by a tenant or occupying owner.

[TAX § 19(d)]

(d) Other requirements; miscellaneous.

(1) Record keeping. Each taxpayer shall, for any taxable year for which the green building credit provided for under this [TAX § 19] is claimed, maintain records of the following information:

(A) annual energy consumption for building, base building or tenant space;

(B) annual results of air monitoring;

(C) annual confirmation that the building, base building or tenant space continues to meet requirements regarding smoking areas, if provided;

(D) tenant guidelines referred to in [TAX § 19(b)(9)(I)], if applicable;

(E) all written notification of tenants and requests to remedy any indoor air quality problems;

(F) initial and annual (by month) results of validation of performance of photovoltaic modules and fuel cells; and

(G) certifications as to off-gassing and other contamination, as prescribed in [TAX § 19(b)(9)(B)(ii)(III)], where applicable.

(2) Reporting to DEC. Each taxpayer shall also provide to DEC the information described in [TAX § 19(d)(1)], in the form and at the time prescribed by DEC, such time to be determined in consultation with the commissioner. Such information shall be provided to DEC with respect to each taxable year with respect to which the taxpayer claims a credit under this [TAX § 19].

Taxation—Documentary Tax Stamps

TAX § 1401 Statutory Excerpt or Summary

Definitions.

[TAX § 1401(c) through (d)(ii)]

(c) “Real property” means every estate or right, legal or equitable, present or future, vested or contingent, in lands, tenements or hereditaments, including buildings, structures and other improvements thereon, which are located in whole or in part within [NYS] . . .

(d) “Consideration” means the price actually paid or required to be paid for the real property or interest therein, including payment for an option or contract to purchase real property, whether or not expressed in the deed and whether paid or required to be paid by money, property, or any other thing of value. It shall include the cancellation or discharge of an indebtedness or obligation. It shall also include the amount of any mortgage, purchase money mortgage, lien or other encumbrance, whether or not the underlying indebtedness is assumed or taken subject to.

(i) In the case of a creation of a leasehold interest or the granting of an option with use and occupancy of real property, consideration shall include but not be limited to the value of the rental and other payments attributable to the use and occupancy of the real property or interest therein, the value of any amount paid for an option to purchase or renew and the value of rental or other payments attributable to the exercise of any option to renew.

(ii) In the case of a creation of a subleasehold interest, consideration shall include but not be limited to the value of the sublease rental payments attributable to the use and occupancy of the real property, the value of any amount paid for an option to renew and the value of rental or other payments attributable to the exercise of any option to renew less the value of the remaining prime lease rental payments required to be made.

[TAX § 1401(d)(iv)]

(iv) In the case of an assignment or surrender of a leasehold interest or the assignment or surrender of an option or contract to purchase real property, consideration shall not include the

value of the remaining rental payments required to be made pursuant to the terms of such lease or the amount to be paid for the real property pursuant to the terms of the option or contract being assigned or surrendered.

[TAX § 1401(e) through (h)]

(e) . . . transfer of an interest in real property shall include the creation of a leasehold or sublease only where (i) the sum of the term of the lease or sublease and any options for renewal exceeds [49] years, (ii) substantial capital improvements are or may be made by or for the benefit of the lessee or sublessee and (iii) the lease or sublease is for substantially all of the premises constituting the real property. . . .

(f) “Interest in the real property” includes title in fee, a leasehold interest, a beneficial interest, an encumbrance, development rights, air space and air rights, or any other interest with the right to use or occupancy of real property or the right to receive rents, profits or other income derived from real property. It shall also include an option or contract to purchase real property. It shall not include a right of first refusal to purchase real property.

(g) “Grantor” means the person making the conveyance of real property or interest therein. . . .

(h) “Grantee” means the person who obtains real property or interest therein as a result of a conveyance.

COMMENTARY

NYS imposes its real estate transfer tax on the creation of certain long-term leases but not routine commercial space leases. Where a lease is taxable, the regulations provide for a formula that reflects the net present value of the future rent stream. Net result: the transfer tax on the creation of a long-term ground lease is comparable to the transfer tax on an outright sale, which is a rational result. Leasing-related transactions (assignments, surrenders, buy-outs, etc) often attract a separate tax, and often do not, without regard to the remaining term of the lease. The lines drawn and calculations required are not at all intuitive. Anyone considering one of these transactions should consider the possible transfer tax implications

(both NYS and NYC) before becoming legally bound. Those taxes are relatively well documented as compared against some other NYS and NYC taxes. The creative strategist who decides to avoid transfer taxes by recharacterizing payments as purchase price or rent for furniture may succeed—but at the cost of incurring a sales tax, which is even higher.

NYC imposes its own real property transfer tax, which varies significantly from the NYS real estate transfer tax. The NYC tax is discussed below. *See* NYC Admin. Code §§ 11-2101 and 11-2102. Erie County (Buffalo) imposes a real estate transfer tax very similar to the NYS real estate transfer tax. *See* TAX art. 31-A, §§ 1424–1437. From approximately August to December of 1999, Nassau County had its own real estate transfer tax. Effective July 1, 1998, and expiring December 31, 2010 (later extended to 2030), five townships in Suffolk County became subject to their own special real estate transfer tax. *See* Tax art. 31-D, §§ 1449-aa–1449pp. Similar enactments apply in some other metropolitan areas within NYS. *See, e.g.,* TAX §§ (1438-A through 1449-00000) (special transfer taxes for various municipalities and counties, each repeating definitions from the NYS transfer tax and imposing a separate tax with its own expiration date). Chronic budget crises throughout the State will probably produce more such enactments. The preceding discussion does not purport to summarize all nonstatewide transfer taxes presently in effect or anything else about NYS or NYC transfer taxes. Those two taxes add up to a massive body of law requiring special expertise for all but the most straightforward transactions.

[TAX § 1402] Statutory Excerpt or Summary

Imposition of tax.

[TAX § 1402(a)]

(a) A tax is hereby imposed on each conveyance of real property or interest therein when the consideration exceeds [\$500], at the rate of [\$2.00] for each [\$500] or fractional part thereof; provided, however, that with respect to...conveyances where the consideration is less than [\$500,000], the consideration for the interest conveyed shall exclude the value of any lien or encumbrance remaining thereon at the time of conveyance.

[TAX § 1405-A] Statutory Excerpt or Summary*Credit.*

A grantor shall be allowed a credit against the tax due on a conveyance of real property to the extent tax was paid by such grantor on a prior creation of a leasehold of all or a portion of the same real property or on the granting of an option or contract to purchase all or a portion of the same real property, by such grantor. Such credit shall be computed by multiplying the tax paid on the creation of the leasehold or on the granting of the option or contract by a fraction, the numerator of which is the value of the consideration used to compute such tax paid which is not yet due to such grantor on the date of the subsequent conveyance (and which such grantor will not be entitled to receive after such date), and the denominator of which is the total value of the consideration used to compute such tax paid.

[NYC Admin. Code § 11-2101] Statutory Excerpt or Summary*Definitions.*

[NYC Admin. Code § 11-2101(2)]

2. "Deed." Any document or writing (other than a will), regardless of where made, executed or delivered, whereby any real property or interest therein is created, vested, granted, bargained, sold, transferred, assigned or otherwise conveyed, including any such document or writing whereby any leasehold interest in real property is granted, assigned or surrendered.

[NYC Admin. Code § 11-2101(5)]

5. "Real property." Every estate or right, legal or equitable, present or future, vested or contingent, in lands, tenements or hereditaments, which are located in whole or in part within [NYC]....

[NYC Admin. Code § 11-2101(9)]

9. "Consideration." The price actually paid or required to be paid for the real property or economic interest therein, without deduction for mortgages, liens and encumbrances, whether or not expressed in the deed or instrument and whether paid or required to be paid by money, property, or any other thing of value. It shall include the cancellation or discharge of an indebtedness or obligation. It shall also include the amount of any mortgage, lien or other encumbrance, whether or not the underlying indebtedness is assumed.

COMMENTARY

The NYC transfer tax varies substantially from the NYS transfer tax. In general, the NYC tax is more burdensome, but it also has some additional exceptions, particularly in the treatment of leases.

[NYC Admin. Code § 11-2102] Statutory Excerpt or Summary*Imposition of tax.*

[NYC Admin. Code § 11-2102(a)(10)(ii) and (iii)]

a. A tax is hereby imposed on each deed at the time of delivery by a grantor to a grantee when the consideration for the real property and any improvement thereon (whether or not included in the same deed) exceed[s] [\$25,000]. The tax shall be:

10. With respect to a grant, assignment or surrender of a leasehold interest in real property made on or after [August 1, 1989], the tax shall be at the following rates:

(ii) at the rate of [1.425%] of the consideration for the granting, assignment or surrender of a leasehold interest in all...[non-residential] real property where the consideration is [\$500,000] or less, and at the rate of [2.625%] of the consider-

ation where the consideration for the granting, assignment or surrender of such a leasehold interest is more than [\$500,000];

(iii) provided, however, that for purposes of [NYC Admin. Code § 11-2102(ii)], the amount subject to tax in the case of a grant of a leasehold interest shall be only such amount as is not considered rent for purposes of the tax imposed by [NYC Admin. Code §§ 11-701 to 11-718].

COMMENTARY

NYC's real property transfer tax and related filing requirements apply to a wide range of lease-related transactions—including some where no one is making any money and nothing is being recorded and it is intuitively obvious that no transfer tax should apply—and must be considered when taking any action regarding a commercial lease. Secondary resources, such as regulations and (particularly) the tax forms themselves, provide surprisingly extensive guidance on how this tax applies to lease-related transactions. The last quoted paragraph of the statute substantially mitigates the burden this tax creates. (That mitigation applies only for the NYC transfer tax, not the NYS tax, but it apparently applies even for the creation of leases that are exempt from the NYC commercial rent tax.) Some other metropolitan areas in the state also have their own real estate transfer taxes, as noted above.

Tenancy—At Will and Holdovers

[RPL § 232] Statutory Excerpt or Summary

Duration of certain agreements in New York.

An agreement for the occupation of real estate in [NYC], which shall not particularly specify the duration of the occupation, shall be deemed to continue until the [October 1] next after the possession commences under the agreement.

COMMENTARY

This statute rarely applies to modern commercial leasing transactions. When it does apply, it means that the parties may be stuck with each other for up to a year, rather than the month-to-month tenancy that they might intuitively expect under these circumstances. Landlords and tenants can avoid these problems by including an expiration date in their leases.

Tenant's Remedies

[RPL § 223-a] Statutory Excerpt or Summary*Remedies of lessee when possession is not delivered.*

In the absence of an express provision to the contrary, there shall be implied in every lease of real property a condition that the lessor will deliver possession at the beginning of the term. In the event of breach of such implied condition the lessee shall have the right to rescind the lease and to recover the consideration paid. Such right shall not be deemed inconsistent with any right of action he may have to recover damages.

COMMENTARY

In addition to statutory provisions on the routine termination of leases and provisions that motivate particular standard language in commercial leases, this section of the New York summary also includes a few statutory provisions on the eviction and lease enforcement process. These statutes are only the tip of the iceberg. Anyone who considers seeking to evict a tenant or to enforce a lease should not proceed without consulting attorneys who toil in those fields every day.

RPL § 223-a bears little relation to the reality of modern commercial leasing, in which a landlord often cannot be sure about when the premises will be available and ready for the tenant. One way to solve the problem is to state in the lease that the term does not begin until the premises are delivered. Even then, counsel is well advised to include an express waiver of this statute, such as:

Tenant waives any right it might have under Real Property Law § 223-a, Landlord's obligates under this Lease on delivery of the Premises constitute "an express provision to the contrary" as Real Property Law § 223-a contemplates.

[RPL § 223-b] Statutory Excerpt or Summary*Retaliation by landlord against tenant.*

[RPL § 223-b (5-a)]

5-a. Any lease provision which seeks to assess a fee, penalty or dollar charge, in addition to the stated rent, against a tenant because such tenant files a bona fide complaint with a building code officer regarding the condition of such tenant's leased premises shall be null and void as being against public policy. A landlord who seeks to enforce such a fee, penalty or charge shall be liable to the tenant for triple the amount of such fee, penalty or charge.

COMMENTARY

This recently enacted statute solves a problem that, to the author's knowledge, does not exist, at least in the world of commercial leases. The statute applies to all leases, not just residential ones.

[RPL § 230] Statutory Excerpt or Summary

Right of tenants to form, join or participate in tenants' groups.

1. No landlord shall interfere with the right of a tenant to form, join or participate in the lawful activities of any group, committee or other organization formed to protect the rights of tenants; nor shall any landlord harass, punish, penalize, diminish, or withhold any right, benefit or privilege of a tenant under his tenancy for exercising such right.

2. Tenants' groups, committees or other tenants' organizations shall have the right to meet without being required to pay a fee in any location on the premises including a community or social room where use is normally subject to a fee which is devoted to the common use of all tenants in a peaceful manner, at reasonable hours and without obstructing access to the premises or facilities. No landlord shall deny such right.

COMMENTARY

Nothing in this statute indicates it applies only to residential leasing, but commercial tenants are not known to meet regularly in reliance on this statute.

[NYC Admin. Code § 22-901] Statutory Excerpt or Summary

§ 22-901 Definitions. As used in this chapter, the following terms have the following meanings:

Commercial tenant. The term "commercial tenant" means a person or entity lawfully occupying a covered property pursuant to a lease or other rental agreement.

Covered property. The term "covered property" means any building or portion of a building (i) that is lawfully used for buying, selling or otherwise providing goods or services, or for other lawful business, commercial, professional services or manufacturing activities, and (ii) for which a certificate of occupancy authorizing residential use of such building or such portion of a building has not been issued.

Essential service. The term "essential service" means a service that a landlord must furnish to a commercial tenant pursuant to a lease or other rental agreement between such commercial tenant and landlord, or pursuant to applicable law.

Landlord. The term "landlord" means an owner of covered property or such owner's agent.

§ 22-902 Commercial tenant harassment. a. A landlord shall not engage in commercial tenant harassment. Except as provided in [§ 22-902(b)], commercial tenant harassment is any act or omission by or on behalf of a landlord that (i) is intended to cause a commercial tenant to vacate covered property, or to surrender or waive any rights under a lease or other rental agreement or under applicable law in relation to such covered property, and (ii) includes one or more of the following:

1. using force against or making express or implied threats that force will be used against a commercial tenant or such tenant's invitee;
2. causing repeated interruptions or discontinuances of one or more essential services;
3. causing an interruption or discontinuance of an essential service for an extended period of time;
4. causing an interruption or discontinuance of an essential service where such interruption or discontinuance substantially interferes with a commercial tenant's business;

5. repeatedly commencing frivolous court proceedings against a commercial tenant;
6. removing from a covered property any personal property belonging to a commercial tenant or such tenant's invitee;
7. removing the door at the entrance to a covered property occupied by a commercial tenant; removing, plugging or otherwise rendering the lock on such entrance door inoperable; or changing the lock on such entrance door without supplying a key to the new lock to the commercial tenant occupying the covered property;
8. preventing a commercial tenant or such tenant's invitee from entering a covered property occupied by such tenant;
9. substantially interfering with a commercial tenant's business by commencing unnecessary construction or repairs on or near covered property; or
10. engaging in any other repeated or enduring acts or omissions that substantially interfere with the operation of a commercial tenant's business.

b. A landlord's lawful termination of a tenancy, lawful refusal to renew or extend a lease or other rental agreement, or lawful reentry and repossession of the covered property shall not constitute commercial tenant harassment for purposes of this chapter.

§ 22-903 Private right of action. a. A commercial tenant may bring an action in any court of competent jurisdiction for a claim of commercial tenant harassment. If a court of competent jurisdiction finds that a landlord has engaged in commercial tenant harassment in relation to such commercial tenant, the court shall impose a civil penalty in an amount not less than [\$1,000] and not more than [\$10,000] for each covered property in which such commercial tenant has been the subject of commercial tenant harassment and may further:

1. issue an order restraining the landlord from engaging in commercial tenant harassment and directing the landlord to ensure that no further violation occurs; and

2. award such other relief as the court deems appropriate, including but not limited to injunctive relief, equitable relief, compensatory damages, punitive damages and reasonable attorneys' fees and court costs.

b. The commercial tenant shall not be relieved of the obligation to pay any rent for which the commercial tenant is otherwise liable. Any monetary remedy awarded to a commercial tenant pursuant to subdivision a of this section shall be reduced by any amount of delinquent rent or other sum for which a court finds such commercial tenant is liable to the landlord.

c. This section does not limit or abrogate any claim or cause of action a person has under common law or by statute. The provisions of this section are in addition to any such common law and statutory remedies.

d. Nothing contained in this chapter shall be construed as creating any cause of action for a commercial tenant's invitee.

e. Nothing contained in this chapter shall be construed as creating any private right of action against the city or any agency or employee thereof.

§ 22-904 Affirmative defenses. It is an affirmative defense to an allegation of commercial tenant harassment of the kind described in [§ 22-902(a)] 2, 3, 4, 6, 7, 8, 9 and 10 that (i) such condition or service interruption was not intended to cause any commercial tenant to vacate a covered property or waive or surrender any rights in relation to such covered property, and (ii) the landlord acted in good faith in a reasonable manner to promptly correct such condition or service interruption, including providing notice to all affected lawful tenants in a covered property of such efforts, where appropriate.

Commentary

This statute, enacted in 2016, is based on a similar statute to protect residential tenants. In its wisdom, the City Council did not see fit to enact a statute to protect commercial landlords from harassment by commercial tenants through strategic use of the court system. In general, this new statute gives commercial tenants even more ammunition against their landlords. It was very kind of the City Council to acknowledge that a

commercial landlord would not be charged with “harassment” as a result of refusing to renew an expiring lease. And, of course, even when the City acts as a commercial landlord, it’s exempt from the statute.

Termination of Tenancies

[RPL § 227]

CROSS-REFERENCE

See “Damage and Destruction.”

[RPL § 228] **Statutory Excerpt or Summary**

Termination of tenancies at will or by sufferance, by notice.

A tenancy at will or by sufferance, however created, may be terminated by a written notice of not less than [30] days given in behalf of the landlord, to the tenant, requiring him to remove from the premises; which notice must be served, either by delivering to the tenant or to a person of suitable age and discretion, residing upon the premises, or if neither the tenant nor such a person can be found, by affixing it upon a conspicuous part of the premises, where it may be conveniently read. At the expiration of [30] days after the service of such notice, the landlord may re-enter, maintain an action to recover possession, or proceed, in the manner prescribed by law, to remove the tenant, without further or other notice to quit.

COMMENTARY

This statute means that a tenant at will or by sufferance will receive the same notice as a tenant from month to month. Only when that notice expires may the landlord commence an action to evict the tenant. The eviction action may itself take a long time to resolve, particularly in NYC. Given the very technical requirements of landlord-tenant law, a landlord should not even give the RPL § 228 notice without consulting New York landlord-tenant counsel.

[RPL § 232-a] **Statutory Excerpt or Summary**

Notice to terminate monthly tenancy or tenancy from month to month in [NYC].

No monthly tenant, or tenant from month to month, shall hereafter be removed from any lands or buildings in [NYC] on the grounds of holding over his term unless at least [30] days before the expiration of the term the landlord or his agent serve upon the tenant, in the same manner in which a notice of petition in summary proceedings is now allowed to be served by law, a notice in writing to the effect that the landlord elects to terminate the tenancy and that unless the tenant removes from such premises on the day on which his term expires the landlord will commence summary proceedings under the statute to remove such tenant therefrom.

COMMENTARY

In NYC, this statute requires any landlord under a month-to-month tenancy to serve any notice of termination as if it were a “notice of petition in summary proceedings.” *See* “Landlord’s Remedies.”

[RPL § 232-b]

Notification to terminate monthly tenancy or tenancy from month to month outside [NYC].

A monthly tenancy or tenancy from month to month of any lands or buildings located outside of [NYC] may be terminated by the landlord or the tenant upon his notifying the other at least one month before the expiration of the term of his election to terminate; provided, however, that no notification shall be necessary to terminate a tenancy for a definite term.

COMMENTARY

Under this statute, a landlord outside NYC does not need to comply with the very specific and technical service requirements for a summary proceeding against the tenant. The landlord must merely give notice.

[RPL § 232-c]

Holding over by a tenant after expiration of a term longer than one month; effect of acceptance of rent.

Where a tenant whose term is longer than one month holds over after the expiration of such term, such holding over shall not give to the landlord the option to hold the tenant for a new

term solely by virtue of the tenant's holding over. In the case of such a holding over by the tenant, the landlord may proceed, in any manner permitted by law, to remove the tenant, or, if the landlord shall accept rent for any period subsequent to the expiration of such term, then, unless an agreement either express or implied is made providing otherwise, the tenancy created by the acceptance of such rent shall be a tenancy from month to month commencing on the first day after the expiration of such term.

COMMENTARY

Absent this statute, the common law rule may say that if the tenant stays and pays, and the landlord accepts the payment, then the lease is automatically renewed for the same term as its original term. This statute instead creates a month-to-month tenancy, which presumably must be terminated according to the same procedures as any other month-to-month tenancy. This statute also leaves open the possibility for landlord and tenant to reach “an agreement either express or implied” inconsistent with the quoted language.

Torrens System

[RPL § 436] Statutory Excerpt or Summary

Termination of title registration procedures.

[RPL § 436(4) through (6)]

4. On and after [January 1, 1997],²⁹ the registrar shall refuse to accept for registration any instrument that is a voluntary instrument. Instead of accepting such instruments for registration, the registrar shall upon payment of the statutory recording fee, deliver to the county clerk, or in the counties of Bronx, Kings, Queens and New York, the register for recording each current certificate of title to all lands affected by that voluntary or adverse instrument. Before delivering the certificate, the registrar shall memorialize or note on the certificate any instruments relating to incumbrances, charges, trusts, liens and transfers that have been filed with the registrar that have not

²⁹ This date is the effective date of RPL § 436.

been memorialized or noted. A certificate of title shall be delivered in the form required for recording.

5. On or before [January 1, 2000], the registrar shall deliver to the county clerk, or in the counties of Bronx, Kings, Queens and New York, the register for recording the certificates of title of all remaining land which was previously registered under this article. Before delivering those certificates, the registrar shall memorialize or note on the certificates any instruments relating to incumbrances, charges, trusts, liens and transfers that have been filed with the registrar and that have not yet been memorialized or noted. A certificate of title shall be delivered in the form required for recording.

6. As of the date of recording of certificates delivered pursuant to [RPL § 436(4) or (5)], the recorded certificates shall be subject only to incumbrances, charges, trusts, liens and transfers as may be memorialized or noted on the certificate, and free from all others except those set forth in [RPL § 400].

After the recording of certificates which are delivered under [RPL § 436(4) and (5)], title to lands shall be conveyed or encumbered in the same manner as set forth in [RPL art. 9 (§§ 290–336)]. All instruments noted or memorialized on the certificates of title so recorded shall have the same force and effect as if they were filed with the county clerk, or in the counties of Bronx, Kings, Queens and New York, the register at the time they were noted or were otherwise memorialized on the certificates of title. No instrument, however, that was filed, docketed or recorded by the county clerk, or in the counties of Bronx, Kings, Queens and New York, the register, but that was not duly registered, shall become a lien, incumbrance, trust or charge against any title which was delivered pursuant to [RPL § 436(4) and (5)], unless such instrument was filed, recorded or docketed after the date such title was recorded, provided, however, that a [judgment] docketed by the county clerk prior to the time a certificate of title was recorded shall be valid as against such land if the landowner received notice of such judgment.

COMMENTARY

RPL §§ 370–435 established a system for Torrens registration of title to real property. That system was used only to a rather limited degree. Under the quoted statute, NYS was to have terminated its Torrens system.

Transfers—Uniform Fraudulent Transfer Act

[No applicable statute]

COMMENTARY

New York has not adopted the Uniform Fraudulent Transfer Act and instead has adopted requirements described in DCL §§ 270–281. See “Fraudulent Conveyances.”

Trustee as Owner of Property

[EPTL § 11-1.1] Statutory Excerpt or Summary

Fiduciaries’ powers.

[EPTL § 11-1.1(b)(5)]

(b) In the absence of contrary or limiting provisions in the court order or decree appointing a fiduciary, or in a subsequent order or decree, or in the will, deed or other instrument, every fiduciary is authorized:

5. With respect to any property or any estate therein owned by an estate or trust, except where such property or any estate therein is specifically disposed of:

(A) To take possession of, collect the rents from and manage the same.

(B) To sell the same at public or private sale, and on such terms as in the opinion of the fiduciary will be most advantageous to those interested therein.

(C) With respect to fiduciaries other than a trustee, to lease the same for a term not exceeding three years and, in the case of a trustee, to lease the same for a term not exceeding [10] years

although such term extends beyond the duration of the trust and, in either of such cases, including the right to explore for and remove mineral or other natural resources, and in connection with mineral leases to enter into pooling and unitization agreements.

(D) To mortgage the same.

(E) Any power to take possession of, collect the rent from, manage, sell, lease or mortgage, granted by this [EPTL § 11-1.1(b)(5)], which is prohibited by the terms of the will, deed or other instrument or by the provisions of this [EPTL § 11-1.1(b)(5)], nonetheless exists, upon the approval of the surrogate, where such power is necessary for the purposes set forth in [Surrogate Court Procedure Act § 1902].

(F) A fiduciary acting under a will may exercise all of the powers granted by this [EPTL § 11-1.1(b)(5)] notwithstanding the effect upon such will of the birth of a child after its execution or of any election by a surviving spouse.

[SCPA § 1507] Statutory Excerpt or Summary

Authority to mortgage, sell, lease[,] or exchange.

[SCPA §1507(1)]

1. In any case in which the power to mortgage, sell, lease or exchange real property does not exist under the provisions of [EPTL § 11-1.1] or for other reasons it is for the best interests of the trust, the court of the county having jurisdiction of the trust may on such terms and conditions as seem just and proper authorize any testamentary trustee to mortgage, sell, lease or exchange real property or any part thereof belonging to the trust.

[RPAPL § 1601] Statutory Excerpt or Summary

Application by trustee for court authorization to mortgage, to lease, to sell, to acquire or to exchange real property or for confirmation of a lease of real property.

[RPAPL § 1601(1)]

1. When the assets of a trust include an interest in real property, the trustee may apply to the court designated in [RPAPL § 1603], and in the case of a testamentary trust, to the court having jurisdiction thereof, for an order authorizing such trustee to mortgage, to lease or to sell such real property or a part thereof; or to acquire land adjacent to such real property or to exchange a portion of such real property for lands adjacent to such real property when either such acquisition or exchange would tend to improve the boundary lines of such real property; or to confirm a lease for a term longer than [10] years made by a trustee of such real property without obtaining prior authorization by a court.

Unconscionability

[RPL § 235-c] Statutory Excerpt or Summary*Unconscionable lease or clause.*

1. If the court as a matter of law finds a lease or any clause of the lease to have been unconscionable at the time it was made the court may refuse to enforce the lease, or it may enforce the remainder of the lease without the unconscionable clause, or it may so limit the application of any unconscionable clause as to avoid any unconscionable result.

2. When it is claimed or appears to the court that a lease or any clause thereof may be unconscionable the parties shall be afforded a reasonable opportunity to present evidence as to its setting, purpose and effect to aid the court in making the determination.

COMMENTARY

This statute has spawned a reasonable number of reported cases, mostly (though not entirely) relating to residential leases. In the reported cases courts have, for example, invalidated these ordinary lease clauses: (a) an attorneys' fees clause (because the type was too small); (b) a commercial

tenant's waiver of counterclaims and defenses against an eviction action; and (c) a clause saying that landlord's acceptance of keys would not be deemed a surrender. A court also applied this statute in a case where a commercial lease allowed the landlord to discontinue furnishing electricity—but the landlord had exercised that right against only one tenant, apparently to retaliate against that tenant for something. The statute does not, however, seem to have opened the floodgates of litigation on commercial leases.

Unfair Trade Practices

[NYC Admin. Code § 22-505] Statutory Excerpt or Summary

Displaced Building Service Workers.

a. For purposes of this section, the following terms have the following meanings:

Building service. The term “building service” means work performed in connection with the care or maintenance of an existing building and includes, but is not limited to, work performed by a watchman, guard, security officer, fire safety director, doorman, building cleaner, porter, handyman, janitor, gardener, groundskeeper, stationary fireman, elevator operator and starter, window cleaner, and superintendent.

Building service contract. The term “building service contract” means a contract for the furnishing of building services, and includes any subcontracts for such services.

Building service employee. The term “building service employee” means any person employed to perform a building service who has been regularly assigned to a building on a full or part-time basis for at least ninety days immediately preceding any transition in employment subject to this section except for (i) persons who are managerial, supervisory, or confidential employees, provided that this exemption shall not apply to building superintendents or resident managers; (ii) persons earning in excess of thirty-five dollars per hour from a covered employer, provided that this amount shall be adjusted on January 1, 2017 and annually thereafter by the mayor's office of labor standards based upon the preceding twelve-month percentage increase, if any, in the consumer price index for all

urban consumers for all items, as published by the bureau of labor statistics of the United States Department of Labor; and (iii) persons regularly scheduled to work fewer than eight hours per week at a building.

City of New York. The term “city of New York” means any city, county or borough, administration, department, division, bureau, board or commission, or a corporation, institution or agency of government the expenses of which are paid in whole or in part from the city treasury.

Covered employer. The term “covered employer” means any person who hires or retains building service employees or a building service contractor, including, but not limited to, a lessee of commercial space, housing cooperative, condominium association, building managing agent, or any other person who owns, leases or manages real property, either on its own behalf or for another person, within the city of New York, provided, however, that the requirements of this section shall not apply (i) to residential buildings of less than 50 units, (ii) to commercial office, institutional or retail buildings of less than 100,000 square feet, (iii) to any lessee of commercial office space whose leasehold is less than 35,000 square feet, or (iv) to the extent that such requirements conflict with section 162 of the state finance law.

Former building service contractor. The term “former building service contractor” means any person who furnishes building services pursuant to a building service contract prior to a termination of such contract.

Person. The term “person” means any individual, proprietorship, partnership, joint venture, corporation, limited liability company, trust, association, or other entity that may employ persons or enter into service contracts, but does not include the city of New York, the state of New York, and the federal government or any other governmental entity, or any individual or entity managing real property for a governmental entity.

“Successor employer” means a covered employer that (i) has been awarded a building service contract to provide, in whole or in part, building services that are substantially similar to those provided under a service contract that has recently been

terminated, or (ii) has purchased or acquired control of a property in which building service employees were employed.

Successor building service contractor. The term “successor building service contractor” means any person who, pursuant to a contract, furnishes building services that are substantially similar to those that were provided under a terminated building service contract or to those that were provided by building service employees previously employed by a covered employer.

b. Terminated Building Service Contract.

1. No less than 15 calendar days before terminating any building service contract or, in the situation where such contract covers multiple buildings, terminating such contractor as to one or more buildings, any covered employer shall request the former building service contractor to provide, any covered employer or the successor building service contractor, whichever person intends to furnish substantially similar services to those that were provided under the terminated building service contract, a full and accurate list containing the name, address, date of hire and employment classification of each building service employee employed at the buildings covered by the terminated contract. The former building service contractor shall provide such list within 72 hours of receipt of the request from the covered employer. At the same time that the former building service contractor provides such list, the former building service contractor shall post the list in a notice to the building service employees that also sets forth the rights provided by this section, in the same location and manner that other statutorily required notices to employees are posted at the affected building. Such notice shall also be provided to the employees’ collective bargaining representative, if any.

2. Upon termination of a building service contract, any covered employer or the successor building service contractor, whichever person intends to furnish substantially similar building services to those that were provided under the terminated building service contract, shall retain those building service employees employed at the buildings covered by the terminated building service contract for a 90-day transition period.

3. If at any time the covered employer or successor building service contractor, whichever person intends to furnish substantially similar building services to those that were provided under the terminated building service contract, determines that fewer building service employees are required to perform building services at the affected buildings than had been performing such services by the former building service contractor, the covered employer or the successor building service contractor shall retain the building service employees by seniority within job classification; provided, that during the 90-day transition period, the successor employer shall maintain a preferential hiring list of those building service employees not retained at the building(s) who shall be given a right of first refusal to any jobs within their classifications that become available during that period.

4. Except as provided in paragraph 3 of this subdivision during the 90-day transition period, the covered employer or successor building service contractor, whichever person intends to furnish substantially similar building services to those that were provided under the terminated building service contract, shall not discharge without cause a building service employee retained pursuant to this section.

5. At the end of the 90-day transition period, the covered employer or successor building service contractor, whichever person intends to furnish substantially similar building services to those that were provided under the terminated building service contract, shall perform a written performance evaluation for each building service employee retained pursuant to this section. If such employee's performance during such 90-day transition period is satisfactory, the covered employer or successor building service contractor shall offer such employee continued employment under the terms and conditions established by the covered employer or successor building service contractor

6. For purposes of this subdivision, "covered employer" includes any person to which a controlling interest in the affected building has been or is being transferred.

c. Transfer of Controlling Interest

1. No less than 15 calendar days before transferring a controlling interest in any building in which building services employees are employed, the covered employer who is transferring the controlling interest in such building shall provide to the covered employer to which the controlling interest is being transferred a full and accurate list containing the name, address, date of hire and employment classification of each building service employee employed at the buildings covered by the transfer of such controlling interest. At the same time, the covered employer who is transferring the controlling interest in such building shall post such list in a notice to its building service employees that also sets forth the rights provided by this section, in the same location and manner that other statutorily required notices to employees are posted at the affected building. Such notice shall also be provided to the employees' collective bargaining representative, if any.

2. The covered employer to which the controlling interest is being transferred shall retain those building service employees employed at the buildings covered by the transfer of the controlling interest for a 90-day transition employment period.

3. If at any time the covered employer to which the controlling interest is being transferred determines that fewer building service employees are required to perform building services at the affected buildings than had been performing such services for the covered employer who is transferring the controlling interest, the covered employer to which the controlling interest is being transferred shall retain the building service employees by seniority within job classification; provided, that during the 90-day transition period, such covered employer maintain a preferential hiring list of those building service employees not retained at the buildings who shall be given a right of first refusal to any jobs within their classifications that become available during that period.

4. Except as provided in paragraph 3 of this subdivision, during the 90-day transition period, the covered employer to which the controlling interest is being transferred shall not discharge without cause a building service employee retained pursuant to this section.

5. At the end of the 90-day transition period, the covered employer to which the controlling interest is being transferred shall perform a written performance evaluation for each employee retained pursuant to this section. If such employee's performance during such 90-day transition period is satisfactory, the covered employer to which the controlling interest is being transferred shall offer such employee continued employment under the terms and conditions established by the covered employer.

d. Entering into a Building Service Contract.

1. No less than 15 calendar days before entering into a building service contract, the covered employer that will enter into such contract shall provide to the successor building service contractor a full and accurate list containing the name, address, date of hire, and employment classification of each building service employee who is currently performing those services. At the same time the covered employer that will enter into such contract provides such list, such employer shall post a notice to the building service employees that also sets forth the rights provided by this section in the same location and manner that other statutorily required notices to employees are posted at the affected building. Such notice shall also be provided to the employees' collective bargaining representative, if any.

2. The successor building service contractor shall retain those building service employees who were providing those services for a covered employer for a 90-day transition employment period.

3. If at any time the successor building service contractor determines that fewer building service employees are required to perform building services at the affected building than had been performing such services for the covered employer, the successor building service contractor shall retain the building service employees by seniority within job classification; provided, that during the 90-day transition period, the successor building service contractor shall maintain a preferential hiring list of those building service employees not retained at the buildings who shall be given a right of first refusal to any jobs within their classifications that become available during that period.

4. Except as provided in paragraph 3 of this subdivision, during the 90-day transition period, the successor building service contractor shall not discharge without cause an employee retained pursuant to this section.

5. At the end of the 90-day transition period, the successor building service contractor shall perform a written performance evaluation for each building service employee retained pursuant to this section. If such employee's performance during such 90-day transition period is satisfactory, the successor building service contractor shall offer such employee continued employment under the terms and conditions established by such contractor.

e. Remedies

1. A building service employee who has been discharged or not retained in violation of this section may bring an action in supreme court against a former building service contractor, covered employer or successor building service contractor for violation of any obligation imposed pursuant to this section.

2. The court shall have authority to order preliminary and permanent equitable relief, including, but not limited to, reinstatement of any employee who has been discharged or not retained in violation of this section.

3. If the court finds that by reason of a violation of any obligation imposed pursuant to subdivision b, c, or d of this section a building service employee has been discharged or not retained in violation of this section, it shall award:

(a) Back pay, and an equal amount as liquidated damages, for each day during which the violation continues, which shall be calculated at a rate of compensation not less than the higher of (1) the average regular rate of pay received by the employee during the last three years of the employee's employment in the same occupation classification; or (2) the final regular rate received by the employee. Back pay shall apply to the period commencing with the date of the discharge or refusal-to-retain by the covered employer or successor building service contractor through the effective date of any offer of reinstatement or reinstatement of the employee.

(b) Costs of benefits the covered employer or successor building service contractor would have incurred for the employee under such employee's benefits plan.

(c) The building service employee's reasonable attorney's fees and costs.

4. In any such action, the court shall have authority to order the covered employer or the former building service contractor, as applicable, to provide any information required pursuant to subdivision b, c or d of this section.

f. The provisions of this section shall not apply to the following:

1. any covered employer or successor building service contractor that, on or before the effective date of a termination of a building service contract, agrees to assume, or to be bound by, the collective bargaining agreement of the former building service contractors, provided that the collective bargaining agreement provides terms and conditions for the discharge or laying off of employees;

2. any covered employer to which a controlling interest in a building is being transferred that, on or before the effective date of the transfer of such controlling interest, agrees to assume, or to be bound by, the collective bargaining agreement of the covered employer that is transferring the controlling interest, provided that the collective bargaining agreement provides terms and conditions for the discharge or laying off of employees;

3. any successor building service contractor that, on or before the effective date of the entering into a building service contract by a covered employer, agrees to assume or to be bound by, the collective bargaining agreement of the covered employer, provided that the collective bargaining agreement provides terms and conditions for the discharge or laying off of employees;

4. if there was no existing collective bargaining agreement as described in paragraphs 1, 2, or 3 of this subdivision, any covered employer or successor building service contractor that

agrees, on or before the effective date of the termination of the contract, transfer of a controlling interest, or entering into a building service contract, to enter into a new collective bargaining agreement covering its building service employees, provided that the collective bargaining agreement provides terms and conditions for the discharge or laying off of employees;

5. any covered employer or successor building service contractors (iii) to any successor employer whose building service employees will be accreted to a bargaining unit with a pre-existing collective bargaining agreement, provided that the collective bargaining agreement provides terms and conditions for the discharge or laying off of employees; or

6. any covered employer or former building service contractor that obtains a written commitment from a covered employer or successor building service contractor that the covered employer or successor building service contractor's building service employees will be covered by a collective bargaining agreement falling within paragraphs (1) through (5) of this subdivision.

COMMENTARY

After the attacks of September 11th, NYC enacted this legislation for the stated purpose of preserving low wage maintenance and janitorial jobs in a then temporarily dipping real estate market. The statute achieves this by, in essence, giving building staff the right to travel with the real estate upon a sale, just like a prior encumbrance (though the right lasts only 90 days) The statute says an owner can prevent that result only by signing up with the janitors' union. In 2016, the City Council extended the statute to reach more job categories; to broaden the definition of employer to include tenants that hire building service employees; and to provide for liquidated damages and reinstatement of wronged employees. Although this statute does not directly affect leases themselves, it is an important recent addition to the legal environment for landlords and might best be categorized here.

Use

[RPL § 231]

Statutory Excerpt or Summary

Lease, when void; liability of landlord where premises are occupied for unlawful purpose.

1. Whenever the lessee or occupant other than the owner of any building or premises, shall use or occupy the same, or any part thereof, for any illegal trade, manufacture or other business, the lease or agreement for the letting or occupancy of such building or premises, or any part thereof shall thereupon become void, and the landlord of such lessee or occupant may enter upon the premises so let or occupied.

2. The owner of real property, knowingly leasing or giving possession of the same to be used or occupied, wholly or partly, for any unlawful trade, manufacture or business, or knowingly permitting the same to be so used, is liable severally, and also jointly with one or more of the tenants or occupants thereof, for any damage resulting from such unlawful use, occupancy, trade, manufacture or business.

3. For the purposes of this [RPL § 231], two or more convictions of any person or persons had, within a period of one year, for any of the offenses described in [PL §§ 230.00, 230.05, 230.20, 230.25, 230.30, or 230.40], arising out of conduct engaged in at the same premises consisting of a dwelling as that term is defined in [MDL § 4(4)], shall be presumptive evidence of unlawful use of such premises and of the owner's knowledge of the same.

4. Any lease or agreement hereafter executed for the letting or occupancy of real property or any portion thereof, to be used by the lessee as a residence, which contains therein a provision pledging personal property exempt by law from levy and sale by virtue of an execution, as security for the payment of rent due or to become due thereunder, is void as to such provision.

5. The attorney general may commence an action or proceeding in the supreme court to enjoin the continued unlawful trade, manufacture or business in such premises.

6. For the purposes of this [RPL § 231], two or more convictions of any person or persons had, within a period of one year, for any of the offenses described in [PL § 225.00, 225.05, 225.10, 225.15, 225.20, 225.30, 225.32, 225.35, or 225.40],

arising out of conduct engaged in at the same premises consisting of a dwelling as that term is defined in [MDL § 4(4)] shall be presumptive evidence of unlawful use of such premises and of the owner's knowledge of the same.

7. Any owner or tenant, including a tenant of one or more rooms of an apartment house, tenement house or multiple dwelling of any premises within [200] feet of the demised real property, may commence an action or proceeding in supreme court to enjoin the continued unlawful trade, manufacture or other business in such premises.

COMMENTARY AND CROSS-REFERENCES

This statute includes two subsections numbered "5." The PL sections cited here relate to gambling offenses and prostitution.

See ABC §105(1)

Utilities

[RPL § 235] Statutory Excerpt or Summary

Wilful violations.

[RPL § 235(1)]

1. Any lessor, agent, manager, superintendent or janitor of any building, or part thereof, the lease or rental agreement whereof by its terms, expressed or implied, requires the furnishing of hot or cold water, heat, light, power, elevator service, telephone service or any other service or facility to any occupant of said building, who wilfully or intentionally fails to furnish such water, heat, light, power, elevator service, telephone service or other service or facility at any time when the same are necessary to the proper or customary use of such building, or part thereof, or any lessor, agent, manager, superintendent or janitor who wilfully and intentionally interferes with the quiet enjoyment of the leased premises by such occupant, is guilty of a violation.

[NYC Admin. Code § 28-309.1]Statutory Excerpt or Summary

General.

The energy and water use of city buildings and covered buildings shall be benchmarked in accordance with this [NYC Admin. Code ch. 28, art. 309 (§§ 1 to 10)].

COMMENTARY

The Energy Benchmark Law went into effect on March 1, 2011, requiring more than 20,000 NYC landlords to submit annual reports of their tenants' energy and water consumption. The goal is to document energy consumption, with the idea of reducing consumption over time. Failure to comply can trigger penalties for landlords.

[NYC Admin. Code § 28-309.2] Statutory Excerpt or Summary

Definitions.

As used in this [NYC Admin. Code §§ 28-309.1–28-309.10], the following terms shall have the following meanings:

BENCHMARK. To input and submit to the benchmarking tool the total use of energy and water for a building for the previous calendar year and other descriptive information for such building as required by the benchmarking tool.

COVERED BUILDING. As it appears in the records of the [Department of Finance]: (i) a building that exceeds 50,000 gross square feet, (ii) two or more buildings on the same tax lot that together exceed 100,000 gross square feet, or (iii) two or more buildings held in the condominium form of ownership that are governed by the same board of managers and that together exceed 100,000 gross square feet.

Exception: The term “covered building” shall not include:

1. Any building that is a city building.
2. Any building that is owned by the city.
3. Real property classified as class one pursuant to subdivision one of [RPTL § 1802].

DWELLING UNIT. A single unit consisting of one or more habitable rooms, occupied or arranged to be occupied as a unit separate from all other units within a building, and used primarily for residential purposes and not primarily for professional or commercial purposes.

ENERGY. Electricity, natural gas, fuel oil and steam.

OWNER. The owner of record, provided that “owner” shall be deemed to include: (i) the net lessee in the case of a building subject to a net lease with a term of at least [49] years, inclusive of all renewal options, (ii) the board of managers in the case of a condominium, and (iii) the board of directors in the case of a cooperative apartment corporation.

TENANT. Any tenant, tenant-stockholder of a cooperative apartment corporation, condominium unit owner or other occupant.

[NYC Admin. Code § 28-309.4] Statutory Excerpt or Summary

Benchmarking required for covered buildings.

The owner of a covered building shall annually benchmark such covered building no later than May 1, 2011, and no later than every May [1] thereafter. Benchmarking of water use shall not be required unless the building was equipped with automatic meter reading equipment by the [Department of Environmental Protection] for the entirety of the previous calendar year. The owner or the owner's representative performing the benchmarking shall consult with the operating staff of the building, as appropriate.

[NYC Admin. Code § 28-309.4.1]

Obligation to request and to report information.

Where a unit or other space in a covered building, other than a dwelling unit, is occupied by a tenant and such unit or space is separately metered by a utility company, the owner of such building shall request from such tenant information relating to such tenant's separately metered energy use for the previous calendar year and such tenant shall report such information to such owner.

[NYC Admin. Code § 28-309.4.1.1]*Owner solicitation of tenant information.*

Such owner shall request information relating to such tenant's separately metered energy use for the previous calendar year no earlier than January [1] and no later than January [31] of any year in which the owner is required to benchmark such building. The office of long-term planning and sustainability may require that such owner provide such tenant with a form designated by the office of long-term planning and sustainability to report such information.

[NYC Admin. Code § 28-309.4.1.2]*Tenant reporting of information.*

Such tenant shall report information relating to such tenant's separately metered energy use for the previous calendar year no later than February [15] of any year in which the owner is required to benchmark such building. Such information shall be reported in a form and manner determined by the [Office of Long-term Planning and Sustainability].

[NYC Admin. Code § 28-309.4.1.3]*Provision of information prior to vacating a unit or other space.*

Where such owner receives notice that such tenant intends to vacate such unit or other space before reporting information in accordance with [NYC Admin. Code §§ 28-309.4.1 and 28-309.4.1.2], such owner shall request information relating to such tenant's energy use for any period of occupancy relevant to such owner's obligation to benchmark. Any such tenant shall report such information to the owner of such building prior to vacating such unit or other space or, if such information is not available prior to vacating such unit or other space, as soon as practicable thereafter, regardless of whether such owner has requested information pursuant to this [NYC Admin. Code § 28-309.4]. Such information shall be reported in a form and manner determined by the office of long-term planning and sustainability.

[NYC Admin. Code § 28-309.4.1.4]*Continuing obligation to benchmark.*

The failure of any or all tenants to report the information required by [NYC Admin. Code §§ 28-309.4.1, 28-309.4.1.2, and 28-309.4.1.3] to the owner shall not relieve such owner of the obligation to benchmark pursuant to this [NYC Admin. Code §§ 28-309.1–28-309.10], provided that such owner shall not be required to benchmark such information not reported by a tenant unless otherwise available to such owner.

[NYC Admin. Code § 28-309.4.2]*Preservation of documents, inspection, and audit.*

Owners of covered buildings shall maintain such records as the [Department of Environmental Protection] determines are necessary for carrying out the purposes of this [NYC Admin. Code §§ 28-309.1–28-309.10], including but not limited to energy and water bills and reports or forms received from tenants. Such records shall be preserved for a period of three years, provided that the commissioner may consent to their destruction within that period or may require that such records be preserved longer than such period. At the request of the [Department of Environmental Protection], such records shall be made available for inspection and audit by the [Department of Environmental Protection] the place of business of the owner or at the offices of the [Department of Environmental Protection] during normal business hours.

[NYC Admin. Code § 28-309.4.3]*Violations.*

It shall be unlawful for the owner of a covered building to fail to benchmark pursuant to [NYC Admin. Code § 28-309.4]. The commissioner shall classify such violation as a lesser violation.

Venue

[RPAPL § 701] Statutory Excerpt or Summary

Jurisdiction; courts; venue.

1. A special proceeding to recover real property may be maintained in a county court, the court of a police justice of the village, a justice court, a court of civil jurisdiction in a city, or a district court.
2. The place of trial of the special proceeding shall be within the jurisdictional area of the court in which the real property or a portion thereof is situated; except that where the property is located in an incorporated village which includes parts of two or more towns, the proceeding may be tried by a justice of the peace of any such town who keeps an office in the village.

[RPAPL § 769] Statutory Excerpt or Summary

Jurisdiction; court; venue.

1. A special proceeding by tenants of a dwelling in [NYC] or the countries of Nassau, Suffolk, Rockland and Westchester for a judgment directing the deposit of rents into court and their use for the purpose of remedying conditions dangerous to life, health or safety may be maintained in the civil court of [NYC], the district court of the countries of Suffolk and Nassau and the courts or city courts in the countries of Rockland and Westchester.
2. The place of trial of the special proceeding shall be within the county in which the real property or a portion thereof from which the rents issue is situated.

[CPLR § 507] Statutory Excerpt or Summary

Real Property Actions.

The place of trial of an action in which the judgment demanded would affect the title to, or the possession, use or enjoyment of real property shall be in the country in which any part of the subject of the action is situated.

CROSS-REFERENCE

See NYC Admin. Code §§ 28-309.1–28-309.4.3

Waiver of Jury Trial

[RPL § 259-c] Statutory Excerpt or Summary

Provision in lease of real property for waiver of trial by jury in actions for personal injury or property damage. Any provision in a lease, executed after [July 2, 1965],³⁰ that a trial by jury is waived in any action, proceeding or counterclaim brought by either of the parties thereto against the other in any action for personal injury or property damage, is null and void.

COMMENTARY

This statute may partly invalidate jury trial waivers in New York commercial leases, depending on the exact scope and waiver of the particular jury trial waiver. If landlord's or tenant's counsel is issuing an opinion on enforceability of the lease, which rarely happens, then perhaps the opinion should raise an exception for this statute. Nothing indicates this statute applies only to residential leases.

Waste and Nuisance

CROSS-REFERENCE

See “Use.”

Zoning Lot

[NYC Zoning Resolution § 12-10] Statutory Excerpt or Summary*Definitions.*

A “zoning lot” is either:

(d) a tract of land, either unsubdivided or consisting of two or more lots of record contiguous for a minimum of [10] linear feet, located within a single block, which at the time of filing for a building permit (or, if no building permit is required, at the time of filing for a certificate of occupancy) is declared to be a tract of land to be treated as one zoning lot for the purpose of this [NYC Zoning Resolution § 12-10]. Such declaration shall be made in

³⁰ This date is the effective date of RPL § 259-c.

one written Declaration of Restrictions covering all of such tract of land or in separate written Declarations of Restrictions covering parts of such tract of land and which in the aggregate cover the entire tract of land comprising the zoning lot. Any Declaration of Restrictions or Declarations of Restrictions which individually or collectively cover a tract of land are referred to herein as “Declarations.” Each Declaration shall be executed by each party in interest (as defined herein) in the portion of such tract of land covered by such Declaration (excepting any such party as shall have waived its right to execute such Declaration in a written instrument executed by such party in recordable form and recorded at or prior to the recording of the Declaration). Each Declaration and waiver of right to execute a Declaration shall be recorded in the Conveyances Section of the Office of the City Register or, if applicable, the County Clerk’s Office of the county in which such tract of land is located, against each lot of record constituting a portion of the land covered by such Declaration.

COMMENTARY

A zoning lot, therefore, may or may not coincide with a lot as shown on the official tax map of [NYC], or on any recorded subdivision plat or deed.

(f) For purposes of the [foregoing]:

(4) A “party in interest” in the portion of the tract of land covered by a Declaration shall [include] only (W) the fee owner or owners thereof, (X) the holder of any enforceable recorded interest in all or part thereof which would be superior to the Declaration and which could result in such holder obtaining possession of any portion of such tract of land, (Y) the holder of any enforceable recorded interest in all or part thereof which would be adversely affected by the Declaration, and (Z) the holder of any unrecorded interest in all or part thereof which would be superior to and adversely affected by the Declaration and which would be disclosed by a physical inspection of the portion of the tract of land covered by the Declaration.

COMMENTARY

By creating a merged “zoning lot” of the type described in the quoted language from the zoning resolution, property owners can move unused development potential (i.e., value) from one parcel to another. The quoted language means that for some leases, particularly recorded ground leases of an entire building, a property owner will need a tenant’s signature as part of a zoning lot merger. To avoid that problem, landlords may wish to include language such as this in any lease where this issue may arise (and it should do no harm in any other lease):

Tenant and every Party-in-Interest claiming through Tenant irrevocably waives any right(s) it may have regarding any zoning lot merger or transfer of Development Rights relating to the Land, including any rights Tenant or any such Party-in-Interest may have to be a party to, to enter into, to execute or to consent or object to, any TDR Document. A “Party-in-Interest” means each party-in-interest as defined in New York City Zoning Resolution (“ZR”) § 12-10 (definition of “zoning lot”), as listed in a Certification of Parties in Interest certified by a title insurance company. A “TDR Document”) means any of these now or later affecting the Land, as Landlord reasonably requests: (a) Declaration of Restrictions as defined in the ZR; (b) zoning lot development agreement; (c) other document to cause the Land to be merged with, or subdivided from, a zoning lot under the ZR; (d) other certificate, document or instrument of a similar nature and purpose; or (e) a consent, subordination or waiver relating to any of the documents just listed. Any TDR Document shall: (w) not directly or indirectly impair any right of Tenant under this Lease (the “Permitted Development”), including Development Rights allocated to Tenant under this Lease and Tenant’s right (whether or not exercised) to develop, rebuild and occupy the Premises for the uses, building envelope and bulk this Lease allows; (x) impose no affirmative obligations on Tenant, except temporary arrangements to accommodate adjacent or nearby construction at no cost or interference to Tenant and obligations not exceeding Tenant’s obligations under this Lease; (y) require the owner of each of the other tax lots within a TDR Document to promptly correct any code violation within its tax lot; and (z) otherwise be on ordinary and customary terms. This Lease shall be subject and subordinate to any TDR Document that complies with the previous sentence. Except for Permitted Development, Tenant has no right to any unused development

rights, rights to construct “floor area,” or comparable rights for the Land (collectively, “Development Rights”). Tenant consents to Landlord's utilization or transfer of all unused Development Rights.

When a landlord enters into a ground lease and then seeks to transfer development rights, disputes are particularly likely to arise.

Landlord and Tenant will often negotiate some arrangement for Development Rights other than as suggested in the language above, such as: (a) Tenant can bring them to the Land, and Landlord must sign TDR Documents; (b) TDR Documents cannot cause anyone to incur obligations regarding other real property; (c) Landlord can pay for any Development Rights Tenant brings to the Land, with Rent adjustment; (d) Landlord cannot transfer unused Development Rights to other land; (e) either party can sell unused Development Rights and the other must sign TDR Documents toward that end; and (f) one party grants another a power of attorney to sign TDR Documents. The suggested lease language provides the vocabulary and starting point for any of these arrangements. They will also require help from counsel experienced with zoning and ground leases, which can become very tricky. If either party ever needs the other to cooperate on any TDR Documents, substantial time pressure will often exist, so the parties may want to build in some monetary incentives.

The concept of Permitted Development assumes the Lease allows Tenant to use certain Development Rights, but others remain available and Landlord can sell them. That is just one of many possible permutations, and not necessarily the most likely one. But it provides a reasonable starting point.

When TDR Documents combine multiple tax lots into a single zoning lot, a major code violation on one of the “other” tax lots in the zoning lot could impair development anywhere in the zoning lot. That cannot be avoided, but: (a) in general, the risk arises only for major code violations, not minor ones; and (b) TDR Documents can address it.

Any arrangement contemplating future approval or negotiation of TDR Documents could create trouble and disputes. If a transfer of Development Rights could become important, the parties may want to go into more detail, attach forms or have a dispute resolution mechanism.

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Getting Started with Commercial Leasing, Third Edition

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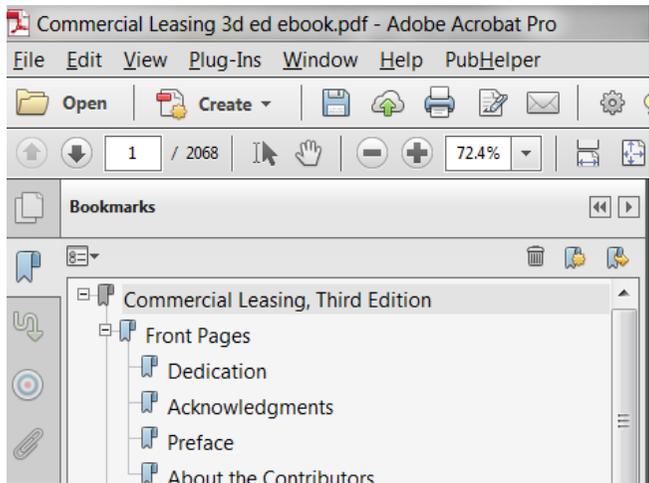
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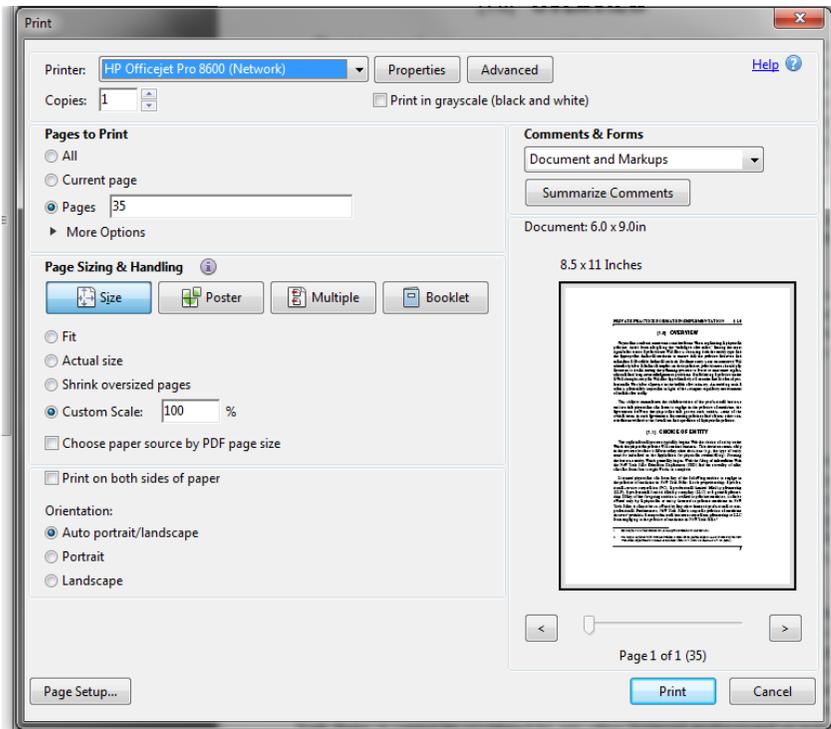


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- Press the Page Up and Page Down keys on the keyboard.

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Note: If the document page numbers are different from the actual page position in the PDF file, the page's position within the file appears in parentheses after the assigned page number in the Page Navigation toolbar. For example, if you assign numbering for a file that is an 18-page chapter to begin with page 223, the number shown when the first page is active is 223 (1 of 18). You can turn off logical page numbers in the Page Display preferences. See [Renummer pages](#) (Acrobat only) and [Preferences for viewing PDFs](#).

Use page thumbnails to jump to specific pages

Page thumbnails provide miniature previews of document pages. You can use thumbnails in the Page Thumbnails panel to change the display of pages and to go to other pages. The red page-view box in the page thumbnail indicates which area of the page appears. You can resize this box to change the zoom percentage.

1. Click the Page Thumbnails button or choose View > Show/Hide > Navigation Panes > Page Thumbnails to display the Page Thumbnails panel.
2. To jump to another page, click its thumbnail.

Navigate with links

Links can take you to another location in the current document, to other PDF documents, or to websites. Clicking a link can also open file attachments and play 3D content, movies, and sound clips. To play these media clips, you must have the appropriate hardware and software installed.

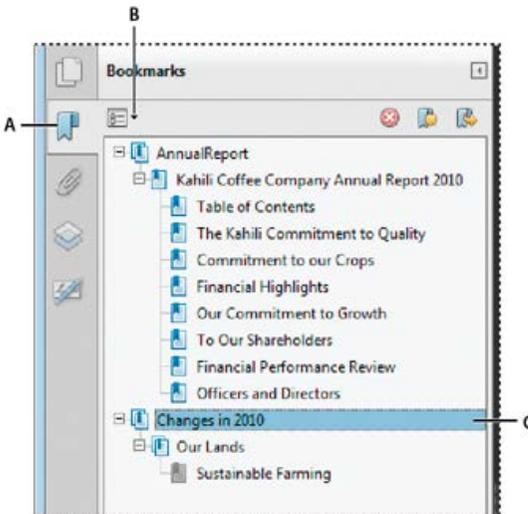
The person who created the PDF document determines what links look like in the PDF.

Note: Unless a link was created in Acrobat using the Link tool, you must have the Create Links From URLs option selected in the General preferences for a link to work correctly.

1. Choose the Select tool.
2. Position the pointer over the linked area on the page until the pointer changes to the hand with a pointing finger. A plus sign (+) or a w appears within the hand if the link points to the web. Then click the link.

Jump to bookmarked pages

Bookmarks provide a table of contents and usually represent the chapters and sections in a document. Bookmarks appear in the navigation pane.



Bookmarks panel

- A.** Bookmarks button
- B.** Click to display bookmark options menu.
- C.** Expanded bookmark

1. Click the Bookmarks button, or choose View > Show/Hide > Navigation Panes > Bookmarks.

2. To jump to a topic, click

the bookmark. Expand or collapse bookmark contents, as needed.

Note: Depending on how the bookmark was defined, clicking it may not take you to that location but perform some other action instead.

If the list of bookmarks disappears when you click a bookmark, click the Bookmarks button to display the list again. If you want to hide the

Bookmarks button after you click a bookmark, select Hide After Use from the options menu.

Automatically scroll through a document

Automatic scrolling advances your view of the PDF at a steady rate, moving vertically down the document. If you interrupt the process by using the scroll bars to move back or forward to another page or position, automatic scrolling continues from that point forward. At the end of the PDF, automatic scrolling stops and does not begin again until you choose automatic scrolling again.

1. Choose View > Page Display > Automatically Scroll.
2. Press Esc to stop scrolling.

PDFs with file attachments

If you open a PDF that has one or more attached files, the Attachments panel automatically opens, listing the attached files. You can open these files for viewing, edit the attachments, and save your changes, as permitted by the document authors.

If you move the PDF to a new location, the attachments automatically move with it.

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