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Default Clauses

Better Drafting Can Forestall Problems

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COMMERCIAL LEASES

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Attorneys are making too much money litigating disputes between commercial landlords and tenants. Even the most frequently used "standard form" leases permit tenants to stall and strangle property owners.[1] And these same leases leave tenants without proper recourse when property owners fail to follow written commitments.[2] Instead of blaming a judge, a landlord, or a tenant, it is time that practitioners recognize, to paraphrase Shakespeare, that the fault is not in the judicial system but in our leases.[3] As the enforcement mechanism in a commercial lease, default clauses must be revised and developed to better meet the needs of landlords and tenants in the existing real estate market.[4]

By taking advantage of equitable judicial relief, tenants have been able to avoid having to follow their lease terms, and poorly drafted provisions have permitted tenants to avoid timely paying their rent and other monies owed under the lease. By drafting provisions which provide (1) that a lease shall be terminated for the chronic nonpayment of rent, (2) that all rents during the lease term are accelerated upon a default in rent payments, (3) that remove the availability of a cure period, and (4) that make all monies owed under the lease as additional rent, many of these problems may be eliminated.

New York courts have produced very favorable decisions permitting parties to freely negotiate lease terms without the imposition of an intrusive judiciary. Even lease provisions producing harsh results for one side have been enforced consistently by the highest courts in New York "no matter how unwise it might appear to a third party."[5]

Chronic Nonpayment

One needed addition to a default clause should be the ability to cancel a lease for the frequent delinquency of rent payments, commonly referred to as a chronic nonpayment of rent termination clause. A landlord who is forced to commence a nonpayment proceeding to collect rent, may still be faced with a tenant who delays and avoids paying the rent for a number of months or in some cases, years.[6] 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 nonappearance, the earliest a property owner can usually obtain an eviction will be a few months after it commenced the nonpayment process.[7] Even after an eviction is scheduled, state law mandates that the tenant be given ten days to pay the amount of rent owed to avoid eviction.[8]

For many property owners, this cycle of late or nonpayment is repeated continuously and, in many cases, perennially. To further enhance the frustration, many cases result in empty tenancies with thousands of uncollectible dollars, not to mention the wasted energy, time and money participating in the collection process.

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As a result, practitioners should include in their default clauses a termination of the tenancy for the chronic nonpayment of rent.[9] A chronic nonpayment clause terminates the tenancy upon multiple defaults in the timely payment of rent. A typical clause will terminate the tenancy once a tenant fails to timely pay the rent more than three times in a year. The third default will allow the termination of a lease.

Despite court challenges, such a provision has been held to be enforceable. In *Grand Libertie Cooperative v. Billhaud*,[10] the Appellate Term, First Department reviewed whether a lease may be terminated upon a single default in the timely payment of rent. Despite being challenged as violative of public policy, the court enforced the lease provision explaining that when a lease between two commercial parties contains a conditional limitation for nonpayment of rent, it shall be enforced in the absence of a showing of fraud, exploitive overreaching or other unconscionable conduct on the part of the landlord.[11] Although this case has been unanimously followed and its thesis has been cited in a number of recent default clause cases, it may be prudent for the implementation of such a clause to be less draconian.[12] The purpose of such a clause—preventing an excessive number of nonpayment cases and collection problems—can be met by a termination of the lease after an excessive number of defaults in a year. If this advice is not heeded, courts may look for ways to frustrate enforcement.

For example, in *Bijan Designer v. St. Regis*,[13] Justice David B. Saxe, when sitting on New York's Supreme Court, dismissed a case when the landlord failed to serve a notice pursuant to the requirements of the lease. Justice Saxe remarked that "whether or not other unspecified methods of notice may be sufficient, I hold that where such a drastic result as acceleration of the full term's rent is sought, the type of notice provided for by mutual agreement must be adhered to. Since the landlord fails to dispute Bijan's assertion that the specified method of notice was not followed, summary judgment dismissing the defendant's counterclaim for acceleration of rent is appropriate here."[14] A more tolerant policy will also increase the ability of negotiating such a provision into the lease without objection.

Rent Acceleration Clause

When used properly, a rent acceleration clause provides another formidable mechanism to ensure the timely payment of rent.[15] Upon a default in the payment of rent, a properly drafted acceleration clause permits a landlord to collect all of the monies due under the lease without having to wait for the lease to expire.[16]

Although an unenforceable penalty and forfeiture in some states and not permitted during the first half of the twentieth century in New York, the Court of Appeals reversed course and recognized its validity for defaults in the payment of rent in *Fifty States Management Corp. v. Pioneer Auto Parks*.[17] In enforcing such a provision, the Court noted that "absent some evidence of fraud, exploitive overreaching or unconscionable conduct on the part of the landlord" equitable intervention was not justified.[18] However, the courts have limited its enforceability to violations involving the nonpayment of rent.[19]

It should be noted that if a tenant submits payment for the full term of the lease at this time, the tenant may remain in possession. As noted briefly above, in

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order to effect such a default, all of the details and requirements of the lease must be strictly followed.

As with chronic nonpayment clauses, the Appellate Division, Second Department, recognized in *GAB Management v. John Blumberg*,[20] that one default in the payment of rent could effectuate an acceleration clause.

Omission of Notice to Cure

Courts have also approved the omission of the standard "notice to cure" normally placed in default clauses in commercial leases.[21] Such an omission takes away a tenant's ability to prevent a property owner from terminating a lease if the lease terms are violated. Of course, a property owner that chooses to exercise such an option may still have to persuade a court that a tenant's conduct or lack of conduct existed and violated the lease. However, the omission of a cure or correction period in a lease provides a property owner with a shield against one of the most paralyzing tenant weapons ever created by a court—the *Yellowstone* Injunction.

A *Yellowstone* injunction, or other similar relief, obtained by a tenant in Supreme Court, prohibits a property owner from terminating a tenancy and freezes any eviction efforts that may have already commenced in a Civil Court summary proceeding. It also tolls any correction period until the parties have had a chance to fully litigate whether a violation has occurred. The availability of such injunctive relief provides an invaluable defensive tool to a commercial tenant.

First, a *Yellowstone* injunction permits tenants to cure any violations even after the litigation is completed. Second, the case will be tried in Supreme Court where it may take years before completion and permit an excessive period of time to cure any violation. Third, a "cure" period, gives tenants' the opportunity to commit knowingly blatant transgressions of the lease. However, if the cure period is eliminated such transgressions will decrease as the reality of the termination of the lease and eviction increases. Finally, once injunctive relief is denied, the case of whether the lease was violated will be tried in a Civil Court summary proceeding without the time impediments of discovery and the lengthy time-line of a Supreme Court matter. In order to obtain a *Yellowstone* injunction, New York Courts have unanimously required that such an injunction be applied for before the notice to cure expires. Without a notice to cure, more than one court has rejected attempts for a *Yellowstone* or similar injunctive relief.[22]

In *Queen Art Publishers v. Animazing Gallery*,[23] the lease failed to include a cure provision. The tenant argued that the clause was unconscionable because the absence of a cure period precluded him from seeking a *Yellowstone* injunction to stay the lease's forfeiture.[24] 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 these circumstances."[25]

In *New Eagle Inc. v. H.R. Neumann Associates, Inc.*,[26] the Appellate Division, First Department reviewed a case in which a commercial lease lacked a cure period. The court then determined that the tenant cannot satisfy the elements necessary to invoke the protection of a *Yellowstone* injunction.[27] The court noted that "the purpose of a *Yellowstone* injunction is to toll the running of a cure period in the landlord's notice to cure...in the case at hand, there is simply no "cure" period for this Court to toll or stay."[28] In effect, tenant's efforts to seek injunctive relief were denied.

Additional Rent

Another small addition to a default clause that greatly influences the ability for a property owner to collect any monies owed under the lease occurs when the lease refers to amounts due as "additional rent." Ergo, monies owed under lease clauses involving taxes, attorney fees, security deposits, letters of credit, and insurance should be deemed additional rent and drafted into the commercial lease.

For example, taking the security deposit to satisfy arrears may result in the landlord's loss of the security money through the end of the term unless the lease specifically provides that a failure to replenish depleted security within a specified time shall be deemed a failure to pay additional rent under the lease.

The Appellate Division, Fourth Department decided in *Perrotta v. Western Regional Off Track Betting Corporation*,[29] that "it is a settled rule that in the absence of an express provision making it so, taxes may not be treated as part of the rent for the purposes of bringing summary proceedings."[30]

It can no longer be disputed that commercial leases, including the "standard form" leases, are seriously inadequate and fail to protect the legitimate rights of property owners.

This small addition permits a property owner to obtain an eviction via Housing Court, as well as a possessory and money judgment if these monies are not satisfied instead of having to commence a Civil Court or Supreme Court case where the expense and time limitations may not justify such an action and certainly will not lead to an eviction upon a successful determination.

Conclusion

It can no longer be disputed that most commercial leases, including the "standard form" leases, are seriously inadequate and fail to protect the legitimate rights of property owners. Although these proposed provisions will have to be negotiated and agreed to by the parties and many adaptations, compromises and creative solutions may be included, this article should assist in the preparation of better default clauses in commercial leases.

1. See Standard Form of Store Lease, The Real Estate Board of New York, Inc. 2/94, Default ¶17.
2. An article by the authors about drafting better lease agreements to protect commercial tenants' rights will be published at a later date.
3. William Shakespeare, Julius Caesar act 1, sc. 2 ("...the fault, dear Brutus, is not in our stars, but in ourselves..."). It should be noted that this article applies only to commercial leases and is not applicable to residential leases.
4. Another addition to a default clause discussed by the authors in a previously published column involved the use of self help in a commercial lease. See Adam Leitman Bailey & John M. Desiderio, Self-Help Evictions, NYLJ, Aug. 10, 2005, p.5.
5. "A lease agreement, like any other contract, essentially involves a bargained-for exchange between the parties. Absent some violation of law or transgression of 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 Altantic & Pacific Tea Co.*, 46 NY2d 62 (1978). See also, *GAB Mgt. v. Blumberg*, 226 AD2d 499 (2d Dept. 1996); *Queen Art Publrs., Inc. v. Animazing Gallery*, 2002 N.Y. Misc. LEXIS 159 (NYC Civil Ct., NY Co., 2002); *Grand Liberte Coop., Inc. v. Bilhaud*, 487 NYS2d 250 (App. Term. 1st Dept. 1984).
6. See www.alblawfirm.com click on News and Appearances and review articles concerning "Candy World."
7. It must be noted that a tenant cannot be evicted for the chronic non-payment of rent unless such a provision is provided for in the lease. See *Carmania Corp., N.V. v. Kalati*, 470 NYS2d 316, 318-319 (NYC Civ. Ct., 1983).
8. N.Y. Real Prop. Acts. Law §751(1). See also, *950 Third Avenue Co., v Eastland Industries, Inc.*, 463 NYS2d 367, 369 (NYC Civ. Ct., 1983).
9. Use Get-Tough Lease Clause to Discourage Chronic Late Rent Payments, Commercial Lease Law Insider, August 2005.
10. *Grand Liberte Coop., Inc.*, 487 NYS2d 250.
11. Id. at 251.
12. *See Duda v. Thompson*, 647 NYS2d 401 (Sup. Ct. 1996); *Queen Art Publrs., Inc.*, 2002 N.Y. Misc. LEXIS 159 (2002); *Liberte Coop., Inc.*, 487 NYS2d 250. See also *New Eagle Inc., v. H.R. Neumann Associates, Inc.*, 791 NYS2d 871 (App. Term. 1st Dept. 2004) (In the court's determination of the notice to cure, the court held "in the case at hand, there is simply no 'cure' period for this Court to toll or to stay.").
13. 536 NYS 951 (Sup. Ct. 1989) (The lease provision of subject in the case provided notice must be made personally or by registered or certified mail. The court held "the parties specifically provided for a method of 'sufficient' notice to the tenant.") Id. at 956.
14. Id. at 956.
15. A typical acceleration clause reads that "if default of any installed payment of rent then the whole of the rent shall at landlord's option become due and payable." *GAB Mgt. v. Blumberg*, 226 AD2d 499, 641 NYS2d 340, 341 (2d Dept. 1996).
16. New York Law states that absent an acceleration clause in a lease, the breach of a lease does not entitle a landlord to make a claim for all future rents under the lease. *Muss v. Daytop Village, Inc.*, 352 NYS2d 28, 29 (2d. Dept. 1974).
17. 46 NY2d 573 (1979).
18. Id. at 116. ("Similarly, equity may relieve against the effect of a good faith mistake, promptly cured by the party in default with no prejudice to the creditor to prevent unconscionable overreaching....It may very well be that since the initial failure to tender timely payment of the August rent was due to clerical error, equitable relief would have been available to Pioneer had its default been immediately cured upon discovery of the error in the absence of prejudice to plaintiff.") Id. at 116-117.
19. Id. at 116.
20. 226 AD2d 499, 641 NYS2d 340, 341 (NY 1996).
21. See *Queen Art Publrs., Inc. v. Animazing Gallery*, 2002 N.Y. Misc. LEXIS 159 (2002); *New Eagle Inc., v. H.R. Neumann Associates, Inc.*, 791 NYS2d 871 (App. Term. 1st Dept. 2004).
22. See B.M.G. *Bagels v. Vorillias Properties LLC*, NYLJ, Nov. 9, 2005, 21.
23. See *Queens Art Publrs., Inc.* 2002 N.Y. Misc. LEXIS 159.
24. Id. at 2.
25. Id. at 8-9.
26. *New Eagle Inc.*, 791 NYS2d 871.
27. Id.
28. Id. at 4.
29. 469 NYS2d 504 (4th Dept. 1983).
30. Id. at 508.

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