Navigating the Dangerous Shoals of a Commercial Lease for Beginners

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By

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John Busey Wood is a member of the commercial real estate group at the New York City office of the law firm Akerman Senterfitt LLP, and advises public and private companies on real estate acquisitions, facilities management, construction and development, brokerage law, commercial leasing, commercial property management and litigation. For over 30 years Mr. Wood has represented owners in the design and negotiation of commercial leases covering in excess of 50 million square feet of retail, office and mixed use space projects. He has assisted large volume space users in the effective management of their facilities portfolios and in reducing costs and risk. These experiences, coupled with a unique blend of professional disciplines and his design and deployment of sophisticated new-generation commercial lease forms during the late 1970's and the 1980's resulted in his being featured in articles on the impact of commercial leases on companies and being referred to by The Wall Street Journal and other publications as "the father of the modern killer lease." His extensive national experience in developable land, improved property acquisitions, large scale retail and office developments, and leasing and management programs have made him an ideal corporate facilities support resource for companies. He is a noted authority on fair market value determination and valuation of properties as well as rental escalations, expenses, allocations, auditing and litigation/dispute resolution. Among noteworthy projects, Mr. Wood directed the legal team in a national portfolio acquisition with a value in excess of $2 billion and he participated in the development, leasing and financing of over 4 million square feet of regional shopping malls and retail centers nationwide. In 1998 he negotiated the largest ground/space lease transaction in the history of New York City, containing more than 1.6 million square feet and including "fast-track" rehabilitation, construction lending, permanent financing and options for fee acquisition. In addition, Mr. Wood has advised, directed teams and designed correlated construction contracts for "fast-track" design-build projects, conversions and renovations in New York City, exceeding 8 million square feet, with values greater than $4 billion. Mr. Wood has also directed large-scale leasing programs for major New York City office towers and mixed use properties. He regularly directs litigation teams in landlord-tenant disputes, construction disputes and retail lease close-outs. His financing, auditing and computer expertise contributed to his uncovering the largest computer-leasing fraud in the United States, the O.P.M. Leasing fraud. Mr. Wood is a licensed Class "A" commercial real estate broker, a Certified Public Accountant and holds B.B.A. (Accounting and Economics), M.B.A. (Accounting and Finance) and J.D. degrees.

Mr. Wood is a member of the Association of the Bar, NYC, New York State Bar Association, American Bar Association ("ABA"), (Vice-Chair of the Commercial Leasing Committee and former Chair of the Office Leasing Subcommittee), and Board of Legal Advisors to the Practicing Law Institute ("PLI"). He has been a member of the Board of Directors of the International Association of Corporate Real Estate Executives (NY Chapter), American Institute of Certified Public Accountants ("AICPA"), and American Association of Attorney-CPAs. Mr. Wood served, from 1982 through 1991, as a member of the Associated Builders and Owners of New York, the New York Building Congress and its Board of Legal Advisors, and the Real Estate Board of the City of New York ("REBNY"). Mr. Wood frequently lectures on property acquisition and management, commercial leasing and construction contract techniques, transaction structuring and brokerage law at major real estate brokerage firms in New York City, REBNY, and at the New York University Graduate School and

Real Estate Institute. He also lectures at PLI, where he is the New York and national Chairman of the National Commercial Leasing Seminars, and at the executive and annual meetings of the ABA and AICPA. Mr. Wood has frequently served as a “party selected” and Federal arbitrator and with the A.A.A. in fair market rent valuation and rental/expense/adjustment disputes and audits and he is an American Arbitration Association - National Neutral - Commercial Panelist-Arbitrator. He has also served as Assistant Attorney General (Kansas), and as special counsel to Bronxville Board of Zoning Appeals, Planning Board and Board of Trustees and is a member of the Westchester-Putnam Boy Scouts of America Council and the National Eagle Scout Association.

Mr. Wood has presented papers on "Equity Leases" and “Work Letters” to the ABA and on “Accounting and Tax Issues for Work Letters and Allowances” to the AICPA. His article "Trump [Tower] Tenant Finds Turnkey [Construction Agreement] Saves the Day" appeared in the Legal Times of Washington and New York, October 21, 1985. Mr. Wood co-authored, with Alan M. DiSciullo, Esq., the treatise Negotiating and Drafting Office Leases, published by Law Journal Seminars-Press (Library of Congress ISBN 1-58852-061-7, 1995-2011 supplemented twice a year); co-authored "Section V.A, Fire and Casualty Insurance" in the Real Estate Law and Practice Course Handbook, Published by PLI, 1994-2010; co-authored "Building Owner's Assumptions Spark Zoning War", Legal Times of New York, August/September, 1985 and co-authored "Financing Real Estate Development through Participation Leases", Real Estate Review, Volume 20, No. 4, Winter, 1991. He is the author of the book, Navigating The Dangerous Shoals of a Commercial Lease, published by New York University Graduate School, 1992-2009 and the ABA. Mr. Wood is listed in Who's Who in Real Estate, Who's Who in American Law, 2nd and 4th Editions, and Who's Who Registry of Global Business Leaders, 1993-4 Edition. Mr. Wood is AV peer rated by Martindale-Hubbell and was peer-nominated and peer elected an American Bar Foundation Fellow. Mr. Wood has been Senior Editor of "Real Estate Corner", a monthly article on commercial real estate for corporate professionals published by The Metropolitan Corporate Counsel, Inc. and has appeared on national television speaking on current trends in national real estate.

John Busey Wood

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The Preface

This work is a modification of the facilities handbook written for professionals called Navigating The Dangerous Shoals of a Commercial Lease (also known as the Guerilla Warfare Handbook for Facilities Directors on How to Accomplish a Significant Facilities Move and Remain Employed). The original "Handbook" was not written for any particular discipline such as lawyers, commercial brokers, landlords or tenants, although written by an attorney-C.P.A.- businessman-real estate broker and land owner, nor is it written in alphabetical order. It is not so much a "how to" work, but rather "how not to" work. For those so inclined, an index will help you with that phobia. The index and contents follow the norm for this industry which is to track the provisions of the New York City early leases and ultimately the form of lease used by the real estate boards and printing companies. It was originally written for the benefit of those poor souls who were responsible for, and entrusted with, the task of helping to find a new home for their company's particular function in leased space. It is modified by this writing for those who find themselves beginning a small business or responsible for a career change in a larger one where they must manage leased assets for their enterprise and acquire space and move.

This work is for those that would like to understand the "Commercial Lease" and those who will find themselves at the mercy of a carefully written intertwining of hybrid legal concepts and highly specialized layerings of specific disciplines which read nicely, feel friendly but are almost incomprehensible to the normal human mind and extremely detrimental to the financial health of a tenant. Those forms are generally in very small print and cover two sides of legal size pages and look well printed. This also is a guerrilla handbook to be used to protect oneself from the well-meaning real estate lawyer, self /professed specialist and save your client literally millions of dollars in unanticipated and unnecessary occupancy and operating costs.

This work was originally written to help facilities peoples at the National Geographic Society in the 1980s cope with predatory New York City commercial lease forms when the Society was beginning the development of very cool animated animal and other videos through the Explorer Television Division. The Society was just a wonderful not-for-profit social entity trying to do good in an expensive and rough environment and needed some protection and understanding of the "Killer Leases" that prevailed at that time. This author having been named the "Father of the modern Killer Lease" by the Wall Street Journal in 1984, it seemed only fitting to be the developer of the "neutering of the Killer Lease by enlightenment", so this Facilities Handbook was born.

Now it appears that the extreme sport of "multidimensional Theft by Lease" or "Formulitic Greed" needs to be put on a more level playing field for amateurs or beginners to survive. So this work is modified and re-written in memory of those facilities managers and directors who have gone before us who crashed and burned their professional careers in reliance on the common belief that written documents can be believed and that pre-printed forms are more than likely reasonable, generally accepted and perhaps represent the equal interests of a landlord and a tenant. And is written to help those more "human" endeavors who just want to run their businesses and survive in their spaces. Reference is also given to the commercial leasing educational web site www.leasingnyc.com and www.officeleasingusa.com with its educational research resources and also to the Swedish-American and German-American Chambers of Commerce Booklets that are posted there to help "cross-border"

companies come to the United States and cope with “Theft by Lease” and the rigors of defending from the business environment of “caveat emptor” and **absence** of the business doctrines of “reasonableness and fair dealing”.

Portions of the materials from the two Chamber’s booklets are included in this work in Appendix “A” for those who may be coming to the United States for the first time to start businesses. It is also recommended for those coming to New York from other jurisdictions in the U.S. that have friendlier laws and practice “fair dealing”, enjoy the protections of the corporate “reasonableness doctrine” and employ protections under common law or statutes rather than rely on the doctrine of “caveat emptor”.

While this work is with much humor and may appear to be sometimes an exaggeration, it is literally based on thousands of actual experiences both inside the workings of owners, builders and developers as well as law firms and tenants' shops and with an ideal goal of increasing the percentage of facilities project directors who can successfully conclude a move and retain their jobs from probably infinitesimal to, in greatest expectation, maybe even ten percent! This is probably the only work on “neutering the Killer Lease” of its kind since those who write to steal from tenants (as I did for my first 20 years) will rarely give away this knowledge without a struggle! With the knowledge contained in this work, much protection will be had from bad things in “Killer Leases” and with the help of experienced and competent counsel in leases, savings in risk and hidden liabilities can run in the hundreds of dollars per carpetable square foot when negotiating a lease with a term of 7 to 10 years. The writer regularly achieves these savings for clients.

This work can not be relied upon as a substitute for counsel and not every real estate counsel will be satisfactory to help with New York City “killer leases”. Though, many counsels will think they can help you and will so advise. Unless they have been playing in this “multidimensional extreme sport of theft by lease” sandbox for decades, they will only think they can help you. As one very famous “home run expert” once said, “ you just don’t know what you don’t know”! For an extensive treatise on the subject of drafting and negotiation of commercial leases, we recommend the two-volume (approximately 3,000 pages) reference work Negotiating and Drafting Office Leases, published by Law Journal Seminars-Press, October 1995-2011, (Library of Congress ISBN 1-58852-061-7) which is also available at www.leasingnyc.com and www.officeleasingusa.com under the “Additional Resource” tabs for research. The treatise is up-dated two times per year by supplements and is in current use as course book for several classes at the New York University Graduate School and Schack Institute of Real Estate. However, this is only recommended for the advanced practitioner, commercial broker/institutional property manager, certified public accountants or legal counsel.

I would like this work to be dedicated, as has been my life, to my wonderful life and love partner of 34 years, Teri Wilford Wood and my children whom I so love and admire, Emily, Jonathan and Alexander.

CHAPTER 1

WHAT IS A LEASE

When the beginner first sees a lease, it is usually rather well printed and looks like a standard form. In truth, the NYC Real Estate Office and Retail Forms of Lease are nicely printed and call themselves just that. Some say “It is well to know thine enemy prior to dealing with it”. Some people refer to a lease as a contract and others refer to it as a grant, conveyance or a demising. I have even heard of it simply called a document or “don’t worry, it is just a form”! In truth, a lease is a living hybrid or combination of a contract and a demising of an interest in real estate for a term as well as a financing agreement and an agreement regulating ones company, operations and even ownership. This is important to remember throughout a lease review and negotiation since the obligations, actions and remedies for the default in performance of obligations may be treated differently if dealt with in the legal context of a contract or when considered in the realm of the law dealing with landlord and tenant relationships and real estate demisings. Truly, a lease is a written contract which grants an interest for a period of time in a portion of the overall interest known as real estate. Real estate is commonly considered the ownership, in its simplest form, of the land and improvements thereon together with any rights above or below the land itself to build in or to enjoy light, air and rights of passage. A lease grants an interest in or a right to occupy the specified portion of the total real estate interest by an occupant for a period of time and is subject to premature termination in the event that obligations required in order to enjoy the interest are not performed.

The contract portion of the lease duration starts on a date which, in many jurisdictions, is a specific date of contract commencement but in some jurisdictions is referred to "as of" a certain date, which has the added effect of causing the obligations in the contract (liabilities, in many instances) to relate back to a prior period in time before the date it is actually executed. In people language, this is the date on which the contract is actually signed and delivered by both parties. This relating back phenomenon can impact throughout the lease causing obligations of repair for conditions which occurred after the "as of" date but preceding the taking of possession to be the obligation of the tenant or causing certain expenses, rentals, escalations or other payments to retroactively occur when not anticipated by one of the parties (usually always the tenant). It is most important to focus on this contract commencement when you are negotiating a lease because your job may depend on it.

When negotiating and reviewing leases, you will regularly encounter two practices of lease designers. One is a pyramiding, if you will, of defined terms and the other is an intentionally designed interaction of these defined terms throughout the lease (rarely where anticipated) which, because of the definition or operation of a particular concept, causes financial risk or liability along with much political suffering and pain. If the writer has been subtle and crafty, the definitions, when layered one upon the other, will seem and sound quite reasonable and even friendly at times (since they are usually labeled with friendly titles) but will actually mean something considerably different from what was anticipated or expected from the use of the nice words in the definition. Unless the impact of this systematic pyramiding and designed interaction is traced throughout the layering and redefining or adjusting of the definition, the result may be (and usually is) totally unfavorable to the reader-

negotiator. It can be like a treasure hunt, with modification of terms showing up in unanticipated portions of the lease, such as exhibits, a work letter or the rules and regulations but having the same force and effect as if appearing in the paragraph originally dealing with the concept. This will leave the lazy or the unfocused reader wandering down what appears to be a very wonderful, friendly path to the reader's and client's ultimate destruction. A fair proof of this recurring result is simply to notice the different answers proffered by different people when asked a simple question, such as that often asked by the executive vice president of the facilities manager, "When does the lease begin?" Difficult answer since the question is not very precise. The contract began on the date specified either at the beginning of the lease or at the end. This may be the date signed, it may be the date delivered or in all likelihood it may be some date in the past that suits the landlord's purposes. That of course, in most instances, will not mean the date that the tenant is allowed to cause work to begin in the premises or the date that tenant or its contractors have the right to take possession or enter into the premises. In most instances, it also is not the date that the obligations to make repairs, provide insurance or other obligations under the lease for the premises began and it certainly will not be the same date that the obligation for payment of rent or other charges will begin. As a matter of fact, if written right, you can make sure that none of the previously mentioned dates for commencement of anything will be the same as the dates for commencement of anything else. If the lease was carefully designed, by the time you are finished listening to answers, no one will have properly answered that question except for the counsel to landlord or a judge, if it becomes an issue. Of course it will become an issue! One might say that it is fairly critical to know when you are getting the space or are obligated to do the things necessary in order to obtain what it is you think you are going to be occupying for however long you might suspect you may be allowed to occupy it for whatever it is you may naively believe it is that you intend to do in whatever it is you may ultimately get. This is what is called layered tenant assumptions at its best! My experience in negotiating thousands of leases has led me to believe that at any point in time a Tenant believes and operates fully believing that they are going to end up with something and pay for it. This is really quite different from what the landlord, who will be giving it, believes he will be giving and what the tenant will be paying him for it. This may also, in most instances, be a different understanding than the broker for the tenant and the broker for the landlord, each having separate ideas, believe is happening in the transaction. It is not uncommon for the lawyers representing the landlord or the tenant also to have a different understanding from all of the other people.

CHAPTER 2

WHO IS THE LANDLORD AND WHO IS THE TENANT

As if it were not enough not to know what you are getting, when you are getting it, and how much and when you are going to pay for it, it is interesting to note that when the parties sign the lease one or more of the transaction participants may not know who is giving it and who might or might not be allowed to utilize it. Having said this, it is important to point out that near the beginning of the lease where there is a date there is usually a recitation of who the landlord and tenant are. But I have seen recitations of who the person who is purported to be the landlord is, but who actually has little or no right to be the lessor or bind the property or the land, and naming a tenant who is actually not going to be the occupant, but which may be a division or an affiliate or a parent of the actual occupant, even though the document defines this entity as actually being the one who must occupy the premises, which of course causes problems right away. In the worst case I have ever seen, the person who was acting as, and believing it was, the agent for the landlord signed the document without authority. It was reflected as agent but defined as the landlord. It actually was an agent of a person who did not even own an interest in the property and was not able to bind or convey the interest it purported to own. But that was alright for the tenant was not the one who was actually going to use the premises although the lease required that the person whose name was reflected as tenant must be the only person to occupy the premises. It wasn't even the entity that was going to write the checks each month to pay the rent. We had a very difficult time after monies were paid sorting out who could sue whom and for what. Granted, these as many practitioners say, were all mere technicalities; but what is leasing without precision. Needless to say, the facilities manager did not last the week.

CHAPTER 3

WHAT IS THE LEASED PREMISES

While it may seem strange that there are actually transactions where the landlord may not even own the building and may have apparently been committed to by an agent who does not even have authority, the tenant is not the one to occupy the premises and that the parties don't know when the lease contract, demising term, obligations, possession or rent commencement occur. It is also curious to know there have also been several examples in life where the demised premises was defined in such a way as to enable no party, including a judge, to agree as to the location, size, measurement and condition of delivery of the space or services to or equipment provided in the space and in some instances even the particular floor of the building where the space was. In one instance we weren't even sure of the building! In that particular instance I was surprised anybody had the courage to bring the signed document to a lawyer. I seem to be in a minority, but I think it is appropriate for job security to focus carefully on each of these aforementioned issues.

CHAPTER 4

TERM OF THE LEASE

It only seems reasonable and practical to have the lease signed prior to the right to occupy the premises. This frequently happens when tenants are required to commit for future space when another tenant is still in occupancy, when landlord has clean up work to do in the premises before giving it to a tenant or when the premises is under construction. The interval between the contract signing and the time of an actual right to possess or occupy the leased premises whether by the tenant or by its contractors or agents is called, not surprisingly or very originally, the contract interval. During this time, the lease is a contract only (and not a demise) in most jurisdictions. After the tenant acquires the right to possess the leased premises (whether exercised or not), the lease becomes a conveyance or a demising. This hybrid document is the lease that most normal people speak of during cocktail conversations. There are different risks and benefits during these differing time periods. One risk is that if due to no fault of the tenant, the contract period goes too much longer than contemplated by the lease so as to frustrate the ability of the tenant to do its work and occupy, with any certainty, the premises in the future, the contract may be treated in most jurisdictions as a contract which may be terminated and with damages given to the tenant. After the tenant acquires the right to take possession of the premises and whether or not the tenant actually does so, the agreement takes on the character of a demising requiring certain procedures to be followed prior to termination which layer over benefits and obligations on a tenant under the Law affectionately known as that of landlord and tenant. In many jurisdictions interpretation and dispute resolution of landlord and tenant laws are regulated by separate divisions of courts which deal only with landlord and tenant matters and summary proceedings.

It is also not unusual for the possession period which commences the demising term, or what is more frequently loosely referred to as the lease term, to occur prior to occupancy which triggers the obligation to pay the fixed rent and in some instances additional rental, escalations and other direct charges for electricity and other uses of building systems. Commonly, the commencement of those obligations is referred to as the rental term commencement. However, it should be noted that there are provisions in leases which cause the rental term commencement to be deemed to have occurred even though there is an abatement of rent and, in certain disputes, that benefit to a tenant of nonpayment of rent can come back to haunt it. As a minimum, I think it would be a good idea for the facilities manager or the project coordinator to be aware of when the contractual obligations, which may have nothing to do with payment of money, begin and to be careful to determine when other penalties and obligations begin to accrue prior to the demising of the premises. It is helpful to differentiate between possession of the premises, right to have possession, actual occupancy and occupancy for conducting normal business operations. Depending on the definitions contained in the lease, any of these could trigger the conversion of this lease from a contract to a demising or from term commencement to rent commencement. This will be discussed further later. There are things that will be covered later on this note such as the obligation to move forward with plans and specifications for the build-out of the premises and provide landlord with other information. Any of these related areas may cause delays in the ability of landlord or tenant to complete the premises and may have very heavy tenant penalties

associated therewith camouflaged in the document in an area of the lease which I will refer to as the work agreement. This will be taken up later and dealt with in considerable detail.

The last little tidbit which may become helpful in landlord-tenant guerrilla warfare would be the little known fact that in many jurisdictions a lease once signed by both parties does not need to be delivered. Lawyers use the term execution loosely, but in its proper construction execution means signing and delivering. Deeds and other conveyances (arguably a lease where the contract and demising commence simultaneously) need to be delivered in order to be effective. However, a lease which for a period of time will be in a contract interval, in some jurisdictions, including the writer's, delivery is unnecessary since it is a contract and not a conveyance at that particular time. There have been instances where landlords or tenants have been the last to sign leases and torn them up only to find out through proper and careful pursuit of facts in the courts that they had a binding obligation at the moment of signing. In several instances I remember, these were grave discoveries.

CHAPTER 5

POSSESSION OR CONTROL

The practitioner of facilities management should also be concerned with actions under the lease which may be deemed to cause the demising term to commence prematurely, such as sending an architect into the premises to inspect and to do drawings which, in some jurisdictions, is sufficient for accepting control or possession of the premises and therefore triggering an occupancy or a demising. This particular concept becomes relevant in leases which cause the rent or term commencement to begin when tenant occupies or takes possession or maybe even just has the right to take possession such as being given the keys or sending some architect in to measure. These are not synonyms in most jurisdictions. Occupancy means going into the premises. Occupancy for the purposes of conducting tenant's business means going into the premises and beginning even low-scale or startup business operations. Possession on the other hand can be as simple as accepting the keys without entering or taking control of the premises, sending an agent, contractor or employer into the premises for purposes other then conducting business or actually sending contractors in to begin work. Any of these actions may take the lease out of the contract interval and may trigger liability under the lease and may accelerate obligations for payment of rent and for other direct payments and services.

CHAPTER 6

PREMISES

It is not uncommon to find the leased or demised premises referred to as the leased space, the space, the demised premises, the lease premises, the leased premises, the premises and even in some instances believe it or not the location or area. Just in case you ever wish to find your leased premises, there are certain attributes of a premises that are important to note such as the point on a vertical plane, the floor number, where the premises may be located on a horizontal plane and how much of the plane is occupied by the demised premises. The variations in the resulting obligation to pay rent, repair, tend to or be responsible for such area are significant depending on how a leased premises is described in a lease. Simply stated, people use the measurement definitions in very unusual ways as well as referring to the premises without measurement by sketch or cross-hatching or lining in the area on a floor plan or otherwise etc. etc. etc. There are innumerable problems that come with these non-standardized reflections, including liability that is unthought-of and certainly unwelcomed, such as being required to pay for, maintain, repair and/or insure areas and equipment therein which one usually would not like to think of as the premises. This may occur when areas are inadvertently (or intentionally) included as leased premises on an exhibit in the lease reflecting a floor plan with the demised area plus other areas marked by cross-hatching. We would do well at this point and for the purposes of the discussion throughout any particular lease to define our terms carefully and fully and remember to check graphic depictions of definitions for corrections or propriety.

CHAPTER 7

AREA

Square footage area is a very illusive term. In every jurisdiction including some small areas within cities, the definition may take on an entirely different aura due to custom of usage than expected by a tenant. Some people actually believe, I am told, that leased area is what they feel that they can walk on and utilize. Either to the landlord's credit or embarrassment, this has never been the case in any jurisdiction in the free world. I like to refer to square footage measurement as rentable (bearing no resemblance to anything in life except your rent payment), carpetable (which obviously is what you can walk on), usable (which is maybe a bit more then you can walk on) and allocable (which is usable plus everything else rationally conceivable). Usable and allocable, when aggregated, may actually equal the rentable area reflected in the lease. It helps for a facilities person to at least understand the concept of area in its simplest and most benign form. I believe this is when zoning regulators got together and envisioned certain horizontal planes stacked vertically to account for space to be occupied for the conducting of business by tenants, for space to be used in common by all for the enjoyment of a building and space to be used only by building facilities and services in order to make the enjoyment of the building possible by way of heating, cooling, telecommunication, etc. This simple concept is commonly referred to as floor area. Of course, this is too simple for any landlord to use because it is an observable, definable, finite and therefore not a very creative or ambiguous measurement upon which to creatively base the rental terms of the lease. In their vision, the regulators would like to see certain density (both building and people traffic) and certain types of utilization mix in urban areas and they do not wish to see conversion of certain areas into rentable, occupiable premises for conducting business. This tends to sidestep their urban planning and overload service and transportation systems. For instance, if a mechanical room is no longer necessary to cool a building because of the miniaturization of the cooling equipment due to advancements in technology, some landlords might convert that to occupiable and rentable area. It does not seem to matter that it was otherwise in some jurisdictions already allocated to be included in rentable area of other tenants. But now, it can be occupied and actually rented as well and maybe counted twice or more. This is called "double dipping" in real estate circles and is considered child's play. I can actually quadra-dip! This of course flies in the face of all the important requirements for zoning, urban occupancy, density and other such niceties. Buildings over the first ten years of their life take on a considerable amount of hidden zoning recharacterization and, therefore, the simple definition is no longer very helpful in leasing. But in the practice it will serve as a bench-mark and as a basis for an understanding of the concept. Assume that a landlord has a floor area of 20,000 square feet. Further assume that 2,000 square feet of that floor area is for building systems and that 1,000 square feet are occupied by columns, riser cabinets and the like. One would believe that you have 17,000 square feet of rentable area. It only seems fair that carpetable areas in the building, if the landlord would like to reflect a lower square footage minimum rent for marketing purposes, should be increased by service and mechanical areas that serve only the demised premises or the demised premises and other premises on an allocable basis. These service areas such as mechanical rooms serving multiple floors, can be allocated on an appropriate square footage basis to

the demised premises and would be added to the floor area. One might go further and add lobbies and other common areas by way of allocation to the floor area. In a simpler sense, this would give you the rentable area. Now we have the beginning of the data to discover true area. As we have seen, landlords and zoners do not measure floors necessarily the same way. That is not to say that landlords among themselves measure it the same way either. Contemplate, if you will, a million square foot building where the floors are measured from the center of a convex window at the interior side to the exterior of the interior core area walls. This will give you considerably different measurements for the building than if you measure from the interior of the core interior wall to the exterior of a concave window at center point. Additionally, this would be a different number than measuring the same interior dimensions of the interior wall to the innermost portion of the sill of the window. Add to that the issue of where to measure the interior demising walls demising multi-floor tenancies. Some measure to the interior point, some to the center, some to the illusive "appropriate point". This can be continued for columns, cantilevered space, etc. I have seen the floor area measurements for rentable purposes of a "to-be-built" building grow on a planned building with 927,000 of approved square feet to 1,056,000 of rentable square feet without a great deal of creativity. Later in the life of a building, one can, of course, look to the conversion of no longer necessary storage space, mechanical rooms and abandoned air shafts, slop sinks and telephone switching rooms to make the building grow even further. One might begin to see that the fixed minimum rent may be more a function of profit and debt service underwriting than a true reflection of the cost to occupy traditionally uniform square footage area. Fixing this measurement of the lease, of course, becomes desirable for a tenant. Not only do you have to concern yourselves with it for your floor, you have to concern yourselves with the method and manner for all other floors in the likely event that you will be called upon sometime in life to pay your share of the building expenses or increases therein. It is also good to note that in a large building not everybody has the same basis for measurement or the same numerators and denominators for court allocation in determining the square footage area of the building. That can also partly depend on whether the building area is determined to be occupiable, leased or leasable, floor area for zoning purposes or just some creative other definition. There was actually a case that I was involved with concerning a problem at a midtown law firm which leased a certain number of rentable square feet without checking to see loss factors, as we call it, which is the difference between the usable and the actual rentable numbers. After occupying the premises, the tenant decided that it would sublet a certain portion of excess capacity and decided to sublease 50% of its space. When negotiating the sublease, the square footage of the rentable area prominently appeared in the sublease but the percentage did not. On the later measurement and preparation of the premises for demising to the subtenant it became readily apparent that due to the new measurement of the square footage in the sublease, the tenant would end up with two-thirds of the premises under the master lease instead of 50%. This of course was devastating to the law firm, who called the landlord to ask if there had been some mistake. There had, but it was not the landlord's. It is also remarkable to note that once you may have determined the appropriate measurement of the premises, it becomes increasingly difficult to know what is contained within the premises in the way of fixtures, equipment, wiring, cooling, windows, blinds, ceilings, and floors since the definition does not usually cover three dimensional space. This becomes important for instance if your demised premises is defined by a drawing of crosshatching of an entire floor when read together with other sections of the lease because the tenant may find itself responsible for repairing and replacing all those things within the demised premises drawn by crosshatching including the piping for the floor above because it is in the ceiling on the floor below or within the floor below, part of the elevator systems that pass through the floor, and HVAC equipment. These are traditionally thought of as landlord's responsibility among other things, with the exception, in all jurisdictions, of structural components. Not a nice omission when a tenant is trying to identify and minimize risk and liability.

Another fun area is what does a building sit on? Assuming you have the vertical and horizontal planes defined properly, the other component of real estate which will come back through escalations and other obligations becomes the land. Many leases define it just that way: "the plot of land upon which the building is erected." Depending on how land is measured for zoning, title or facilities operation purposes, it can be 100 acres or it can be only so much of the land as is necessary to support the building, which would be about the same as the floor plate for the ground floor. I have seen obligations and escalations and other charges cover very wide ranges, including land owned by the landlord and by others. The definition frequently is to call the plot of land on which the building or improvements are erected as "hereinafter the land". This is fertile ground (interesting comment) for a great deal of fun and hidden liability which we will cover later, and can include innumerable improvements not being utilized by or benefiting tenant or necessary for its use of the demised premises.

For the beginner, it is best to probably work in more simple terms. Always ask an architect or the broker to ask its architect to measure the “net carpetable” space in the to be leased premises. When looking at multiple candidate spaces to lease, this becomes most important. The “net carpetable” area is that which you can stand on. This does not include columns and building machinery. Then take the total annual rental being demanded for the space (the rentable number of square feet times the fixed rentals per square foot plus electric charges if priced on a square foot number) and divide that number by the amount of square feet the space is being advertized at or offered as. That will of course be the rentable square foot rental per annum that was quoted to you. Then take the same annual rental amount for the space and divide that number by the “net carpetable” measured number of square feet that can be stood on. That number will vary from building to building, but will be somewhere between 30% to 50% larger or more costly for the carpetable square foot than for the quoted rentable square foot. Since there is no standard of measurement for rentable measurements in NY, this will quickly tell you how much per building one is going to be paying for space that can be used.

CHAPTER 8

USE

No other section causes more trouble than the use of the leased premises. Uses can be permissive, excluded, exclusive, mandatory, specific or general. Just to name a few more adjectives, they can also be difficult, expensive or impossible depending on how the lease is drafted. Examples of those are of course: "shall be used only for blowing of glass on Thursdays between the hours of 2 and 7" and "drying and painting of glass on Fridays between the hours of 3 and 6" and "by the tenant hereinabove named only and for no other purpose whatsoever". This really means no other use or no use during any other time or by any other occupant. For a variety of constructions ambiguities we are also not certain of which hours, a.m. or p.m., and whether the stated hours are inclusive or exclusive. There are more restrictive uses than that but it might be hard to imagine. More permissive would be the leased premises may be used for any lawful purpose. It does not say when, how or by actually whom. This of course is the best; however, in the event that there is a particular use that you need and you need to know that the building, zoning and other service needs will be met, including certificates of occupancy, sufficient electricity etc., you must specifically state that as a required use of the tenant. This will serve to obviate the requirement to continue to pay rent if for zoning reasons or certificate of occupancy reasons or even insufficiency of building services or failure of other requirements of the landlord or building, the tenant is unable to utilize the demised premises for the specifically stated purpose. Tenant user groups usually do not like paying rent for premises that they may not occupy for the purposes they explicitly required of their facilities managers. This, of course, has happened before. The logic of this section flows over into who the tenant actually is, how there can be other tenants by assigning, subletting, operating agreements and otherwise. These will all be covered later but the problem rises or falls based on the specific and permissive characterization in the definition of the use.

Uses can be continuous or interruptible, space can be required to be occupied or it can be empty, all or designated areas of spaces can or may be required to be used for specific uses or not; however, all of this must be addressed carefully early on in leases or the pyramiding and reuse of the definitions will later cause all sorts of bad things to befall the tenant. These difficulties have made great cocktail conversation for previously employed facilities directors since damage to tenants usually translates into total destruction of facility directors.

If you are beginning to see a pattern at this point, you may be getting the feeling that all you really need to know in order to become an avid leasing enthusiast you learned by the fourth grade, to wit: who, what, where, when, how, why and how much. I believe if all these questions are carefully answered early on, a lot of the interesting dilemmas which I have observed would have disappeared.

Another area of concern is a use clause in a lease that requires mandatory occupancy of the premises. This kind of requirement is quite appropriate when you are depending on customer traffic, as in a shopping center or in a mixed use project, in order to make all of the occupancies viable or in order to maximize percentage rental income to the landlord. In a commercial office, warehouse, industrial park, or other similar lease situation, however, these are hardly necessary. Similarly, the requirement of

the use of the entire premises and a prohibition against vacating the premises should be looked on with disfavor. A landlord has a genuine interest in seeing that the tenant does not abandon the premises. However, the difference between vacating and abandoning is a legal distinction that seems to run uniformly throughout the jurisdictions. Abandonment means vacating the premises with no intention to return to, control, protect, perform in or pay for. Vacating merely means not occupying the premises but otherwise performing under the terms of the lease, such as obligations to insure, to repair, to maintain, and to pay rent.

Additionally, the use may be circumscribed with limitations which prohibit interference with the building's operating systems, such as those for heating and cooling. The character of the use and the manner of use also may be circumscribed to limit interference by way of smell, noise, vibration or debris and supplies maintained in walkway areas throughout the building. These kind of harmony clauses are inserted to enable tenants to get along with one another and to allow landlord to service and operate the building systems in an efficient and cost-effective manner. These kinds of harmonious occupancy clauses, which in their purest sense are benign and important, must be carefully reviewed in order to avoid any impairment of the ability of the tenant to occupy the premises for an intended use which by its very nature may be non-harmonious. The theory is that a tenant with a use that may be different or less harmonious is probably paying a higher rent or has satisfied some other need to get the use it anticipated and should not have other provisions in the lease which impair its ability to benefit from its bargain.

Care and attention must also be given in the use clause to any requirement to obtain licenses and permits for operation within the demised premises. If the clause contemplates specific permits or licenses that deal with a specific use by tenant, such as telecommunications, running a school, running a beauty salon or such other specialized activity like a nuclear reactor, these kinds of permits or licenses should be obtained and maintained by the tenant. In some instances, if such licenses are not maintained the landlord may find itself liable. For example, day care centers or schools operating in office buildings, which have not properly registered nor complied with licensing requirements, may cause a landlord to be liable in the event of a fire, hazard or a death in the demised premises. Landlords, of course, have a valid interest in seeing that tenants do comply. These types of special use requirements should not be confused with general permits or licenses to occupy any demised premises. Many clauses, however, go a little beyond the appropriate boundary and obligate a tenant to obtain and maintain all permits and licenses required in order to "occupy" the demised premises. It seems to me that occupancy permits, certificates of occupancy (permanent or temporary), or any other types of permits which are required for the stated use of the demised premises, including initial alteration permits which were negotiated for in the lease, should be the burden of the landlord. Landlord will have to be specifically required in the lease to obtain them and maintain them as well as take no action which would impair the ability of the tenant to occupy the premises pursuant to them. The absence of a statement to this end can cause endless problems with the tenant in the beginning of the lease and throughout the lease occupancy period, especially if there is a change in law or change in requirements affecting the building or premises and the landlord does not undertake to comply with such changes. Landlord's failure to comply may actually either legally or practically shift the burden to the tenant.

We have also seen situations where a particular use under the zoning resolution for the area appeared not to prohibit the specific use that the tenant intended to employ in the premises, but upon filing of plans and a request for building permits, it was discovered that the building department would not approve the intended alteration for the intended use. This result, although not unusual, was highly disruptive. The matter went to litigation whereupon a lower court ruled that the tenant must continue paying rent. Upon appeal from the lower court ruling the appeals court stated that if the lease and the

underlying obligation to pay rent were conditioned upon a specific use of the premises it should have been specified in the lease, along with a representation and warranty of the landlord that the intended use was permitted, and an undertaking by the landlord to deliver the premises in a manner permitting the tenant's special improvements and to obtain a certificate of occupancy allowing for the use. Since no such obligations were contained in its lease, the tenant continued to pay its rent until it went into bankruptcy and ultimately never was able to occupy the premises. How would you like to have a case like that to enhance your career path (or spiral)?

CHAPTER 9

DEMISED PREMISES APPURTENANCES

Appurtenances is just a nice word for what is in the demised premises and who owns it, cares for it and feeds it. As we discussed earlier, sometimes the appurtenances are defined very craftily by reference to a crosshatched schedule buried deep in the heart of the lease or on the very, very last page. Sometimes the very, very last page is omitted from tenant's draft! Sometimes this is an accident! If defined carefully, this can include a lot of landlord's or ownership type properties and equipment, the maintaining, care and feeding of which is expensive and can be by that method thrust upon an unsuspecting tenant. I know of one instance where a crosshatched floor plan picked up a generator that serviced the demised premises plus five other floors. Because of the luck of the draw and the proper level of craftiness on the part of the landlord, that generator was included in the demised premises for care and feeding, and had to be cared for and fed frequently by the tenant. The other tenants got a free ride. Not nice, but an electrifying experience for the facilities manager.

Clauses dealing with appurtenances usually define the improvements and alterations as well as the building systems found within the demised premises and prescribe who owns them, who can depreciate them and who must maintain, repair, restore and refurbish them. Common appurtenances are built-in furniture and fixtures, heating and air conditioning equipment, communication equipment, tile floors, partitioning, paneling and wall treatments. Fixtures have to be watched carefully since those are the things that are installed into real estate and become part of the real property by their attachment. Although commonly occurring in retail and restaurant leases, we have found situations where the trade fixtures of computer, broadcasting and telecommunication companies once installed, even though easily removable, became the property of the landlord. Not only did the landlord get the benefit of depreciation, but at the end of the term of a short term lease the landlord was able to relet the premises to a tenant using just such very expensive equipment. This is a killer not only for the client but also of facilities managers. On the other hand, there once was a case I had where we were careful in the lease to define everything located in the premises at the commencement of occupancy and installed thereafter, no matter who paid for it, as tenant's property able to be removed at the end of the term. Well, wouldn't you know, the landlord put in over $100.00 a square foot of work and the tenant left with the heat, ventilating and air conditioning systems, the security and alarm systems and the fire systems among other things. The same landlord provided water fountains, toilets and sinks which unfortunately were crosshatched as part of the tenant's space even though they were located on a multi-tenanted floor. These were similarly removed by the tenant. It is hard to believe that the facilities manager in that instance didn't become Senior Vice President, but of course, one is never rewarded for what one does right.

The definition of appurtenances and how they are dealt with at the end of the term not only impacts on the financial aspects and reporting of the transaction but also will impact on condemnation and insurance proceeds. So dealing with them appropriately up front will save you time and heartburn later. Of course, I know you may say that just the other day you worked through the trauma of

occupying a brand new one hundred story building with its tenant improvements just completed and half of it was condemned! Unlikely to absurd. But once in a while it does make a big difference. It is especially difficult to explain when your client is the one who makes his entire livelihood from these trade fixtures and other appurtenances all of which are required to be left behind at the end of the term or were not paid for after condemnation or replaced by insurance after casualty.

CHAPTER 10

REPAIRS AND VARIOUS OTHER COVENANTS

In many leases, landlords and tenants covenant with respect to repair and maintenance of the building itself, the public portions of the interior and exterior of the building and the demised premises. Some leases contain only covenants of the tenant and the landlord's covenant rests in the law of the jurisdiction or in the common law of implied covenants of repair and maintenance, habitability and quiet enjoyment. One may be rudely surprised at the deficiencies in the common law level of repair if the lease is silent. It therefore seems a good practice to have the landlord covenant as to tenant's expected level of repair. There are, of course, many different levels of repair and varying liabilities and indemnities which run with the particular level of repair. Tenants generally are put in a position of repairing the non-structural portions of the demised premises as well as any other portions of the building, structural or otherwise, which are injured by tenant or its agents, visitors, invitees, etc. Usually landlords will undertake an obligation to perform the level of maintenance and repair consistent with the quality, class or level of the building. For instance, in New York, a lease of space in a first-class building should contain landlord's representation and warranty to provide first-class repair and maintenance. First-class speaks to quality as well as timing.

One must be very careful and clear about who has what obligation for what area of the building with respect to repairs. Landlord may obligate itself to repair public portions of the building and the structural components of the building, but may crosshatch or define the demised premises to include the exterior windows and wall of a curtain wall exterior building. I know of at least two instances where the curtain wall buckled and windows were damaged and the landlord required the tenant to pay for the repair. The tenant, of course, opined that the windows and curtain wall were structural. The courts involved in both cases determined that a curtain wall type of exterior is non-structural and because of the crosshatching it was the obligation of the tenant. A similarly obnoxious result occurred when landlord obligated itself to take care of public area structural portions of the building. However, tenant was to repair everything within the demised premises, structural or otherwise. In this instance, not only did the tenant replace the floor by floor air conditioning system, it also had to replace a portion of the floor that buckled.

In some leases, landlords attempt to shift repair obligations to tenants, including structural obligations, latent defects, remediation of hazardous materials like asbestos and other ownership-type repairs and require tenants to hold the landlord harmless from failure to make those repairs or advise the landlord when such repairs are necessary. Additionally, landlords at times limit their liability or totally exculpate themselves from liability for breakage, and damage or injury resulting from breakage, of steam pipes, water pipes, waste pipes, electrical wiring, etc. These types of clauses and liabilities and responsibilities better suit a net lease such as a ground lease where the tenant controls services and maintains the entire project with minimal or no participation or oversight of the landlord. Where the landlord is running a tower office building, these types of exculpations and indemnities as well as

obligations imposed on tenant to make repairs and perform maintenance seem inappropriate to me. These obligations can become exceptionally burdensome and expensive if the tenant is not careful when it receives the premises to make sure that the premises are in a good state of repair allowing the tenant to concern itself only with future routine maintenance. Existing conditions, which upon discovery, would be determined to be violations, hazardous and injurious situations or fire law and insurance underwriting deficiencies, can cause a tenant considerable grief and expense after the lease has been signed. Additionally, changes going forward such as changes in regulations, building ordinances and zoning and fire law requirements can be extremely expensive for a tenant who is required to pay for the cost of putting the premises in compliance. One must watch out for the surprising costs that arise from a cost definition that's expanded in the lease to encompass not only repairs and maintenance, but replacements and improvements.

Running on the same turf with the obligation of landlord to make its repairs is the tenant's right to enforce such obligation if the landlord defaults. Failing all else, the tenant should be allowed to make the repairs that are essential for the enjoyment of the premises and to collect the costs of the repairs from landlord or credit the costs against rent with an interest carry for the unamortized balance until depletion of the credit. You can bet the landlord has that right of self-help and collection in most leases these days by making defaults and cure costs convert to additional rent with interest and enforcement costs. Other areas of concern are how, when, and where repairs are made and how materials and work are staged in order to accomplish the project and minimize the impact to tenant's operations. Timing in many jurisdictions can cause great expense. For instance, repairs required to be made after hours can generate incredible overtime costs and additional charges for security and services in a building. Staging of materials and work can also create havoc and expense if it needs to be accomplished in other premises not controlled by the tenant. A limit of the amount of materials to be maintained in a tenant's premises for a landlord's or other tenant's work should be considered. Any more than a day or two of materials supply may be disruptive. Abatement of rent for the area used by landlord should be considered. Additionally, landlord's right which is reserved to make replacements or improvements which affect the tenant's premises can be awesome in practice. This usually takes the form of erecting additional columns, risers or pipes through the tenant's premises. Replacement of existing columns, risers or pipes is less problematic if put where the old ones were. Just as an example, there was once a building that had an antiques auction floor that was being slabbed over for a new tenancy. The building boasted the benefit of being able to receive ten extra stories of buildable space without depleting its unutilized development rights. The landlord, being the delightful soul he was, decided to lease the existing premises prior to building the extra ten stories which would require support columns, risers, feeders and water columns, all to be projected through the existing premises during construction of the addition. The lease, of course, stated that a minimization of tenant disturbance would be pursued but otherwise also allowed for demised premises space to be taken for new columns, water pipes, risers, etc. all without adjustment of rent for lost area and for disastrous impact on the particular tenant. Also the access to and use of the premises would be affected by staging and by disruption for probably up to two years. Of course the front of the building and lobby would have looked like a disaster area for a very long time, possibly the duration of the lease. During lease negotiation, the landlord refused to remove the rights, but promised faithfully that he would never do such a thing! These are the situations that enrich the soul of any believer. If you are dumb enough to fall for this, then it enriches just the lawyer.

Landlords are infamous for completely exculpating themselves or rather excessively limiting the extent of their liability for negligence for their work or failure to respond to the needs of a tenant or to their obligations under a lease. For instance, buried in many clauses that state that landlords are not responsible for property entrusted to building employees are clauses which limit the landlord's liability or eradicate it entirely for damage to tenant or its property or persons from the negligent effectuating of

repairs or replacements in the building or for explosion, falling plaster (of all things!), steam, gas and electricity shorts or leaks, etc., etc. If that wasn't bad enough, the landlord often has the audacity to include those costs and expenses for remediation of such damage to the building in the operating expense escalation clauses. It appears that some landlords have no shame whatsoever. I know of one instance where a landlord sent an unlicensed plumber up to a high floor to work on the plumbing. During his work, the plumber as an afterthought decided to tighten a valve on a high pressure water column without first shutting off the pressure on the lower floor. As could be expected, the valve exploded and flooded several floors before being turned off. The destruction was quite impressive. The landlord of course did not want to pay for the resulting damage. The lease supported his position.

It seems to me only fair in a commercial lease where a tenant is occupying a quality building, that the landlord continue to maintain and repair at that same level throughout the tenancy. Additionally, landlord should maintain insurance for damage, fire and casualty and cover its negligence and damage which may cause business inconvenience or interruption to tenants and to take responsibility for its actions, omissions and their impact on the occupancy of the building. It seems to me that on repairs and negligence, the landlord and tenant can fully insure and look first to their insurance with minimal disruption and impact on the businesses of either. It should be remembered that insurance such as that in most buildings can be obtained and the negligence of landlord and tenant may be properly covered. Insurers will also waive their rights to claim recoupment of losses paid from the negligent party. This is commonly referred to as waiving the insurer's rights of subrogation.

Besides reserving the right to change the public portions or other portions of the building whether voluntarily or as required to effectuate repairs, many landlords in form leases also reserve the right to repair, alter and replace the risers, feeders and columns in the building. They reserve this right while specifically limiting or prohibiting tenant's right to any adjustment of rent for inconvenience, interference with use or expansion of the public portions of the building into the usable area of the demised premises. These clauses may seem innocuous, but during the life of a building because of technological advances risers and feeders for electricity and telecommunications become outmoded. Landlords find themselves packing their buildings with more and more electrical wiring and fiber optics, as well as discovering that the dense packing of wiring from the basement tapering off to the higher floors is now reversed because of telecommunications satellites and send/receive services. Landlords are beginning to find more wires coming from the roof rather than to the basement than ever before. The riser conduits and columns are not sized in most buildings for this inversion of wiring utilization and, therefore, the columns must be expanded into the space of tenants. Since rents in many areas range from $30 to $60 a square foot, an encroachment like this can be expensive to a tenant who must continue to pay for space it no longer is able to use. Adjustments in rent should be required and made in the same ratio as the square footage of the usable area compares to the square footage of the rentable area, which is set forth in the lease. Additionally, the landlord should be required to minimize any interference in the premises caused by the work, the staging of materials and debris and dust. Also the work should be conducted after hours or on weekends even though this may cost the landlord more. To minimize the intrusion of new cabling, the landlord should be required to include the cables, risers and feeders in existing column shafts or adjacent thereto. Only in unusual and necessary circumstances should landlord be allowed to run new shafts or columns through the premises.

Much consideration should be given to the tenant's special use in a building that may be undergoing structural alteration or restoration. For instance, an extremely well-regarded, old line private banking establishment found itself with planks, scaffolding, plywood window protection and other unsightly and noisy accoutrements as new improvements were added to the exterior of its premises. This sort of reconstruction impaired the bank's business considerably, but was allowed in the

lease. In the event something as substantial as that might occur, the lease should address the possibility and find a suitable, mutual solution during construction. This may be abatement of rent and a partial and temporary relocation of those parts of the tenant's business on which the construction has the most detrimental impact. Temporary costs, additional rentals and moving expense in and out should also be addressed.

CHAPTER 11

CONDEMNATION

Not a great deal of space will be taken in this handbook for condemnation (nor in many buildings we hope). Condemnation is unlikely to occur, but even if it were a more common occurrence, the issues and concerns to be addressed are beyond the scope of this work. This section will give real estate directors sufficient information to enable them to understand the risks and issues for negotiation. Principally, condemnation is a taking of property by some form of governmental entity with compensation to those whose interest in real estate has been acquired through a condemnation award equal, in theory, to the value of the real property so taken. There is also an award for costs resulting from the condemnation, such as moving expenses and loss of personal property, furniture and removable fixtures, and goodwill if any. Interests in real estate are three-fold. First, there is the fee or true ownership interest in the land and the improvements. Next, is the leasehold interest for a term of years. That is the interest of a tenant who has the right to use the property during the term of its lease. The last is the reversion or remainder interest, which is the value of the real estate after the leasehold interests have expired and the entire interest in the real estate re-vests in the fee owner of the land. There are other hybrid and modified interests in real estate, but these will suffice to alert the reader to the areas to be addressed for award benefit during negotiation of the lease. The tenant has several concerns in the event of condemnation. The major concern of the tenant is the cost or expense of obtaining comparable space in another building for at least a comparable number of years and at a rental not in excess of the price being paid by the tenant for the premises being condemned. Any increase in the rental for the remainder of the term should be present valued and reimbursed out of the real estate condemnation award. Additionally, a tenant needs to be reimbursed for the residual value of any personal property, furniture and fixtures which are not able to be moved and the fixture footings and other real property improvements that were built by the tenant or for the benefit of the tenant in order to operate in the premises. Moving costs, consulting and brokerage fees, etc. as well as fix-up costs at a new premises should also be considered. Location and goodwill of the business are also of value and should certainly be addressed. The landlord, of course, must replace his property after condemnation and has an interest in seeing that the award justly and completely compensates him for the property so that comparable property can be acquired without expenditure of additional funds beyond the award by the landlord. It should be noted, also, that a mortgagee is equally concerned that the award not be less than the mortgage on the premises. There may be more than one mortgagee, as, for example, leasehold and fee mortgagees. Their concern would be that the award would be equal to or exceed the sum of the outstanding balances of both mortgages. Hence comes the difficulty in assigning or allocating the award to the tenant's interest in the real property vs. the landlord's interest. This difficulty arises out of the fact that mortgagees tend to lend money based on raw land plus improvements as enhanced by tenancy rental flow, expense reimbursements and tenant improvements funded by the landlord. To a mortgagee a creditworthy tenant paying a high rent adds value to the land. However, in real estate theory and condemnation procedure, a tenant's interest is not an addition necessarily to the value of the land, but certainly is a valuable interest and compensable. The greater

the disparity between the benefit to the tenant of a below market lease and the market conditions for comparable space plus its tenant improvement residual value, the larger the portion of the award which should go to the tenant. Hence the rub. Since condemning authorities are not known for their generosity and there is usually a battle royal among landlord, tenant and mortgagees for the meager award, this battle is better fought at the beginning during negotiation of the lease, because if not, it will be lost by the tenant in the end. There are endless varieties of methods for dealing with this, but the simplest theory and easiest to negotiate that I have seen has been an allocation of a portion of the award over the term of the lease to tenants with fixtures. That award will usually decline as the fixtures are depreciated and will increase again if they are replaced during the term of the lease. Tax consideration should be given to the value as well as the useful life of the fixtures in reducing the allocation. This also is a helpful, if not mandatory, process when you have leasehold improvements and fixtures of the tenant which are financed. The financing company is interested in having the loan reduced and you can usually time and match the loan payments, the depreciation and tax benefit and the condemnation award allocation.

Attention also has to be given to any loss of abatements of rent during the period of inability to use and restoration of the premises in the event of a partial taking in condemnation. This is most critical during preoccupancy construction and fit-up of the premises.

CHAPTER 12

ALTERATIONS

What happens at the building and the demised premises after the lease commences and while the demised premises is being readied for occupancy is usually of considerable interest to both parties since it is a big cost item and is fertile ground for disputes and additional hidden costs. If the tenant was savvy enough to insist upon landlord's representations that the building and the demised premises both complied with all laws, rules, regulations and authorities and that there were no latent defects or imperfections in construction, including undiscovered violations and defects and hazardous materials or conditions, and that the demised premises would be in a condition ready to receive building construction permits and tenant's contemplated alteration work, then going forward in the lease is easier to deal with than if the demised premises were taken "as is" either willingly and knowledgeably, or unwittingly. Assuming this quantum leap in faith (and you should not), then all that has to be worried about is future compliance with existing laws and with new laws.

I have seen better than eighty percent of the time, when tenants have undertaken to prepare the demised premises with initial alterations for occupancy, unanticipated increases in costs and considerable delays in the work resulting from the usual field conditions of the building or demised premises which should have been the landlord's obligation to cure but were not pointed out and provided for in the lease and were not discovered by the tenant's architect. This area has been responsible for the greatest increases in budget, delays in work and increases in the number of transfers, demotions and replacements of facility and leasing directors. One must be on guard for those alterations which a normal tenancy use should expect which trigger the need for otherwise deferred remediation or compliance in the demised premises or building. Handicapped access and asbestos are frequent repeat offenders. The responsibility for these should be sorted out beforehand in the lease.

In addition to discussing appurtenances, it is not unusual for the landlord to prohibit certain alterations and conditions in the premises as well as mandate what has to be removed at the end of the term. I believe the tenant's major concern is to have the ability to utilize the premises for its permitted use throughout its term, including in the event of business changes and technology changes. The landlord, of course, has a very legitimate interest in seeing that the building's floor loads, electrical consumption, heat, noise and order radiation, vibration and other utilization are within safe parameters and within the comfort range for other reasonable tenants. Additionally, a landlord has concerns with the effect on the ability of building systems to deliver heat, ventilation, air conditioning, water and electricity based on modifications or alterations. From this point though, landlords tend to branch out significantly. Some of the additional requirements that may be found would be requirements of advance approval for plans and drawings; insurance for builder's risk together with bonding or security; approval of all contractors; approval of hoisting and delivery times and locations; and supervision and general conditions of the landlord. There are some valid arguments for landlord's pre-review with respect to contractors in the building. Certain contractors have been known to do inferior work and be invasive with respect to other areas, building systems or tenants in the building. Some even seem to

attract fires! There is nothing worse than having a sophisticatedly designed building get mucked up (term of art, very sophisticated) by a contractor who produces shoddy work or causes violations and other problems by improper filings of plans or by not following the filed plans and specifications, building department or fire and insurance underwriter recommendations or ordinances. Some landlords, of course, make this a new art form by limiting contractors to those in which landlord has an interest. Some landlords reserve design and content decision rights and basically totally interfere with the ability of a tenant to do its work. It seems to me that a fair stance is that once a tenant has taken possession of the premises it should be allowed to make any non-structural changes that do not detract from the outside appearance and which do not materially and adversely impact on the ability of landlord to efficiently deliver building services or later lease the premises unless the tenant has agreed to remove the alterations and restore the premises. Certain reasonable controls for alterations in excess of $50,000 would seem to include pre-approval of plans for location, floor loads and layout, and a requirement that any liens be removed and appropriate insurance and bonding be obtained. I do not believe that landlords should receive profit, overhead, supervision or general condition fees from tenants for initial alterations to the demised premises. Maybe not even for any alterations. Landlord's attention to the proper alterations in a building would seem to me to be a normal ownership responsibility. Also, it seems fair to me that a tenant should be allowed to remove, provided it restores to its original condition, any installations put into the demised premises at tenant's cost. There are some alterations which landlord would be reasonable in asking to have removed at its election such as unique fixtures and built-ins which are indigenous only to a specific, highly specialized use, as well as floor-through stairwells (big ticket items) which are expensive to install and in all likelihood will need to be restored for a future tenancy. It does not seem unreasonable for a landlord to prescribe that any installations, alterations or repairs be done in accordance with the class and quality of the building. Also, that the materials be new and not subject to financing, liens or UCC filings (under general circumstances). It also is not unusual for major alterations to receive the review of landlord's architect and engineer, the cost of which is usually borne by the party who is successful in negotiation. These clauses can be very subtle and can also be dangerous if not properly addressed or administered over the term of the lease. Two instances that come to mind were that anything put into the premises such as floors, mill work, computer raised floors, ceilings or glass by tenant after its initial occupancy of the building became the responsibility of the tenant for repair, maintenance and cleaning. Additionally, unless approval was obtained for such installations, they were required to be removed. Another clause required all improvements in excess of $25,000 to be logged and recorded for the term of the lease. These installations were required under all circumstances to be removed at the end of the term. Failure to maintain the list and identify the alterations required the entire installation to be removed at the end of the term. These were big costs in both instances. Also, clauses that say that alterations at tenant's expense will be done at such times and in such manner as landlord from time to time shall designate, can be killers. One example I remember was the installation of a very detailed sound studio and broadcasting room for a radio station. The wiring and the partitioning was, of course, extremely intricate as well as the sound deafening and acoustic padding. The landlord exercised its prerogative to require such work to be done after hours and on weekends. The then foreseeable impact on the job was to multiply the entire cost times about three. Although the tenant and almost everybody else determined that this was unreasonable, the clause was entered into in a jurisdiction where any consents and approvals of the landlord, unless required to be reasonable, could be arbitrary. The results, of course, in most instances can and will be quite chilling. Also, imagine the small innocuous clause that says that after landlord has approved the plans and specifications for any alterations, repairs or improvements that any amendments, additions or changes to such plans and specifications shall not be made without the prior written consent of landlord. Additionally, landlord was not required to be reasonable and had no specific time period in which it had to respond. That was not a serious problem

here because the tenant's project administrator forgot entirely to ask the landlord after the initial approval and there were some 263 change orders of not inconsequential magnitude. The really unnerving thing was that the alterations and improvements added significant value to the entire installation and otherwise would not have been objectionable from the landlord's viewpoint. However, as it many times happens when landlords and tenants don't get along, the landlord had the right to inspect the completed work and required the tenant to either remove all unapproved work wherever located and restore the premises in accordance with plans originally approved, or obtain landlord's consent to the changes. In this instance, the demand was made not because the landlord truly found the alteration changes and amendments to be objectionable, but because the landlord wished to have relief in the electricity clause where he was losing money. Of course, there was a negotiated settlement. The tenant got its changes and so did the Landlord! In hindsight the budget for construction after considering the addition of the present value of the increased electricity payments to landlord over ten years of the lease, was destroyed and so too was the facilities director's career.

Any mention of redelivery of the premises by the tenant to the landlord at the end of the term that deals with appurtenances should receive careful scrutiny. The jurisdictions differ considerably in their result when construing a clause requiring the tenant to quit and surrender the premises to the landlord "broom clean and in good order and condition at the end of the term." The clause really should require the tenant to quit and surrender the premises broom clean and in good condition subject to reasonable wear and tear and damage by fire or other casualty and condemnation. Even the term "reasonable wear and tear" takes on totally different connotations in various jurisdictions. The best case that comes to mind is an industrial complex where large roller trucks and fork lifts were used regularly up and down the loading bay paths to raise and lower large bundles of paper and metal. The major damage done to the floor over the years, which caused the foundation to actually crumble, was considered reasonable wear and tear for industrial establishments in one jurisdiction because the court determined that the landlord, in the absence of any language to the contrary, understood the particular use and the normal results on concrete floors. In another jurisdiction, the tenant was required to restore the entire floor and grading area based on similar language. It's amazing that people read leases, take the words literally and imply their own understanding without giving consideration to local laws, terms of art or trade usage. The old adage that people hear what they want is still alive and well. It is not surprising also that these unemployed facilities people received differing unemployment benefits in the different jurisdictions.

Landlords have a valid right to be interested in the floor load of their buildings and the positioning and quantity of heavy machinery, safes, vaults, freight or stored matter or equipment and fixtures brought into the demised premises. Reasonable regulation and pre-review can save all parties great difficulty and tenant surprise floor load support costs, but it should be reasonable and there should be a procedure in an expedited manner for the review. This is especially important where the tenant makes its living off of trade fixtures of considerable weight, and it is highly recommended that the engineer of the tenant provide a schedule of specifications as well as relative locations of all equipment to be moved into the premises or to be utilized therein in the foreseeable future. This should be approved prior to lease signing in equipment intensive uses. Usually, along with the lines of the approval and regulation of the location, placement and inclusion of such equipment in the demised premises comes an innocuous little clause that requires tenant to indemnify, insure and hold harmless landlord against any obligations, liability or claims resulting from the presence of any furniture, fixtures or equipment in the demised premises. As you will see in the insurance section, this little sentence can totally undo the insurance nirvana that most landlords and tenants seek to obtain in the equilibrium of commercial insurability. That is, everybody insure, look to their insurance and waive direct actions against each other and subrogation rights of their insurers in the event of any loss.

Along the same lines of tenant's changes and alterations some landlords always get the idea that the landlord may wish to make alterations and changes. I don't believe there is a single jurisdiction which prevents landlord from making reasonable changes or alterations to the building provided there is no negative impact on the tenant with respect to both ingress and egress of the demised premises and the enjoyment of the demised premises. This doesn't seem to satisfy landlords who put in elaborate clauses allowing themselves the right to make improvements, changes and alterations to the building, the common area, the demised premises, the halls, the entrance ways to the building, the entrance ways to the demised premises, the bathrooms and the stairs and to change the address of the building, and even the elevators and the electrical conduits and pipes, just to mention one or two! This is some feat, but can you imagine the impact on the tenant where landlord decides to do something unusual like this? I have, surprisingly, two just such instances to share. The first is a building on Lexington Avenue that had its front entrance on the avenue and two side freight entrances. The landlord figured out that if he moved the front entrance to the building to one of the freight entrances, he could expand the retail Lexington Avenue space by almost 80 percent and make a fortune. Since the clauses in his leases afforded just such a right, he did so. To the chagrin of the tenants one morning they reported to work to find that their entrance was temporarily a grubby loading entrance. Upon inquiry, they were advised that the other side entrance would become the main entrance within six months and that they would have a new address and would have to change all of their stationery and suffer the indignity of having a side street entrance when they had paid for a Lexington Avenue address and entrance rental. As stated earlier, the other such instance was where a building was leased, but had the right to add ten additional floors on the top. The addition of the floors required relocation of the elevator, main water columns, HVAC equipment, front door and bathrooms on all other levels. If you can believe it, I understand that this was done (although I have not confirmed it), including the running of support columns down through the building to support the ten extra floors, with major interference to the tenants, but no substantial interruption of the rent payments! There were some unhappy campers in that building for about two years. One can also argue that there can be a significant impact on the real estate tax and operating cost escalation provisions if the landlord is allowed to improve and add onto the building, even if such addition may not benefit the tenant. The real kicker in New York is the right of the landlord to voluntarily, temporarily or permanently close the windows in the building without interrupting or diminishing the rental flow. This particular clause was born out of the fact that windows sometimes are temporarily boarded up or protected due to construction nearby or because of repair work. Also adjoining property owners would sometimes build a building next to the windows out of which you thought you had a great view. In the old days if this was done without an allowance for such in the lease, rent would abate. Now, of course, it not only does not abate, but if the clause as generally written is taken literally, the courts will uphold the right of the landlord to build a building next door and cut out the light in its entirety. These clauses, of course, should be limited to involuntary closing up of the windows and only on a temporary basis, where view, light and air are important elements of the rental payment. Also they should be carefully drafted to exclude an involuntary boarding up if the landlord is a part owner of the project next door.

CHAPTER 13

COMPLIANCE WITH LAWS

Compliance with laws takes on two dimensions, one in time and the other in type. The easiest issue to work with is compliance with laws for the premises and the building occurring prior to the tenant taking occupancy. In most jurisdictions there is no requirement that the demised premises or the building be in any particular condition except as represented through advertising, inspection or representation. Advertising and inspection can be a problem since in a majority of jurisdictions, representations with respect to real estate must be in writing to be valid in a commercial setting. Hence, as you may imagine, most leases don't discuss the issue of the condition of the building or the premises other than to state that landlord makes no representations and tenant takes it "as-is." This is the source of expenditures of more funds than one would ever imagine over the term of a lease. Imagine, if you will, coming into a building with violations of fire laws, hazardous waste laws and handicap access requirements. The tenant does its drawings after signing its lease and begins the process of obtaining permits to demolish the old premises and permits to alter and build the new one. In one of the worst cases I have observed, the tenant's architect discovered, when attempting to obtain the demolition, asbestos and building permits instead of during the feasibility study for candidate premises, that the building was not in compliance with certain fire laws and handicap access laws and the previous installation was not approved by the building department. Architects tend to tell you these things, if left on their own, after you sign the lease! The landlord, of course, did not volunteer to remove any violations in the building or in the premises and many months were lost in the tenant's preparation due to the inability to obtain permits or to settle with the landlord and cause the obstructing violations and conditions to be removed.

In another case with a similar result the landlord represented that there were no violations in the building or the premises which would prohibit the work from being accomplished. In fact, there were not violations of record, but there were conditions present which, if discovered by the building department and the fire department, would have been deemed to be violations. At the time of the request for the permits for demolition and construction, the agencies, of course, found the conditions and issued violations. The tenant, of course, requested the landlord to remove them, but the landlord's argument was really quite good. The landlord maintained it was not responsible since the violations occurred after tenant took occupancy of the premises and there were no violations prior to that time. The judge ruled in the case that had tenant wished a representation from landlord concerning facts or conditions which if discovered or because of passage of time would be deemed to be violations, he should have so written it. Tenant loses, counsel retires! The facilities manager would not have been able to defend against this one, however the facilities manager recommended the deficient attorney. Guilty by association and recommendation. I think a safe road map for facilities people to follow would be to have simple covenants at the beginning of the compliance section requiring landlord to deliver both the building and the demised premises, together with all systems, in such condition as to not be in violation of any laws, ordinances, rules, regulations or authorities whether existing or whether constituting violations upon discovery of the facts. This allows the tenant to commence its building and

causes landlord to pay for any discovered conditions which would impede its progress or delay its completion. If one goes the distance to get the representations, one should also obtain an indemnity for damages and costs associated with curing any defects in the building or the premises or any violations or conditions, together with removing any hazardous materials, and also for the reimbursement of costs resulting from the delay in the tenant's work, additional costs of materials and labor and any re-working (affectionately referred to in the trade as "impact costs"), as well as the costs associated with remediation of the condition which was a breach of the warranty. You perhaps noticed that I slipped hazardous materials in in the last sentence. There have been instances in which I have experienced an otherwise sterling delivery of premises by a landlord to a tenant, fully demolished, plans approved and permitted and ready to receive tenant's work, with one exception: the demolition contractors had spilled some chemicals in the premises on the concrete slab floor. The spill was wiped up but not scrubbed out. The spill was fairly toxic, absorbed into the concrete and was properly diagnosed by the tenant's work crew which promptly refused to take control of the job site, lest they be required to remove the materials and incur liability for the spill. Of course, the landlord was not required to deliver the premises spill free, nor was he required to take responsibility for the demolition contractor even though the company was a wholly-owned subsidiary of landlord. Ah justice denied! We now, of course, require in essence, representations that the premises will be delivered in all manner and condition susceptible of immediate receipt of tenant's work and obtaining of tenant's permits. Any condition not caused by tenant which occurs that impedes the tenant's progress in commencing its work would be a violation of this representation. Additionally, we require from landlord those permits and certificates of occupancy which are required for tenant to be able to commence its work. Certificates of occupancy are a subject deserving of an entire book and will be left to zoning and construction counsel to sort out. Or give me a call. Suffice it to say that one may do one's work and have a lease to occupy a premises and, nevertheless, be prohibited in so doing by being unable to receive a certificate to occupy the premises and conduct operations. In some jurisdictions the landlord is under no obligation to provide such a certificate. It is always best to require this in a lease. Additionally, in some jurisdictions a certificate of non-applicability is required for asbestos. In some other jurisdictions a removal certificate and an inspection certificate are required. Most tenants and tenant's contractors believe that this should now be a landlord's responsibility and will not take possession of the premises and commence the term of the lease until all of those certificates which are required in order to get building permits have been obtained, are sufficient and are issued.

The second dimension is the type of violation. There are violations that occur because of the particular use of the demised premises and there are violations that occur that are not premises or use related, but real estate and improvement generally related. I think the easy approach for a tenant and the most logical is that landlord, in order to accommodate the specified and permitted uses set forth in the lease, should undertake the necessary alterations and compliance work in order to allow the premises to be so utilized. If there are very special requirements based on tenant's use, many tenants expect to pay for those alterations and accommodations. Irrespective of who pays for the costs associated therewith, it would seem that so long as a tenant uses the premises for the stated permitted use, any alterations or changes which are required because of new violations should not necessarily be the tenant's obligation, unless maybe again they are specific and unusual in scope. In most jurisdictions it is the owner's obligation to continue to cause the building and the premises to comply with all general laws affecting improvements of real estate. Additionally, in most jurisdictions it's the landlord's obligation to continue the building certificate of occupancy in the condition required so as not to interfere with the use contracted for in the lease by the tenant. This also goes for temporary certificates of occupancy being converted into permanent certificates of occupancy at the right time. As with most leases where the tenant has represented that it will take the demised premises in its "as-is" condition

together with the building, and which contain statements that landlord makes no representations with respect to the building, premises or tenant's ability to use it for the permitted use. Failure to be able to occupy to conduct business purposes will not relieve the tenant of the obligation to continue to pay rent.

Because of the advent of fire laws and hazardous waste laws, many of the hitherto landlord ownership costs to be absorbed and defrayed by the landlord are being turned into escalation costs or increases to be paid by tenants. Many mortgagees insist that a landlord's profit, which is the source of payment of debt service, not be eroded by unusual changes in laws and compliance costs and requirements. This, of course, raises a new issue for tenants who are otherwise comporting themselves appropriately in the premises under the lease. It is not unusual in some buildings in the Northeast and other major business centers to find that a change of law can require the expenditure of, in some instances, up to $7 to $15 a square foot in a short period of time. In negotiating who is to defray these costs, one should give attention to the benefit period and the remainder of the term of the tenant's lease. This subject is better dispensed with in an escalation and operating expense related section and will be treated there in this book.

The easy subject for compliance with laws is the violation and remediation costs incurred because of tenant's breach of its agreements or covenants under its lease including the conducting of the permitted use. Those, of course, should be paid by the tenant and since failure to correct the condition may subject landlord in certain instances to penalties, liens on the property and criminal liability, the landlord will necessarily require tenant to allow the landlord, after due notice and failure of tenant to remediate, to use self help, remediate the violation and charge the tenant the cost thereof.

Of course, any later performed improvements, alterations or repairs in the building or the premises should, and in all likelihood would, be required to be in compliance with all laws and authorities. The landlord usually reserves the right to inspect tenant's plans for alterations to confirm for itself and its mortgagee that compliance is going to be obtained.

CHAPTER 14

DEFAULTS AND CONDITIONS OF LIMITATION

All leases have defaults prescribed in the document and penalties for the failure to avoid the specific defaults. Many leases also specify a variety of alternatives for remedies with respect to the defaults and also deal with how the landlord enforces the terms and ultimately gets the premises back in the event that the defaults are not cured. Some leases are more dangerous than others in this regard. Those dangerous leases have additional sections that they innocuously call conditions of limitation or further limitations. Either way stated this should put any businessman and certainly practitioners in my area on notice of potential great loss after much surprise. Conditions of limitation, simply put, are rights under law to extinguish tenant's rights and the interest in their lease without due process, hearings or more than abbreviated notice. With that, of course, goes the rights to their improvements, good will, business location and any equipment materials, etc. that may be in the demised premises. It does not extinguish, of course, rental payment obligations and in many instances accelerates those obligations and turns them into contractual damages which survive the termination. If properly written and properly effectuated, after the appropriate periods of time have passed from default and notice, the lease will expire on its own without any intervention and since this expiration is ab initio the courts have found themselves in a position of being unable to reinstate the lease or protect the rights of the parties. In order to preserve the lease and the tenant's right to due process, recourse to the courts must occur before the end of the expiration of the notice period for cure. Just to give you an idea of the magnitude of the surprise and problems, there is one example I remember as a young associate involving a very large company in New York City that had several hundred thousand square feet of space in a building where there was an ongoing dispute with the landlord concerning payment of electricity rent inclusion costs at a rate which was below the actual cost to landlord for the electricity consumed. The tenant, of course, stood behind its lease provisions which allowed this to continue at an accelerating cost to the landlord. After frequent conversations had by the landlord with the tenant to receive some relief on the subject, the landlord became offended when he was roughly treated by the tenant. The landlord then elected to watch the conduct of the operations on the premises by the tenant and discovered one day that card key pass system locks were placed on the doors on each floor for night entry. The landlord further noticed (by merest of coincidences I am sure) that this was in violation of the provisions of the rules and regulations with respect to changing locks without the landlord's consent. The landlord, of course, through its general counsel decided to send a notice of default. The notice specified that these changes of the locks were in violation of the terms of the lease and requested that the default be cured. The default was not cured within the requisite time for cure under the lease, and a second notice was sent stating that the locks had not been restored and it was a continuing default and that the landlord would look to exercise its remedies under the lease. Time passes on, locks do not get changed. Landlord then elects to send a condition of limitation notice which specifies that there was a continuing default, that there had been specific notice and the lease would terminate by its own terms with no further action of the landlord at the end of three days. Three days passed and there was no action or response by the tenant. The landlord then sent a notice to the tenant's president requesting a move out

date. This, of course, was a considerable shock to the president who discussed it first with his facilities manager and then his lawyers. Litigation was commenced. This went through several appeals, but was affirmed on the premise that if there was any relief expected from the court, the tenant should have taken the case to the court before the expiration of the three day notice period and consequently the lease, pursuant to its condition of limitation. The court was without power to reinstate the lease or even hear the issues of whether there was indeed a default or if the default complained of was material. The landlord and the tenant, of course, then settled. The settlement increased the electricity by a considerable amount after unbelievable amounts of legal fees and court costs had been paid. Of course, the tenant paid for the landlord's legal fees and court costs because that was required under the lease. The real result, of course, was that the tenant could have been removed from the premises and lost a very long-term, highly favorable lease. What would have happened would have been that the rental payments under the lease, if they had gone to market, would have almost doubled. The tenant also would have lost its fixtures and tenant improvements. Now this is pretty tough to explain to your board of directors and your shareholders. It was impossible, of course, for the facilities man and the inside counsel to explain to the president and I am told they are no longer with the firm.

This brings us to the real issue before us and that is what should tenants attempt to obtain in their default sections under leases that will help them avoid this kind of problem. Of course, the first that comes to mind is to not have a condition of limitation and require everything to be by notice and ultimately litigated. Not many landlords in major metropolitan areas will agree with this, so the fall-back position would be to have all the defaults specifically enumerated, carefully described and each specific default coupled with a specific period for cure after the receipt of a written notice and a second notice period advising that the time period for cure has expired and that unless it is cured the condition of limitation or other remedies will commence at the beginning of or at the expiration of a certain number of days. Additionally, these notices should be sent in a manner likely to be received by a responsible, knowledgeable person at the tenant, which would be verifiable in court as being received by the recipient. Additionally, most of my clients insist upon the mandatory notice also issuing concurrently to the law firm of the tenant for quick response times for such dangerous situations. The absence of the proper mailing or copying of the notice to the lawyer would be deemed insufficient notice for the exercise of the condition of limitation. On the other hand, unless you bring the issues before a court before the condition of limitation period expires in the lease, it dissolves and terminates ab initio. The issue of appropriate service in the absence of fraud will not be heard by the court. Obviously, this particular concept puts the below market rental advantage of the premises at risk as well as the possibility of losing good-will of location, loss of furniture, fixtures and improvements, and, of course, a great disruption of business in the event the tenant has to move.

There are many clauses that deal with short-term remedies such as discontinuing an inappropriate or dangerous use within 24 hours. These are very dangerous because they don't afford the normal period of time for notice and cure or reaction by the tenant. These clauses should not be allowed to receive condition of limitation remedy benefits.

Assuming that you've taken care of timely notice, special and careful enumeration of defaults and careful enumeration of grace periods for cure before notice, one other thing to keep in mind is those types of default which trigger incurable situations. For instance, many leases say if you miss your payments of base rent or additional rent more than two times in any year, the third one is a default that allows the landlord to terminate the lease. Now I am not really certain whether these incurable defaults are enforceable in all jurisdictions. In some jurisdictions I suspect they would be frowned upon since courts do not like forfeitures and there is no way to cure this particular position. However, in case you do not know how conservative or liberal your court is, it would be good not to have any type of

incurable default in the lease. Another such incurable default position is those "attempt to" clauses. Landlord can terminate the lease if the tenant attempts to assign or attempts to sublease. In most instances, an assignment whether attempted or not is an assignment and generally cannot be undone. Many times the business people in the tenant's office accomplish quickly things they feel they can, only to be put in the position of finding out that they were prohibited and had harsh remedies for the violation. The only way to really avoid this is to negotiate it away in the beginning.

Curing of defaults is an interesting proposition. There are many defaults that can be immediately cured by payment of money or issuance of statements. There are many defaults that can be cured but over a period of time and sometimes the time period expands to accommodate circumstances. There are some defaults that can be commenced to be cured and worked upon for a period of time, but may never actually be truly cured. All of these types of defaults have to be accommodated in the prospective of a tenant who is surprised, means well and commences the curative process. Provided a tenant has commenced in earnest to cure and continues in earnest to remedy the default, it is my belief that these types of defaults should be put on the back burner with remedies deferred. In order to keep landlord from being able to take remedial action you have to specify that in the lease.

Another constant source of problems and arguments is whether the tenant has to actually occupy the premises. There are many instances such as shopping centers or retail spaces where a tenant would definitely be required to occupy the premises. From the standpoint of percentage rent or traffic generally to the retail establishment, these are material areas of concern for the landlord and all retail tenants in the project. Also, ground leases and net leases where the building if empty would be uninsurable is another concern and the valid exercise by a landlord of an appropriate requirement. On the other hand, office space and general space in a multi-tenanted building where the landlord has no legitimate concern whether or not it is occupied, provided the tenant performs its responsibilities and obligations in addition to paying rent, are areas where the word should be changed to abandoned rather than vacant in the default section. A tenant in those use areas should be allowed never to occupy if it doesn't want to and if it does occupy, to vacate the premises at will so long as it performs its obligations and pays rent. Abandonment in most jurisdictions connotes no intent to return and certainly no intent to perform any obligations including those of paying rent.

Cross-default sections are another source of great difficulty. It seems innocuous and friendly that a landlord would be concerned that if a tenant were in default of one lease, it might become in default under other leases. Unless this is a net lease or financing lease or in a project where the space was negotiated together or tied together, I have little sympathy for the cross-default provision. If a tenant allows such a clause, one must be very careful to make sure that an affiliate does not assign itself into a cross-default situation or an unaffiliated successor cause the problems years later. Additionally, one must be careful that landlord does not acquire any other buildings not related to the building under the valuable lease which might allow a future trigger of a default under both. I've also seen instances where cross-default clauses among leases also had cross-default language in the event of a change in condition of the guarantor for either lease. This gets to be three dimensional chess. It's hard to know whose in default, whose on first and whose up to bat. However, you can bet it will only be significant in a situation where tenant has substantial improvements or a very strong vested interest in operating in the premises. Or, quite frankly, when the market is on an upswing and there is a lower fixed rent reserved in the subject lease. Cross-default should not be given lightly if at all, and certainly, cross-defaults based on guarantor's activities should come under considerable scrutiny. If you add that together with an assignment to a new tenant which does not extinguish the obligations of the named tenant from being a default under other leases or the guarantor's for the other leases or the other tenant (see what I mean?), I suggest it borders on absurdity.

CHAPTER 15

RE-ENTRY BY LANDLORD

In almost all jurisdictions after default, notice of cure and failure of the cure to occur during the grace period, remedies will vary from termination of the lease by operation of law, termination by dispossess proceedings and re-entry by landlord. Landlords would like to be able to go back and take over the premises, change the locks and detain the contents of the premises including trade fixtures and merchandise at will. Attention should be given to these remedies in order to avoid disruption of business resulting from inadvertent error or default as opposed to material, significant, egregious defaults which are not cured and which affect the ability of the landlord to continue the lease relationship. Re-entering triggers a great deal of legal issues and should be dealt with more at length in a legally (as opposed to not so legally?) oriented work. What I really mean (like in leasing) is not what I said. This is a business practitioner's handbook or manual, remember? Also, the concept of re-entry by "force or otherwise" should be dealt with in a different more legal oriented environment. It is important, however, not to contractually give up the rights to defend against a re-entry or contractually allow the condition of limitation terminating the lease and having a landlord re-enter outside of due process in court systems.

That is if you would like to appear as the reasonably prudent corporate officer to your shareholders. Additionally, contracting for re-entry by force or otherwise is problematic. These sections should be carefully reviewed with counsel.

One should also be careful about triggering remedy rights of a landlord contractually by allowing a remedy to arise in the event of a threatened breach of certain of the obligations under a lease. Many leases I see specify that the landlord may exercise its remedies in the event of a default or a threatened breach. These types of threatened breaches should be dealt with by injunction, not by prematurely defaulting the tenant and terminating a lease.

In the event of a true default and a termination of the lease, the landlord is really concerned with two things. The first thing is getting the premises back as quickly as possible and re-leasing it. The second is recouping its damages. Damages take on many facets. The first damage that comes to mind is the difference between the rental that would have been paid by the tenant and that which is obtainable in the market. To the astute landlord, this many times is not a damage. Sometimes this is a negative difference or actually no loss to the landlord at all but really a wind-fall. In some jurisdictions, the difference can be participated in by the tenant. In most jurisdictions it cannot unless set forth in the lease. In all jurisdictions a tenant can be required to pay the difference either monthly when the difference occurs at the same time periods as if the lease had not been terminated or in some jurisdictions in a lump sum accelerated at the end of the default and cure period. Accelerated rent, however, should be discounted to the present value by an agreed upon interest rate or by market conditions. In the event of this acceleration and present valuing of rent, there should be an off-setting of such damages by re-leasing or mitigation. In some jurisdictions, the landlord is not required to mitigate damages at all and since mitigation would be speculative, the landlord is allowed to keep the

entire accelerated rent. In those jurisdictions and quite frankly, in any jurisdiction, contractually the tenant should cause the landlord to reduce the rents by any mitigation that occurs and the tenant should attempt to cause mitigation to occur by requiring the landlord to either mitigate damages actively or at least not hinder mitigation attempted by tenant.

How a landlord mitigates damages is of some concern. Landlords have a tendency to repackage space, make alterations and incur costs knowing that those may ultimately be borne by the defaulting tenant. It is also very hard for premises to be re-leased for the exact remaining time on the then terminated and unexpired lease. Some flexibility should be allowed to a landlord to repackage the premises and lease it as expeditiously as possible to mitigate the damages that landlord and tenant will sustain. Appropriate contracting for the redecoration and repackaging of the premises seems appropriate and should be contained in the lease as opposed to left to common law to arbitrate.

No discussion of damages and remedies would be complete without a conversation on exculpation. Exculpation or something less than total limitation of liability is sought by most tenants who have to conduct business in a form other than a corporation. Service organizations and law firms, for instance, that have unlimited personal liability for each of their partners must consider limiting the total liability in the event of a catastrophe. Partial or total exculpation comes in many flavors and packages. As of late, we've seen the more popular versions of overall limitations of liability under a lease as three million dollars or one year of basic rent. Some have been the unamortized costs of landlord to enter into the lease including legal fees, brokerage fees, concessions, abatements and improvements in the premises. We have seen limitations on liability per partner of a dollar amount as well as the ability of partners to move in and out of liability due to death, retirement or withdrawal from the business or partnership. Similarly, landlords limit their liability in the event of damages since they, in most instances, are partnerships in order to receive the flow-through tax benefits of owning real estate. The common limitation is to the equity of the landlord in the real estate project. In the days of 110 percent financing or layering of multiple leases and leasehold mortgages or equity mortgages, this kind of limited liability is dangerous. It bodes well at times for a tenant to require a landlord to have its equity not be less in any event than 25 percent of the value of the project. Since value goes up and down, one may find that the number gets small. However, the number is always larger than the equity when a project is over mortgaged.

CHAPTER 16

SERVICES

There are very few sections of the lease that cut right to the heart of the ability of the tenant to enjoy their premises. Services such as heating, plumbing, air conditioning, ventilating, elevator and cleaning are the fundamental reason to be in real estate and enjoy the operations of your business. When you get the service, how much service you get, what the quality of the service is, and what is the cost for the service when you don't normally get it, are issues which should be reviewed with great attention and care. It is amazing to me how many leasing specialists sign a lease without determining how much electricity or how much HVAC (heating, ventilating and air conditioning) there is available today and tomorrow or if it is available at all. One story comes to mind where ventilating was not a service provided as a matter of basic cost. It was interesting to find out that the definition didn't include ventilating in the lease and the building was a sealed facade building. So when it was not hot enough to require air conditioning or cold enough to require heating, the building still needed to be ventilated. There was an additional charge for that. The per hour charge wasn't huge, but the total cost was and was out of budget and certainly a windfall to the landlord every day for the entire term of the lease. Additionally, there are instances in older buildings where the air conditioning cools quite a few floors at a time, so that tenants who needed after hours air conditioning for late operations as a matter of routine found out that they had to pay for the cooling of ten floors. The lease did not specify cooling for tenant's floor but did specify a per floor charge with a caveat that in many instances, depending on the floor location of the tenant, more than one floor would have to be cooled. Such floor configurations could run as much as five hundred dollars per hour in some buildings today. I think, as a minimum, tenants should require a certain quality and reasonable quantities of all essential building services to be provided to the demised premises and distributed throughout the demised premises on all business days and during customary business hours; all the foregoing of which should be defined in the lease. Additionally, a tenant should be allowed to have cleaning throughout the demised premises at a standard specified in the lease. There are several buildings in New York City where the specifications for cleaning are subtly, but notoriously, deficient. For one floor in a not too large a floor footprint building, a tenant found out that its additional monthly cleaning was over $25,000 just in order to have the premises cleaned in a manner minimally acceptable to health standards and enjoyment. The really proper level of cleaning would run about $250,000 per year. These things should be discovered and negotiated at the beginning of the relationship rather than after the lease is signed. Another tenant recently had intended to put a quarter floor raised floor environmentally conditioned computer room in its premises only to find out that it could only get sufficient electricity at an incredibly greater cost, but could not put in the supplemental air conditioning packages required to keep the computer room cool. Other instances where tenants have been able to put the systems in, they have found that the cost to put them in and run them was exorbitant. These costs are standard and can be fixed at the beginning of the relationship.

Another concern of tenants is when can the services be interrupted. Normal interruption for repair and maintenance or emergency is understandable, but should be limited where possible so as not to

interfere unreasonably with the tenant's operation. Many landlords reserve the right to interrupt the services for alterations or new improvements in the building (building additional building area) or in the event a tenant is even immaterially in default under its lease. These should be scrutinized very carefully and limited to what's appropriate given the operations of the tenant in the premises.

It is of more than passing of interest to note that in tall buildings in New York City, elevators have become quite a profit center. Many landlords require additional charges for after hours passenger and freight elevator operation. The prices include a components of labor, "supervision" (profit) and electricity. One might note that most of these are paid for elsewhere through escalations or rent inclusion electric. Additionally, landlords are charging freight elevator service charges for move-in, move-out and alterations. These charges may also show up on contractor's invoices as hoisting or temporary services. It is interesting to note that move-in and move-out is generally required to be after hours when the rates are the highest. Tenants should not be required to pay for move-in and move-out freight elevator service, nor should they be required to pay for hoisting of materials to the job site for the initial installation. They should also make sure the landlord isn't charging the tenant's contractors either since the tenant will be later billed for the service by the contractors. The landlord should have some investment in bringing a new tenant into the building. I remember one tenant that was very happy with itself for getting the move-in and the hoisting for initial construction costs removed from the elevator section as well as supervision, profit and general conditions of the landlord usually appearing in the work letter. The small oversight of not having costs removed for the move-out caused the tenant to have to pay a very large cost for the move-out. This helped the landlord make up for its loss on the move-in. Obviously protracted negotiations on leases have their ups and downs (sorry!).

It seems appropriate to me for tenants to require landlord to provide any requested and reasonable amounts of chilled water, condenser water, additional air conditioning, and additional electricity that they may need throughout the term of the lease. Projecting these needs can be difficult but a talented architect aware of technological trends can assist considerably. This savings more than justifies the concerns about costs associated with bringing the architect into the leasing team early on in the process. One should also fix the costs associated with providing the additional or future levels of service at the beginning of the relationship. It costs less than when you later need it.

I think one of the most important concepts when it comes to services arises when other areas of the lease are in dispute. Even if a default has been declared, provided the lease has not been terminated or a court order issued, services should be continued on a regular basis. Services should not be used as leverage or blackmail to extort a tenant's performance where otherwise it would not or should not be required. Also, when additional levels or types of services are needed in buildings, it is incumbent upon tenant to make sure that the lease requires landlord to be reasonable and to accommodate all technological advances and additional needs of tenant where the same are commercially reasonable for the enjoyment of the premises. These days, this of course includes the use of wiring, satellite antenna dishes and considerably more air conditioning and conditioning types of services, equipment and, of course, electricity. Fixing the costs for these accommodations is also extremely important and it seems incumbent upon a tenant to think ahead if it has a ten to twenty year lease to see if these services are available and generally acceptable to tenant as well as landlord and at actual cost to landlord without mark-ups.

CHAPTER 17

CUSTOM OF DEALING AND WAIVERS

It is customary when dealing with services or other obligations under the lease for the landlord and tenant to make accommodations for each other or waive certain requirements or ignore certain defaults. Life under a lease is a very fluid relationship with much interaction, many accommodations and frequent referrals to the original lease document by either party. Odly enough, once the lease is signed, it's also a recurring phenomena that no one ever looks at the agreement again when they should but operates however they feel is appropriate as, of course, the conduct continues in the relationship. It is also important to take note of who the parties are that are bound after the signing of a lease. The landlords may sell their interest in the building, may do a ground lease for the improvements and/or the land or may reorganize. In those instances, it is important to know who remains bound to perform the obligations of the landlord and receive the rent. In most states these obligations or covenants run with the land or run with the lease. This means that the landlord who is expecting to receive the benefits of the lease, which include rent and other performance by tenants, is also bound and obligated to perform those obligations of the landlord which are to be provided for the rent. Many leases, however, play with this concept and try to sever the obligation of the landlord to perform or grant the benefits required of the landlord to be enjoyed by the tenant from the tenant's obligation to pay its rent and otherwise perform under the lease. In addition to separating the two obligations, they also try to cutoff the obligation of the existing landlord at the time he sells or leases the building and also limit the obligations of the new landlord. A tenant can find itself in an interesting vortex if it finds that its lease severs the obligations of payment and performance by tenant and landlord respectively as well as cuts off the liability of a new successor landlord from pre-existing liabilities of predecessor landlords. In short, a tenant that is paying its rent and performing under its lease may find itself with a new landlord with no liability for obligations under the lease such as tenant work or other concessions or even certain services. The tenant will still be required to pay its rent and will have to look to the prior landlord to satisfy the obligations. If this is also a vortex within the void of a landlord who has limited its liability and any recourse for its obligations to its equity in the project, it's interesting to note that there is no equity in the project because the predecessor landlord will have sold it by then. Although theoretically as interesting as a three dimensional chess board, it can have some very nasty practical results to a tenant who expects to be able to finish its premises and receive certain services for the rent payments that it's making and doesn't like chess. This coupled also with limitations on the covenant of quiet enjoyment which we have discussed earlier can cause a real mess for a tenant. Usually at the time of a substitution of the landlord, the old course of comfortable dealing goes by the way side too. Leases with no waiver clauses limit any impact on the lease of the favorable custom of dealing between the parties which may be at odds with the lease language. The new landlord who probably paid too much for the building will now try to increase costs to the tenants and limit any favorable treatment not expressly required by the lease. Negotiating a lease should be always done with an eye to the "new unfriendly landlord" scenario.

Just as it is important to know thy enemy, it is also important to note which party is the tenant. Tenants, of course, cannot limit (usually) their liability by assignment and subletting since they remain liable under the terms of the lease, but in this context a tenant can find itself in default by changing its

entity or by reorganizing or changing its ownership makeup. Partnership tenants can also be made to look like corporate tenants and corporate tenants can be made to have the same liabilities as general partnerships. All these things have been attempted before in leases and unless carefully read can cause great harm. Tenants must pay careful attention these days to these limitations because voluntarily or otherwise they may find themselves in an incurable default situation where they may very well lose their beneficial lease and demised premises improvements. Fear not, much of this subject will be treated in the assignment and subletting topic later.

CHAPTER 18

ELECTRICITY AND WATER

It's amazing how even small children know to ask certain questions on things that are very important to them such as food, water, batteries for their toys and other forms of power. You've heard the questions range among how big, how many, how much, what, where, how, when, why, why again and what if. Now there are very few things in life as important to the enjoyment of a home or an office as the ability to use water and electricity. I can't imagine a premises without heat, ventilation, air conditioning, smoke detectors, power, lights, stereos, refrigerators and toys; all a function of electricity. It seems strange to me that one of the most important areas of a lease is the most taken for granted and least understood by landlords, tenants, architects, engineers and lawyers. There are some landlords that understand the topic very well and many tenants of those landlords help defray the cost and provide the profit for the research and development endeavors of the landlord to creatively maximize their return on such an innocuous area. Once I tested my theory of the almost total absence of knowledge in the field by negotiating for my client, a very sharp landlord, a roof top space lease for a large very sophisticated mobile telephone company. The use of that term dates me a bit, but for those of you who don't remember, that was the predecessor of the cellular phone and was more of a status symbol than business tool. This is because 90% of the time a dial tone was unavailable due to congestion on the few open lines. Nonetheless, it was an extremely profitable area for the telecommunication companies and there were some highly desirable spaces in town on top of strategically located buildings where you could rent gravel for four to five dollars a square foot and buy your electricity from the public utility company at a reasonable price. With respect to electricity, this was not one of such locations. I decided to take the approach of renting the space, which was raw gravel space, but including in the rent a certain factor or amount which we call the rent inclusion electricity factor which represented in its simplest form the price to be paid per square foot for electricity presumably consumed during the year for the transmitters and receivers and other related equipment for this telephone site. Now being adventuresome, I decided to include in that factor not only the probable cost of running the transformers and related equipment as estimated by our electrical engineer, but also a "cost" cushion for administering the billing and a profit factor. Being a good creative soul, I elected to allow the review and adjustment of that figure annually under three scenarios, the first being any change in the rates of the public utility company, the second being any increase in consumption (term of art) of the equipment at the site, and the third being "on occasion", for no particular reason other than if one and two did not catch all changes. The clause worked something like this. The rent was $10.00 a square foot and the rent inclusion factor to be added was $7.00 a square foot. Of course, the actual cost per square foot (for the electricity) was determined to be approximately $4.00 a square foot so the balance was what I refer to as an "extra".

Now the impact of the changes in our determination of the consumption per year and the changes in the rates was interesting. The changes in rates by the public utility company servicing the building would cause the rent inclusion factor to be increased in proportion to the percentage increase in the rates. As you know, rates can go up ten to thirty percent a year as they did in some of those years and these would be small pennies per square foot of actual additional costs if you figure the actual kilowatt hours consumed at the actual increase in cost per kilowatt hour. However, there was no real correlation

between the actual additional costs of the consumed electricity and my formula which was much more like a porter's wage formula which increased the rent inclusion factor which also contained my extra. It became apparent after five years when the increases in rates percentage-wise were a bit dramatic and the impact on the $7.00 figure was melodramatic.

On the consumption front, it might not surprise you that we had what is called the right to conduct an incremental survey. This works in a sort of unusual manner. When the tenant originally installs its equipment and begins its operation, the landlord comes in and does what is called a survey of the inventory of equipment consuming electricity or which could consume electricity if plugged in and operated within the leased area. If done properly, any equipment in or near the leased gravel whether broken, old, boxed, unboxed, plugged in or not, can be captured and included in the survey from time to time.

As one might note in the start-up operation at the end of completion of construction, there is very little equipment hanging around the site that is not plugged in and running. But over the years, many pieces of equipment died or wore out and it was cheaper to leave the equipment in place and bolt a new piece next to the old one or on top of it rather than remove the old one. As with most sites this site had several cooling fans, some compressor equipment and a transformer or two together with a transmitter which were no longer operable, but rather than remove them from the site they were just disconnected. Under an incremental survey, any time after the first survey of the premises, the surveyor is instructed, if the clause is written properly and sometimes if not, to inventory all equipment which if plugged in and if operating would consume electricity. Presume it's consuming electricity and presume it consumes it 24 hours a day seven days a week. This is what is called connectable load as opposed to connected and consuming load.

Now, the next bit of adjustment comes from assuming all equipment was plugged in and running 24 hours a day, seven days a week, and at its highest electrical needs (or rather demand). Again, if the clause is written creatively enough, one may presume a peak power demand consumption for each piece of equipment. It's good for you to know that there are itty bitty red and blue books floating around for engineers to look at which will tell you the normal consumption, peak consumption and demand characteristics of anything made by mankind that consumes electricity. Our surveyor was very agile in his ability to use his little book and, of course, we priced things that would consume at peak power electricity for only a few seconds in any period of the day, but, of course, we would presume they were consuming at that demand all the time of operation. For instance, think of your air conditioner in your window at home. If you don't have one think of someone else's air conditioner in their window at home. The compressor, when it kicks on, can use 15 amps of power very quickly in order to get running the first time. That will happen for less than two seconds. Thereafter it may run somewhere between four and seven amps in demand. It may run at peak power 40 - 50 seconds a day. The way our surveyor was instructed to price the consumption caused the consumption to be three to four times higher under that scenario, but if you assume that the compressor doesn't run for quite a bit of the time during the day or in winter, the consumption charge for electricity and for units such as that might be 100 times greater than actual consumption, under a properly written aggressive clause.

There are many more tricks to this. If you assume the right at each re-survey to do what's called in incremental survey of connectable load, the scenario further plays out by the surveyor keeping the original survey in place and merely adding to the surveyed amount those new pieces of equipment that are being used or that are on the site and sitting around whether or not connected. The old pieces which were obviously no longer working or which were no longer at the site were not deducted from the survey amount. So the survey, of course, is something that incrementally grows and, due to changes in rates and charges of the public utility and the assumptions of the characteristics of consumption, the charge turns into a monster. The logic of this type of electrical consumption bears no resemblance to the actual cost of the

electricity consumed by the equipment at the site, you might observe. That is wonderful, but this observation must occur prior to signing the lease. This type of electricity clause is merely a profit vehicle for the landlord if properly drafted and properly administered. I believe this landlord was able to receive the largest price per square foot for gravel anywhere in the upper plane of Manhattan. I do believe it may be a record for many years to come and certainly an embarrassment for the landlord, but more importantly for the telecommunication company whose project director took early retirement about halfway through the initial term after the increases in the electrical expenses began to roll in.

I used the preceding story merely as illustration to cause one not to have their eyes glazed over and rolled back in their head when I do my following discussion on the attributes, requirements and needs of the tenant for electricity, water and other fundamental elements of nature such as sewer service within the demised premises. Defining a few terms at this point will make the discussion easier. Let's have the following terms have the following meanings:

1. Consumption: The utilization in a particular area, such as the demised premises, of electricity.
2. Demand: At any particular time, the amount that is being consumed. Therefore, peak demand would be the highest amount of electricity consumed at any point in time within the demised premises. Note that consumption is over a period of time and generally should be measured in 24 hour periods.
3. Connected Load: What is plugged in.
4. Connectable Load: What electrical consuming equipment is in the premises which could be connected and which could consume whether or not it is operable.
5. Power or Load: The amount of watts or kilowatts deliverable to the demised premises.
6. Watts Per Square Foot: Watts or amps, as converted, to be delivered to a point in the demised premises, hopefully a metered panel, and based on either rentable or usable square feet. This is generally required to be standardized by building codes in most cities except New York City.
7. Sewer Service: Not the same as water service. Please make sure that you have contracted for a place for the water service to go.
8. Survey: The review of the things within the demised premises which may consume electricity and what, when and how much they might consume.
9. Electrical Costs: This, of course, could be anything. Preferably it is the actual cost per kilowatt hour as billed to landlord as evidenced by the bills monthly of the public utility company to the building on average for the entire building consumption for the whole year, taking into account seasonal and time of day surcharges and net of any credits, abatements or incentives, all as divided by twelve months and the total number of rentable square feet in the entire building as well as those spaces which are allocated for escalation purposes to other tenants. This is a heavy statement. If you ask for this from most landlords, they will either not understand you or hate you. Those who hate you are the guys who otherwise would have stolen from you. Those who don't understand you are probably not making much profit on electricity anyway.

This last statement of cost takes into account something we have not yet discussed, that is, the possibility that the sum of the rent inclusion electric factors of all tenants in the building and for those spaces which should be tenantable and charged accordingly may already equal or exceed the entire

building electricity charges. If it doesn't, add it together with the electricity consumed for the common areas such as lobbies, air conditioning systems and mechanical rooms, but excluding other areas which are not to the benefit of all tenants-in-common such as garage and retail space, and this should equal the charge that should be assessed evenly throughout the tenants in the building. Of course, that number minus any work done in the premises by landlords in order to improve, repair or decorate the premises for current or future tenants should also be deducted.

Careful attention has to be given to what portions of the electrical, gas, water or other natural resource allocation goes on between tenant's use in its premises and its reimbursement of landlord for operating expense escalations or utility reimbursement or surcharges. One can envision some landlords obtaining reimbursement from between one and a half and three times the entire building electric meter by way of rent inclusion factors, escalations and direct charges for overtime services. One might also understand that after hours heating, ventilating and air conditioning as well as special elevator charges all have a component of labor materials and electricity. If all of those plus after hours lighting and rent inclusion electric factor reimbursements are taken into account, it's a clear picture on what the cost of electricity for public areas, operating expense escalation and demised premises should be. This is not an answer, it is a provocation.

There are other interests of the tenant other than just cost of electricity. With change in electricity and power consumption needs of sophisticated tenants, the big questions, in addition to how much it costs, are how much do I need today, how much will I need tomorrow and will I be able to obtain additional power in the building as my needs and technology change. This is not a simple question, and is rarely voluntarily addressed in the affirmative in a lease. The norm is that electricity is granted by capacity at the time of construction, and that capacity is the minimum that landlord feels it can get away with per usable square foot in the building.

Future needs are not guaranteed, and if they are satisfied by a landlord, it is generally with additional sizeable costs and profit factors included. Also if the particular use, which may be unusual and power intensive, is not described in these clauses, it may be prohibited anyway. I cannot tell you the number of tenants that have come to me with problems because the particular use was not allowed, or if they negotiated to have it allowed, there was not enough riser or feeder capacity or power load capability to the demised premises and the cost in order to get the necessary amounts there was extortion by the landlord. In essence, be like a child. Ask what is there, what you can get, how much it costs, where it comes in, when it comes in and will it be available later if you need more. When I say where it comes in, one must be careful to understand that electricity may be delivered to the floor and it may be delivered in 25 different locations. When a tenant takes overall space, one does not necessarily know where the feeders and junction boxes are.

Beware of the premises where you rent a floor and find out that your rent will be increased by an electricity charge that is by way of submetering. Submetering is a wonderful concept and reduces generally the cost to tenants of electricity and levels the playing field more, as if the tenant were purchasing the electricity directly from the public utility at the public utilities rate, except in the event that it is delivered to the floor in seven different locations because the previous tenants all had seven different meters. You must also not assume rates or proper submetering of only consumption in the demised premises. Segregating lines, setting up new junction boxes and redistributing the electricity to the location you need can be a change order exceeding $50,000. Needless to say, electricity can be a shocking financial experience in any move and can severely limit the ability of a tenant to operate in a demised premises that is already leased. Beware up front.

One should also consider what amount should be paid during the construction period. If the landlord is doing a build-to-suit, and is otherwise delivering a turn-key at landlord's cost, electricity

and other general conditions should also be at landlord's cost. In many instances it is cheaper during the construction phase than during the occupancy phase for electricity. These should be considered during negotiation, because you can save your legal fees right away just in the intelligent negotiations of the electrical clause or the freight elevator charges.

There are other arguments such as the issues relating to discontinuance of furnishing electricity on a rent inclusion basis. This should not be allowed unless the landlord is compelled by law or public service utility regulation to discontinue. If that is the case, the rent inclusion electric charge should go away, the lines and meters should be installed by landlord at its cost, and service should not be discontinued until direct service is obtained by the tenant. No voluntary discontinuance by a landlord should be allowed. This changes the character of the business terms and also allows for individual retaliation by landlord or extortion. I have seen it all here.

Landlord generally will exculpate itself or limit its liability for loss or damage or inability to use the premises sustained by reason of failure, inadequacy or defect in the character, quantity or supply of electricity or other raw materials to the premises. Many jurisdictions allow this complete exculpation and it is imperative to the practitioner to cause it to be limited to those things not within the control of landlord, or caused by landlord's acts or negligence. I have seen times where landlord has sent unlicensed, inexperienced contractors to the premises to play with power lines and water mains, only to find the premises equipment fried by electrical spikes or shorts or flooded out. I cannot begin to tell you the horror stories which occur because of this. It is important that the landlord understand its liability, act professionally, and have insurance covering these types of losses.

CHAPTER 19

ASSIGNMENT, MORTGAGING AND SUBLETTING

It's a very basic premise on leasing a facility that you lease the space you need today, plus some space that you may need to grow into allowing for normal expansion. Also you should anticipate extraordinary expansion and contractions through rights of options and first rights of refusal and the right to downsize by assignment or subletting for business cycles. Downsizing is the area where the most resistance from the landlord is felt. Leasing in the 50's, 60's and early 70's was so much easier because the tenant committed to pay a certain amount of rent, take the premises and return it at the end of the term without committing waste and with only reasonable wear and tear. What the tenant did in the premises during the term and what it did with the premises during the term were not so much an issue. There are many different ways to address all the issues which occur in assignment and subletting, but I think the most logical and easiest to follow will be to take care of issues associated with the different aforementioned functions of acquiring and disposing of space. For instance, I recategorized space as expansion space and excess space. The issues for both are different and the perceptions of landlord and tenant to those types of space and their treatment are also different.

Expansion space or rather extra space that a tenant takes which exceeds its immediate requirements should be given favorable treatment by landlords. A landlord may have a tenant who would like only three-quarters of a floor but the landlord might like to induce the tenant to take more than that in order to ease the needs of the landlord to lease. Additionally, the tenant, in taking three-quarters of a floor, may already be factoring in a quarter of that for expansion space. One might argue that none of the traditional 1980's reviews for subleasing of that type of space would be appropriate for a landlord in the 1990's. One might further argue that a tenant should be allowed to market that space, deal with it as it sees fit and not have to account for anything other than its appropriate use to the landlord. The areas that should be bypassed at least on excess space would be the request of landlord for approval of the sublease form or the sublessee, any calculation of profit sharing of the sublet rentals with the landlord, any right of the landlord to recapture the proposed space, any right of the tenant to subdivide the premises and do necessarily resulting alterations, and the right of the tenant to offer the premises through advertisements and otherwise compete with the landlord who, but for this leasing, would have had to lease that extra premises in addition to its other excess space.

The arguments landlords put forth with respect to subleasing such as to justify their right to review the creditworthiness of the subtenant really only apply at the time that the tenant is substantially out of the premises, and the subtenant might in the future be the entity to which the landlord looks for payment of the rentals for the premises. In an expansion space scenario, I do not believe this applies. Since it is axiomatic that the subleasing of the premises cannot confer any greater rights to the subtenant than those held by the tenant, and further that the uses, obligations and responsibilities are the same for a subtenant. It is easy also to argue that the landlord should have no right to review the transaction or the essential terms or the resulting sublease document. In essence in this instance of

expansion space taken by the tenant which relieves the landlord from the burden of marketing, subdividing and otherwise dealing with smaller, irregular space, the subletting should be unfettered, and actually the landlord should promote and assist the tenant in its quest.

Regulation of the numbers of tenancies within the demised premises, the regularity of the dimensions of the premises and the duration of the time and overall amount of the expansion space subletting program are valid interests of the landlord, but should be determined initially in the lease and not revisited throughout the program. Additionally, in the event there is a limitation on the number of subleases, their duration or the amount of space initially sublet in the program, the tenant should allow for replacements of subleases which are prematurely terminated due to default by the subtenant or otherwise. These vanishing subleases should be able to be replaced in the same unfettered way as the initial expansion space subletting.

Excess space from time to time of a tenant should be allowed to be addressed by a tenant in an orderly subleasing program. Here a landlord may have more of an interest in the nature of the subtenant, its creditworthiness, its type of operations and the characteristics and its operating manners, as well as minimizing the impact of competition resulting from the availability of previously committed space prior to the end of the tenant's lease term. A tenant can expect a landlord to desire to have the right to reasonably approve its selection of subtenants, and possibly to have a right to recapture the excess space by way of termination or assignment, if the sublease is for substantially the balance of the term of the lease, or by subleasing from the tenant if the sublease term is substantially shorter than the balance of the term of the tenant's lease.

Careful attention has to be given to the basis upon which the landlord will recapture the proposed portion of the leased premises which the tenant proposes to sublet. If it is by way of assignment, one must make sure that either the tenant is released from liabilities or that the assignment is to the landlord, in its landlord capacity, and thereafter if there is a subletting or an assignment by the landlord to a new tenant, the particular use is compatible with tenant's operations and that tenant's reasonable consent is required to be obtained for purview areas. The obligations to restore that the tenant has under its lease should also be addressed.

A classic trick is for a landlord to cause a tenant to sign a lease where landlord allows for a tenant to sublet excess premises that may be for substantially the balance of the term of the tenant's lease subject to landlord's right to block the transaction by recapturing the demised premise on the lower of the lease terms or the proposed sublease terms. The recapture allows for either a sublease or an assignment to the landlord "or its designee". Of course there is no problem with the termination of that portion of the premises, it just reduces and adjusts the lease document to a smaller space. However an assignment to landlord or its designee can allow a landlord to sidestep liability in the chain of responsibility and have the space assigned from the tenant to a third party who may have poor credit and shallow pockets. The tenant must allow for a severance of any continuing obligations under the assignment as, for instance, the responsibility to pay rent or return the premises in any particular condition at the end of the term. Otherwise the tenant remains liable secondarily or in surety even though the primary obligations may have been amended. If the transaction results in a sublease to a third party, tenant will remain primarily liable.

Other issues which arise when the landlord has the right to recapture are on what terms in the event of a sublease to the landlord and who bears the cost of subdividing the premises, segregating the service facilities and systems and other related costs. A strong tenant will of course insist that the landlord will recapture on the same terms as provided in an offering letter from a proposed sublessee to tenant and that the landlord will pick up the demising and other costs as provided in the letter.

In either of the types of unneeded space subleasing, there are some other concerns which affect or interfere with the ability to sublease. The first is the right of landlord to review, approve or recapture. In any instance where there may possibly be a subleasing program, an early trigger of any recapture right or of issues signalling difficulty with approval are paramount in importance to the tenant. The lease clauses today that require fully negotiated sublease documents to be proffered to the landlord prior to obtaining landlord's consent to the transaction are unrealistic and counter-productive. Essentially they completely thwart the tenant's right of sublease, since very few proposed sublessees will negotiate and enter into agreements that may not actually become effective. Also the timing of approval is critical since many proposed sublessees will not wait around for a long period of time for landlords to consent or recapture. Many of the clauses today allow for up to 90 days of processing under different scenarios before a sublessee knows that it has a sublease. My recommendation is that any of these rights be triggered early by a letter of intent from the tenant to the landlord suggesting a proposed subleasing and any continuing outstanding issues be finally determined when the tenant is able to send a letter of intent signed by a proposed sublessee or assignee reflecting their intent to lease or take the premises by assignment. In this instance, a very short trigger period for approval should be provided for if the earlier notice has occurred.

It should be noted that when there is an assignment, the tenant is not released of its obligations under the lease, but merely turns into a surety guaranteeing the subsequent performance by the assignee. In the event of a sublease, the tenant remains primarily liable for the performance under the lease, and a landlord is not required to accept any performance from a subtenant. If a tenant expects in the event of an assignment to be released from the contingent liability of the lease, it should provide affirmatively for such release in the lease document or it will be considerably disappointed. So also will the treasurer when he directs the accounting firm to remove the lease liability from the current financial statements. No company needs to have an unnecessary extra twenty million dollar liability on its balance sheet.

Most lease documents today provide that the change of the ownership of a tenant by stock transactions or change of partnership interests, the merging of entities or the acquisition of the tenant by a parent, or the sale or transfer of the assets or consolidation of assets of a tenant will trigger a prohibited assignment and expose the tenant to a default situation or loss of the entire demised premises. I have had many calls over the years where large public accounting firms, law firms, or corporations had completely negotiated their merger or acquisition agreement, had executed it and were in the executory interval, only to find that in preparing for closing, one or more of the leases for the facilities of the different offices prohibited the transaction and the leases were in danger of terminating. It is my belief that a tenant should be allowed to have transactions in its stock or changes of partnership interests provided the character of the tenant and its creditworthiness stay substantially the same as at the time the lease was signed.

With public companies, I believe the prohibition of stock transfers should be totally excluded and with small closely held corporations, the prohibition against a stock transfer assignment should only be triggered in the event that certain key owners transfer their interests and leave the corporation. These key owners must be very unique individuals and a significant part of the elements that the landlord relied upon when granting a lease under the terms provided. Care must be taken when allowing these clauses to remain in large corporation tenant leases. Usually, a landlord will provide that the clause should stay in as long as it excludes insiders, as that term may be defined to mean those with insider information and holding large blocks of ownership stock.

These days, corporations of any magnitude cannot control who buys and sells their stocks, and many corporations will find themselves wholly owned by a parent holding company and maybe traded

off many times over during the term of a 25 year lease. These transactions would violate the insiders limitation. These clauses receive a great deal of scrutiny, and well they should since they can cause a premature forfeiture of a significant asset of the corporation.

Additionally, a company that may go public, private or convert into a partnership, should allow for these exclusions from the prohibition. This is true as well of companies that expect to offer significant blocks of equity. In the event of a partnership, mergers and acquisitions are similarly of concern as well as the withdrawal of partners in the event of death, for estate planning or retirement. It seems only fair that a partner who was responsible for a lease that causes a withdrawal of a partner to trigger a default would retire from the firm, cause the firm's lease to terminate and accelerate rent and continue to be liable for the damage obligation!

Clauses seem to be creeping in around the country where the landlord can exercise an option in the event of a proposed subleasing or an assignment by the tenant to have the exclusive right to market the premises for the tenant and even to earn a brokerage commission as an exclusive agent. Allowing landlords to market the space conceptually may be fine if the building is otherwise fully occupied, but not a wise move in the event that the landlord has space which he is attempting to lease.

Two marketing areas of concern in a subleasing program are the right of the proposed subtenant to be able to obtain a non-disturbance agreement from the landlord and the subtenant's right to further assign or sublet. If it is a fairly long-term sublease, most tenants will find a subtenant will probably have the same needs of assignment or subletting in the event of expansion or contraction as does tenant. Traditionally, landlords do not wish to grant that right to tenants to pass on to their subtenants, and of course it will affect the tenant's ability to market the premises in any subleasing program.

Another area of concern is the ability of the subtenant to receive the same services and rights under the lease. The subtenant does not have what is called privity of contract with the landlord, nor does it have privity of estate. These are two legal instances where a landlord has to respond to the subtenant, and where they are required to deal as if in contract for the premises. Absent either of these legal relationships, a landlord can ignore a subtenant and its request. Therefore, the tenant will have to agree to endeavor to obtain from the landlord any of those services or rights that the sublessee is entitled to under the sublease in the event the landlord fails to provide them. In many jurisdictions a consent to the sublease may cause privity of contract to occur between sublessee and landlord, but this is not automatic and will have to be determined by counsel, since it is a highly technical area.

As a matter of practicality, it is very important to focus on the business terms of the transaction in the design of the lease document rather than after the execution when embarking on the subleasing program. For instance, it is important to note that a subdivided premises will have a larger loss factor for partitioning and walkways than the space leased to the tenant. Therefore when entering into a sublease document, it is important to make sure that the square footage area you are demising fits into the practicality of the situation. I remember once being a silent party to a transaction where a law firm had leased certain premises and did not understand the difference between rentable, usable and carpetable. The Tenant sublet a portion of the premises based on the rentable numbers but divided the premises and partitions based on carpetable measurements only to learn that it had sublet over 50% of its carpetable area when it only intended to sublet about 25% of its leased area. This is an embarrassing thing to do after the documents are executed. This will also impact on the tenant's proportionate share of reimbursement from the subtenant as well as its newly found need for unanticipated expansion space requirements. You may remember this example earlier in this handbook.

When the landlord requires a sharing of the cash flow or profit from the subleasing, the tenant should pay careful attention because these concepts are not the same. Additionally, there are many

variations on the cash flow and profit themes and, unless great attention is given, a tenant may find itself sharing a portion of a profit which exceeds considerably the net cash flow from the transaction. Simply put, and fairly articulated, I believe that the tenant, if it is sharing a profit, should only share to the extent that there is an actual realization of a profit by way of receipt from sublessee, when and as paid, of monies which exceed the rental and other payment obligations for the same space required to be paid or accrued for by tenant to the landlord under the lease, and only after amortizing from those excess monies (if any) the costs associated with the subleasing, such as brokerage commissions, architectural fees, engineering, alterations and reasonable legal fees. These should be amortized over the term of the sublease in the event that they cannot be reimbursed from the excess cash flow from the subleasing early on. Also in the event that fixtures are leased to the subtenant, there should be deducted from any net cash proceeds the costs associated with the fixtures and equipment. By making sure that it is cash paid, one does not encounter the problem of mismatching of payments and obligations by agreeing to pay the landlord for the sublease rentals payable under a sublease but yet not received, after deducting those rentals paid rather than payable under the lease.

There can be adjustments in rents under the lease as well as adjustments of rentals under subleases, and there should be a quasi-cash flow modified profit calculation, so that the benefits actually received, if any, by the tenant sublessor are then shared, as if and when received, with the landlord. I have seen horrible instances where a tenant has agreed to pay the difference between subleasing rentals reflected in the sublease and rentals reflected in its overlease, which were smaller, only to find it had to forgive or never received at all some of the sublease rentals for large periods of time after the subtenant defaulted and after the sublease was ultimately terminated. Because of the way the clause was written in the tenant's lease, there was no discontinuance of the obligation to pay that differential, even though that differential no longer existed. Similarly, there are clauses written that do not allow the netting from the profit calculation of those costs associated with the subleasing. It seems to me that if a landlord wishes to participate in the fruits of the subleasing, those fruits should be a fair reflection of the economic position of the tenant at the end of the day, and all adjustments to the net economic effect and all costs associated with the earning of that benefit should be fairly represented in the calculation. Can you see yourself trying to explain to your employer why it should make share payments to the landlord of portions of profits that do not exist from a sublease that provides nonexpectant cash flow!

Additional attention has to be given to a lease where the landlord has the right to recapture a portion of the premises in the event of a proposed subleasing program by way of an assignment or a sublease to the landlord. A tenant has several valid concerns if it is remaining substantially in the balance of the premises. One of these concerns is the compatibility of any sublessee's or assignee's use with the operations of tenant. Tenant should be careful not to allow direct competition. In addition, Tenant should not allow landlord to provide to its sublessee or assignee better signage, entry ways, or presence on the floor than had by tenant. Landlords generally will attempt to retain the right to alter the floors, change the sublet premises or amend the assignment document or sublease. In any of these instances, a tenant may find the enjoyment of its own demised premises severely interfered with. Additionally, the tenant may find the demised premises returned at the end of the term considerably altered and with the continuing obligation of the tenant to restore the demised premises at the end of the term of its lease before delivering it to the landlord.

Many landlords are including clauses in leases which are designed to be anticompetitive and which prohibit the tenant from negotiating and entering into a sublease agreement with any existing tenants in the building, or those who are affiliated with existing tenants in the building, as well as any prospective tenants or affiliates thereof with whom the landlord has dealt over a period of time. These

clauses have a tendency to exclude a very large population of prospective sublessees. It is understandable that the landlord would not wish to have the tenant interfere with the landlord's leasing program for comparable space in the building. However, as we have already mentioned, the space in question is expansion space, and that is exactly what should occur. If this is contraction offerings, then the limitation of competing with landlord should be only with respect to a very finite group of people that the landlord has been negotiating or discussing proposed lease terms with within a very short period of time, and only in the event that landlord has comparable space to that being offered by the tenant. These clauses deserve a great deal of careful scrutiny. I would suggest that the tenant only be limited so as not to compete with any entities with whom landlord is then in active negotiation for comparable space in the building.

There are also clauses that limit tenant to a leasing program which does not undercut the landlord's market. I have seen clauses that say that any sublease space cannot be offered for less than 90% of the then current market value per rentable square foot, and further that market value would be deemed to be whatever landlord is asking for comparable space in the building. This is difficult to ascertain and, quite frankly, I believe it to be an unfair limitation of tenant's ability to market its sublease space. Additionally, in the subleasing clauses frequently landlord includes a default which becomes incurable along the lines of a mandate that the tenant will not offer the space through brokers or advertise a rental rate. This type of clause has two complications. First, it inhibits the ability to market the space and effectively compete in the real estate arena for the sublease project. Secondly, it effectively blocks the consideration of any sublease when the landlord is approached for its approval because the sublease has been previously tainted by the breach of this prohibition paragraph. Although I have only seen it occur once, it was considered an incurable default under the lease for having offered the premises in violation of the paragraph thus leading to the complications and possible termination of the leasehold estate for the entire premises. All of these are quite unreasonable, possibly anticompetitive and therefore illegal and unnecessary and should be modified or removed entirely.

CHAPTER 20

RENTALS

Base Rent

We have already discovered in this work that when you hear the figure of $40.00 per square foot for base rent or fixed rent (used interchangedly here), you should have more questions at that point than answers. I think probably the first question that comes to mind is what is a rentable square foot? What percentage of a rentable square foot can you stand on or can you benefit from? Why aren't there round feet out there just to fool us? Additionally, there are certain components of base rent that we will wish to unbundle. For instance, does the base rent include an inclusion charge for electricity which frequently is affectionately referred to as the rent inclusion electric factor? If yes, then is the base rent increased over the years? If it is increased, is it on a stepped up basis or by application of a consumer price index or other deflator formula? If so, what portion of the base rent should have the deflation application? Clearly, it should not cover those areas already being adjusted or increasing due to cost increases. Therefore the rent inclusion electric factor should be deducted prior to the adjustment. We should now take the time to unbundle the other components of the base rent so that we can have a better understanding of how it and other charges should be dealt with in the many different sections of the lease. Let us assume for the moment that we have a $40.00 per rentable square foot of fixed rent.

Let us assume that debit service exclusive of principal amortization is $20.00 a rentable square foot. Let us further assume that the office or other space leases in the building are based on an escalation concept, whereby the landlord will pay the first year's operating expenses and taxes and the tenant will reimburse the landlord over the term of its lease for any increases over the first year costs or frequently referred to as bases. Therefore let us assume that operating expenses for maintaining the building, cleaning and management for the first year will be $5.00 per rentable square foot. Let us assume that real estate taxes and special assessments for the first year will be $7.00 a square foot. Let us further assume that electricity will be $2.00 per rentable square foot and is included in the $40.00 per rentable square foot base rent quote. This of course is generally not the case. Usually the electricity charge gets added on when the lease comes out, but let us assume that all landlords play fair upfront and that is part of the $40.00. Therefore of the $40.00 per rentable square foot, $34.00 represents the costs to feed and clean the building and $6.00 per rentable square foot in year one represents a profit. Let us further assume that as you will see in the subsequent chapters of the book, the maintenance, taxes, operating expenses and electricity will all have their cost increases over the term of the lease which will be reimbursed by the tenant and that the debt service is based on a fixed rate permanent mortgage so that the $20.00 is cost constant over the term of the lease. As can be seen, the profit portion of the rent is really only 15%, the debt service is approximately 50%, the operating expense is approximately 13%, taxes are approximately 18%, etc.

We will also assume (probably improperly) that there is a correlation between the base rent of $40.00 per square foot and the number of rentable square feet in the building which, when multiplied by the base rent, would give you these scenarios. To date we also know that the sum of the demised premises in a building that is fully occupied will be larger than 100% of the carpetable area and may well be 25% greater than what should be the rentable area. But that conversation will be saved and elaborated upon more in the next section. This just helps you see that the 20,000 square foot lease in one building at $40.00 a square foot may be the same as 22,000 square feet in another building at $40.00 a square foot or 18,000 square feet in another building at $40.00 a square foot. That is the easy approach. Now try and compare a $36.00 per square foot base rent to a space quoting for a 20,000 square foot space $40.00 a square foot but is really only 18,000 square feet. Comparing apples to apples becomes considerably more difficult. Next you will add in the variables attributable to the work being performed or the credit given for work by the landlord on the lease, affectionately referred to as the Work Letter, and the assumptions for the components of other rentals, such as escalations for increases over a certain different base amount for taxes, operating expenses, porters wage formula, utility expenses and electricity, which of course you have already discovered. This makes the comparison extremely complicated, but still doable. It must be done of course in the preliminary stages while pricing comparative deals. In truth, it is generally focused on by experienced facilities directors and lawyers, either late in the negotiation or after execution of the lease and this moves us to the next section in the wonderful world of discovery called escalators.

Escalations

It is important to note immediately that the word escalation means exactly what it means. Escalation I believe must be derived from the old Atlantian term escalator, or always going up. Atlantis is where it is because escalations eventually weighted it down. Escalation clauses generally are written in a way that they can never go down and usually cover only increases in costs whether such increases actually occur or not. Given the writer's prejudice on how they work based on the rather crafty ways I have participated in writing them, I will spend a moment to explain some of the issues involved. Some parts of the country have net leases, and some parts have not so net leases. In essence, a net lease is where the tenant pays a smaller base rent per square foot (presumably net of all bases), but then pays a percentage based on its occupancy of the building in relation to all of the leasable areas in the building (we hope) times the actual cost to operate the building plus taxes and any shared common area charges. These are called pass through changes since they are to be paid net of cost markups and discounts to the landlord.

The not so net leases are what are generally encountered in office and retail space, and they are those where there is generally a larger base rent figure which presumably is an aggregate of, as we have seen, the profit and other costs bases associated with the building. When these components are bundled in to the base rent, people lose sight of the fact that those should be the numbers used for the base years which landlords expect to cover operating and other expenses of the building including debt service, and over which the tenant is expected to pick up his proportionate cost or expense share. Somehow, there has not always been a coherent direct translation of those numbers into the escalation provisions. Just as certain buildings have different usable to rentable square foot ratios, they also have different competitive advantages or disadvantages in the costs to operate. For instance, there are many buildings in New York City that have real estate taxes in the $6.00 to $8.00 per rentable square foot range. There are also some $12.00 per rentable square foot numbers.

Additionally, some buildings have an incredibly disadvantaged position when it comes to utility and electrical efficiency, and their cost per rentable square is much higher than those that are high tech

and new. Similar discrepancies occur with respect to operating and cleaning costs for a building that is old versus those one that is new, and versus those that have very sharply negotiated positions in older cleaning contracts, and those which have brand new maintenance and operating contracts which are possibly very advantageous to the unions. Therefore these numbers have to be looked at and unbundled when doing comparisons between to the components of base rent and the actual costs of particular buildings for the base years projecting actual costs of occupancy per building and comparing apples to apples when picking a building out of the candidates.

One other note of interest: many of the proposed candidates will have different concepts of base years for each of the different escalations. Some will have the last year as a base year, while some will have split years or half years. Some will have fiscal years covering portions of two calendar years. Some will have the current year of occupancy or the current year of the term (these of course will be considerably different). Some will pick a lease year which actually could be often a year and some months of actual possession by the tenant. In any event, care and attention should be given to these differences in order to have the definitions fully understood. Additionally, the base year may be triggered by the contract portion of the lease term or it may commence on the substantial completion of the premises when delivered by landlord to tenant. This is usually an extremely big difference in economic results and should be observed.

Going forward, it should be considered that this principally is a work on commercial office with some retail. There are some very subtle but expensive differences which translate through imperfect parallelisms to all retail, regional malls, mixed use buildings, including residential, office and retail, but with some major costly differences which I usually like to refer to as landlord grabs. Having spent a lot of time designing those leases, I would say that discussions in depth on the differences would be better taken up in other writings of which I am sure there are plenty or soon will be.

Other Considerations

At this point, one might ask, if in any year the market base rent contains a profit portion, or no profit portion if it is a bad year, plus the sum of the other costs representing the bases per square foot being underwritten by landlord, then if the landlord is able, through mirrors, to create a larger than life building because the sum of the demised premises is over 100% of the building size, or is able to apply the bases to the calculation of escalations for the same operating expense taxes, etc. to different tenants or to collect taxes from the tenants in different improvements on the same combined tax lot containing the building which duplicate actual taxes paid or not paid, should the tenant be allowed to have the benefit of landlord collecting more than actual costs by having his base rent reduced to the extent of such over collections or possibly have its expense or tax escalations reduced? If you can even follow this last sentence, you are ready to read leasing speak sentences which are generally longer and just as convoluted! The prior statement though is an interesting concept that has not received a lot of attention by practitioners representing tenants. Quite frankly, I have never heard it raised before, but I think it should be considered as all part of the same linear equation when leasing in a building.

Taxes

In order to understand what a tenant will be paying in the way of tax escalation, one must understand the amount over which it will pay the increases as well as what the definition of taxes really is made up of. The easy one is to figure out what the base year or the base amount or factor for taxes

will be, and one might also take the extra time to correlate that to its component in the base rent just to see if it truly pencils out. The more difficult concept is calculating what taxes are.

Simplistically, taxes are a payment made by a landlord in most regions to a governmental or quasi-governmental agency resulting from amounts reflecting special or benefit assessments imposed on the property plus tax rates or mill levies applied to the value of the property as determined or assessed by the governmental entity. Special assessments are usually impositions either in dollar amounts per quantity of real estate value, rates or dollars times square foot area, or numbers of people and they are usually paid in installments based on the useful life of the benefit to the benefit district which includes the land and building. These special assessments may be based on land or improvements or both, such as sidewalk, traffic or sewer and water assessments. They also may be benefit related to transportation, landmark displacement or other special governmental related or humanistic related services. One must take the time to make sure that the base taxes, if it is otherwise not a number, includes the concept of that portion of the special assessments, the installments of which fall within the base year period. Also all special assessments should be calculated based on the installment method, whether or not the landlord pays them in installments, so as to smooth out the impact over the term of the lease.

Landlords generally fail to include installments of special assessments in the base years. It seems to be a common affliction, and I am not certain how it originated. The other prevailing method among other many types of real estate related taxes is the valuation times a rate approach. Here the taxing authority determines the assessed valuation of the land and the assessed valuation of the improvements upon which a mill or a tax rate levy will be imposed. Land and improvements are generally treated differently. Land may be assessed at a full value and the improvements may be phased in or partially abated. Also, some areas have different rates for the two different components. When determining the taxes, especially for the base year, one must make sure that any reduction or limitation on the full amount of the assessed evaluation of the land or the improvements by way of incentive abatements, or by the timing of when it becomes part of the assessment rules, as fully completed, are not only understood, but that the impact on base taxes is adjusted if appropriate to avoid an artificially low base tax amount above which the tenant will pay future escalations. (This concept is with many thousands of dollars per month and worth the effort to understand this long sentence.)

In some jurisdictions, an otherwise completed building with tenants in it may not be on the tax rolls at full value, irrespective of incentive abatements, for up to two years after it is actually physically completed due to technicalities of the assessment rolls. Additionally, even if fully assessed either in dollar amount or assessment, it may reflect additional abatements or what I refer to as a below the line abatement deduction, or an artificially low assessed valuation through an incentive abatement program which erodes or becomes smaller with each year of the program allowing the assessed valuation of the land or the improvements to increase from year to year without regard to the actual increase in the value of the project due to market conditions. If you have noticed, in that last statement, that the assessed value of a project can increase in several different ways simultaneously, then you have not missed the point of this discussion. Just as we have noted that many buildings have different taxes, they also have different base years, as we discussed, base factors, different abatements and different special assessments. They also increase on the tax rolls at different times such as at sales or refinancing. So if one is going to try to calculate the impact of the base amount of taxes that will be paid by landlord, and the amount of increases each year including possibly the first year which will be paid by the tenant, in order to compare these premises with other proposed projects for leasing, one has to dig in to the existing taxable components of real estate taxes, such as land, improvements, air rights or development rights, easements, special assessments, assessed valuations, abatement amounts, free

trade zones, payments in lieu of taxes, abatement formulae, etc. before one can come to the appropriate comparable number or calculation.

The components of assessable real property rights include the actual land, any improvements on the land, easements benefiting the land, encumbrances on the land, air rights and unutilized development rights (one being a function of real estate and the other being a value conferred or stolen by zoning), income from the property (presumably from advantageous leases such as the ones we are discussing or competitive advantages from lower taxes) and types of use. Once you have determined the property's characterization and assessed valuation after deducting any incentives, abatements and adding any installments or special assessments and determining what is the taxable lot you should be paying for (such as the building plus only so much of the land as should be benefiting the project) under the particular lease, you can go about calculating what the taxes should be for the base year and estimating future escalations. I say include only so much of the land as is necessary to support the building, because there have been some nasty habits recurring over the years in many of the larger cities of including the building that the lease is in with other combined tax lots, which include other excess improvable land and improvements not necessary for, nor even benefiting the enjoyment of the building by the tenant. This I call warehousing at the tenant's expense. Landlords call it involuntary investing by tenants. Once you get through the fluff of understanding that a garage is part of the building, but it services everybody but the tenants, and there are other buildings on the property that may or may not be assessed and may or may not pay their freight on the combined tax lot, one can then start to sort out those payments and those calculations that are relevant in equity or morally to the building wherein lies the possibility of a new facilities manager.

Once you have the hang of how real estate taxes are computed and what the base amount of the taxes will be that the landlord will be funding, it is not as smooth sailing as one might imagine. A facilities manager worth his or her salt will not allow taxes to increase because of additional improvements to the building other than those in the demised premises nor will they allow the base taxes for the base year to be subsequently reduced and have all the subsequent years recalculated. A good example of this is when you are paying that $40.00 a rentable square foot and taxes are $7.00 per square foot for the base year, but there is a little extra word or two inserted in the lease after the base year definition saying "as finally determined". In this instance, these three little words mean that in the second, third or fourth years, depending upon the appeal process for taxes in the particular region, the base year assessments may be redetermined and reduced.

So remember now that the tenant is still paying $40.00 per square foot of base rent. However, the landlord at this point after the adjustment is only paying $6.00 per square foot of the base for escalation for taxes. Since he budgeted for $7.00 per square foot and is now paying $6.00, he has $1.00 savings in payments per year for the rest of the term of the lease. However, since the clause allows the landlord to adjust the base year in the lease downward, in subsequent years, that will increase the escalations payable by the tenant per square foot. For instance, if the second year after the assessed valuation adjustment, the taxes per square foot are now $7.00, the tenant will pay an additional $1.00 of escalation per square foot that it had not anticipated. Even though the taxes per square foot are at $7.00, which is the same amount that was anticipated when the $40.00 per square foot rent figure was advertised. Therefore as oddly as it may seem, the landlord has saved $1.00 per square foot per year and the tenant is paying an additional $1.00 per square foot per year, and this will remain so for the remainder of the term of the lease. Of course this is no small amount and has to be defended against.

Additionally, some landlords think that if a building is not completely occupied, they should increase the occupying tenant's proportionate share so that it is paying its fair share of taxes based on the percentage of the building actually occupied. Rather than adjust the tenant's proportionate shares

for the periods that they are in occupancy during the year, the landlords increase the real estate taxes to an amount which would reflect a building fully occupied and improved by tenant installations and pass that through to the tenant for application of its tenant's proportionate share. Although there is some argument in favor of this theory with respect to operating expenses, there is no justification whatsoever with respect to real estate taxes.

Therefore if a tenant is occupying half the building and its tenant proportionate share is 50%, if it is the sole occupant of the building it should pay presumably under this scenario, 100% of the increases in taxes. That will be a different result than having a tenant pay its tenant proportionate share of 50% times the assessed valuations which presumably in landlord's estimate would occur had the building been fully tenanted and occupied and with all tenant improvements and installations in place. The difference between these two numbers is of course a windfall to the ownership. Side stepping the windfall for the moment, there are certain ownership costs associated with having new or empty buildings. Taxes certainly are one of those ownership costs. Unlike operating expenses which increase by usage of tenants and which may correlate to the usage by one singular tenant in the building, real estate taxes do not.

Two other concepts, which can be elaborated upon during negotiation, are that only taxes paid by landlords should be paid by tenants and only as, if and when paid by the landlords. This is usually quarterly or semi-annually and, provided that tenant's sufficient funds check reaches the landlord within four or five days clearing time prior to landlord having to pay taxes, there is no compelling reason for taxes to be paid monthly or earlier by a tenant. Additionally, these escalations must be based on taxes actually paid as opposed to when assessed. If the taxes are subsequently forgiven before payment, there should be no payment required for that portion by the tenant or, if forgiven after the payment, there should be a refund to the tenant of its share of that excess payment.

One also has to allow for subsequent years tax review and reduction proceedings after the base year, both allowing the landlord to recoup a portion of the cost of performing such review procedures and allowing tenant to recoup its fair share of that refund amount which was paid through escalations partly by the tenant. The astute facilities manager should watch out for what is currently in vogue, and that is payment in lieu of taxes. On any taxing lot there may be tax exempt improvements which are assessed, but no taxes are collected. These include governmental entities and charitable and religious entities.

Depending on how the clause is written defining taxes, it may be the assessed valuation of all improvements times the tax rate even though the landlord is only paying the amount resulting from that calculation on some rather than on all of the improvements. This also is true in the event of any incentive or other abatement programs. This generates a problem for the base year which is easily overcome by using the assessed valuation times the tax rate for the base year, but in the subsequent years basing it on taxes actually paid or payable, which means that you have an appropriate base year, but you will never pay more taxes on your proportionate share formula than landlord pays for that same share.

Porters Wage or Penny Wage Formulae

Landlords many years ago, in order to avoid disputes and arguments over what constituted a necessary and appropriate operating expense, designed a new way to calculate escalations based on a formula that purported to have a relationship to the cost of running a building, which was the relative increases from year to year of the cost of porters or other comparable union employees as set forth in the union contract for the building or for the industry. In its simplest form, the hourly wage rate of a

standard employee would increase from year to year and the number of cents that it increased would then be multiplied by the rentable square footage area of the demised premises and the result would be the escalation for that year. Each subsequent year, the calculation was revisited over the previous years wage hourly rate.

The formula in the old days was a small hourly wage and small cents increase applied on what was called a penny for penny escalator. Also square feet were square feet! Early on, landlords discovered that they could make it one and a half, two or even three pennies increase in the tenant's escalation for every one penny increase in the wage rate. As time went on, it became obvious that this was quite a profit center, because as the hourly wage rates got larger, a 10% increase in the wage hourly rate became 300 pennies instead of 10 pennies. Also, one square foot became one and one third square feet. That multiplied by more than a penny for a penny became an incredible increase per square foot for escalations under that formula. It is also good to note that there was no relationship between the increase in hourly salaries and the cost to operate or clean the building.

Not being one to be outdone by a small city like Chicago where the penny formula began, New York City decided through certain landlords to add to the computation the hourly rate increase plus the impact on pricing of the hourly rate of fringe benefits which were negotiated on behalf of the union employees rather than hard hour cost increases. As the hourly wage rate became larger, the resistance in union negotiations caused more benefits to occur in the fringe area rather than in the hourly rate so as to make the contract more palatable. It is also interesting to note that if you price fringes based on the hourly impact, you must divide the cost of the fringes or the benefits by the number of hours worked in the fringe period. Well, this generated a great deal of variables and has been a veritable storehouse of creativity for landlords. Not only do many of the landlords use a different denominator for the hours worked for the benefit period, they do not always price the benefit or even the hours in the denominator from year to year consistently and in accordance with any generally accepted standards. One might say that there are so few standards in this field, that of my clients, not a single one of them prices the fringes the same way nor has an hourly wage increase that is even close to the same number from year to year as others. This inconsistency and non-standardized approach to price in the impact of this formula on escalations can make comparison of proposed premises for leasing very difficult.

These days if we were to ever agree to a porters wage formula, it would probably be one-half to three-quarters of a penny increase for each penny increased in the actual wage rate without calculation attributable to fringe benefits. However, because of the profit potential, most landlords having significant tenants have moved back to actual net operating expense "pass throughs"; Pass throughs being a thought that the actual cost alone is all that is passed through on a percentage calculation to tenants. I will try ardently to dispel this notion in my next section.

Operating Expense

A more straightforward approach to having a tenant pick up the increase in costs to operate a building is the operating expense pass through. Two concepts are appropriate here, operating expense which means appropriate, reasonable and reasonably necessary expenses incurred in operating the building and not the garage used only by other than tenants. Operating is a pyramid definition on its own which can include management, repair, maintenance, partial replacement, cleaning, decorating, landscaping and possibly altering. There are two ways to define it, the very long way which enumerates everything that can be included in an operating expense and a short way that merely speaks of all costs associated with operating, managing, repairing or replacing portions of the building. Both

definitions approach the same reasonable middle ground, but from two different avenues. The smaller clause really allows practically anything that is reasonably appropriate for operating a building to be included, and the other clause only allows those things specifically enumerated to be included.

The difference has been bridged by adding at the end of the three page clause, the additional parenthetical or prepositional phrase..."or any other such cost or expense of operating or maintaining the property". So landlords can say it long or short, but whatever is said has to be sorted through carefully and the definition modified to fairly express the parties' intentions on those costs and expenses which are fair game to be included in an operating expense escalation cost. Either way, there should be careful attention given to those exclusions from operating expense which fit the nature of the deal. This varies with a variety of factors including the size of the space being leased and the number of years it is being leased.

A large tenant looking for a large block of space for a lot of years is generally making the election to lease in order to avoid those periodic but usually unplanned for capital expenditures associated with ownership. The last thing they would like to do for instance is to come in to a long term lease at a rent which is supposed to even those expenses out over the years only to be charged for large capital improvements or violation curations associated with the ownership position in a building. Therefore one of the first arguments that usually arises is what capital improvements, if any, are allowed to be passed through via operating expense escalations. Those types of capital improvements usually revolve around issues of capital expenditures associated with curing of defects in construction, latent defects or completing construction and original fit-up for operation. Additionally, those capital expenditures associated with curing violations of laws, curing conditions which if discovered would be violations and otherwise putting the premises prior to leasing and other leasable premises and the public portions of the building in compliance and also hazardous substance free. That issue also can be bifurcated and dealt with both during the pre-leasing period and during the term of the lease.

Clearly, anything that has occurred up to the time of the commencement of the lease (contract, occupancy or operations as negotiated) should not be passed through via an operating expense clause unless it is for the base year. Ongoing issues are subject to negotiation. Generally large tenants do not allow any capital expenditures benefiting more than one period to be charged as operating expenses. Those that allow it require that the capital expenditure be amortized and included year to year only in the amount representing a straight line basis depreciation and not at all in the last two years of the lease. Many tenants will agree that capital improvement costs can be included for otherwise operating expense saving improvements, but only to the extent of the actual savings or in some instances the estimated potential savings on an annual basis amortized over the useful life of the improvement. There are usually also limitations excluding any reimbursable costs from insurance, condemnation awards, other tenants for direct services and overtime and additional services, as well as levels of service that are greater than the level of service of a particular tenant under the lease. Under duplicative costs would be taxes and electricity payments as opposed to the cost of electricity furnished to non-public areas in the building.

Other exclusions include any debt service on mortgages or rental under ground leases, costs of any work in leasable or leased premises (non-public areas), costs associated with professional fees for disputes or litigation with tenants, landlord advertising or promotional expenses, costs for casualty which are or would have been reimbursable by insurance had landlord carried full value insurance, salaries and fringe benefits which are above comparable salaries and benefits for comparable employees, salaries of personnel that are shared among buildings or those above the grade of a building manager, fees or costs in excess of the comparable market value thereof for services rendered by vendors affiliated with landlord, and any type or line item service which landlord is generally providing to the building but not to the tenant under the lease.

In addition to having exclusions, there should also be a general provision requiring all services to be delivered at landlord's actual net cost. Actual at the time of disbursement is an easy concept. Net at any time means that if there are any discounts, volume, credit backs or other payments or benefits received by the landlord related with any service provided to the building, that those find their way back to the benefit of the tenants.

Another area that is quite controversial is those operating expenses resulting from the negligence of the landlord. One example which I gave in this book was that of the landlord who allowed a non-union, non-licensed plumber to come in the building and inspect and work with some of the risers and feeder pipes. The same plumber who affixed his wrench to a high pressure water column in order to tighten a slightly dripping shut-off valve without turning off the pressure in the pipe. The cost associated with repairing the damage from the flood, the impact on the tenants and the damage to the plumbing are things that should be reimbursed by the insurance, but whether or not reimbursed should not find their way to an operating expense escalation clause. The reason I say this is that landlords who operate at least first class buildings are expected to have a certain level of management and operating ability, and they receive a management fee and have a manager specifically paid for that. If there is negligence, then that should come out of the management fee or the ownership pocket.

The grossing up practice we discussed in taxes applies more appropriately to operating expense escalations. For instance, if there is a tenant in the building and it is the only tenant using the elevators, one would expect that if the cost of the elevators went up the next year and still only the one tenant was in the building, it should pay for the entire increase of the operating expense of the elevator over the first year. If for instance the tenant is a 50% occupant of the building, you could either double its tenant proportionate share so that the tenant would pay 100% of the increase for the operating expense attributable to the elevator over the base year, or possibly you could increase the operating expense to a number that would result in approximately the same payment if the building were 100% occupied. Of course it is easier to adjust the finite tenant's proportionate share with accuracy if it is not too complicated with tenants moving in and out of the building, than it is to adjust with accuracy the operating expense that would occur if the building were 100% occupied.

In the elevator scenario, if the building were fully occupied I would suspect the expense of the elevator would be more than double what it was in the base year. However, the expense of heating in the winter is significantly less than double the cost if the building was 100% occupied instead of 50% occupied, because the body warmth of human beings in the building in the morning and throughout the day causes the heat requirement from the heating equipment to be considerably less. Tenants should pay careful attention to this aspect of the non-linear relationship of occupancy and resulting operating expense for each type of service. The type of service and the relationship to full occupancy is different in its linear or non-linear reaction to activities resulting from a fully occupied building. The next issue of course is what is a fully occupied building.

Most people consider a fully occupied building to be one that at any time has achieved a 90% leased level. Of course you can tell if that is different from occupancy level. Some buildings may never in their lifetime reach a 90% occupancy level. When limitations on the grossing-up or other operating expense concepts are based on an occupancy or a leasing level, careful attention has to be paid to the particular concept to see that it is practically achievable. One instance comes to mind on a rather large space lease where the landlord is not allowed to increase operating expense escalation over a flat rate per square foot with a small increase per annum not to exceed a certain percentage throughout the term of the lease until such time as the building is 90% or greater occupied by tenants. This small increased limitation has significantly hampered the landlord, since the landlord in that instance expected to be about 90% leased within the first two years. The odds are that it may not be 90% occupied for quite some time, if ever.

The vehicle for issuing statements of operating expense escalation, and for the challenge and review thereof, is subject to wide disagreement among practitioners. I will take the risk of saying what I think is fair, and that is that operating expenses should be reflected on a consistent basis from year to year and based upon generally accepted accounting practices as applied by those certified public accountants practicing generally in the first class building market in a particular locale. The expense statements should be in sufficient one line item detail so as to provide a tenant with relevant information and should be in that same detail and prepared the same way from year to year. I do not believe there should be a mini statute of limitations on the right of a tenant to review the expenses or to correct errors, nor should there be a limitation on the landlord's right to correct previously issued statements or issue statements when it has failed to so do. The landlord should have the right to collect operating expense escalations and reasonable estimated installments monthly in arrears and be able to adjust for unanticipated significant increases, but not by more than 3% over the previous year's line item amount. I believe landlords and tenants should reconcile these estimated payments within 30 days after the end of any lease year, and that any underpayments or overpayments should be recouped with interest carried until paid.

I also personally believe that disputes evolving out of expense or tax escalations should be decided by arbitrators with 15 years experience in the management of commercial real property and litigation should be avoided. Litigation is an imprecise way of trying to get a lay person through a lot of custom, practice and sophisticated standards and then apply some fairly sophisticated detail in concise contract law thereto. This leaves a lot of room for errors in the administration of the intention of the parties when those who do this all the time are better able to interpret the intent of the contract and apply it to what is custom and practice in the area based on the terms of art used in the lease. It also saves a lot of time and a lot of money.

Consumer Price Index

Landlords typically like to keep the profit portion of their base rent from eroding due to inflation over the years of the lease. If one could believe that all operating and other escalation calculations were merely a pass through of the actual increase in cost to landlord to operate the building and that only 100% of the increases were passed on and reimbursed by the tenant and that, otherwise, the sum of the base years for escalation fit into the base rent number with the appropriate profit portion that the tenant believes is reasonable for a landlord, then I have no problem with the application of the Consumer Price Index to obviate the impact of inflation on the buying power of the profit portion of the base rent dollars to the landlord. Those are a lot of hurdles to jump, and I have not yet met a landlord who could hurdle each one of them with clean hands. Assuming I did, then we could unbundle the particular components of base rent and might find out that somewhere between 15 and 25% of the base rent is profit, and therefore an application of an increase in inflation from year to year on the base rent will be applied only to the extent of the profit portion and in the best case, would not be greater than 25%. I, along with most, disagree as to the type of price index; whether it should be the GNP Deflator Index which has a different bread basket of items than the Consumer Price Index or not is subject to a debate that I will opt out of.

One might note that the largest components of the bread basket of items associated with the running and operating of the building would be the increase in the labor rates and the increase in the cost of energy and fuel. Some people tie the escalation to the percentage increase in the rates or costs (two different concepts, you will note) of electricity charges or gas or steam charges, or quite frankly a combination of all three with different rates in the calculation to the portion of the fixed rent. I am sure

that you are just as good at modelling numbers and impacts as I am, and I will leave that decision to the economists. The only issues that I feel strongly about are that the deflation mechanism only be applied to the portion of the base rent which is truly otherwise not adjusted for increases in cost, and that is of course the true profit portion, and that the application of whatever formulae is done in such a way that subtle compounding does not occur. An example of compounding, however small, occurs when you take a base rent and add to it the adjustment from one year to the next of the application of the deflator, and the next year take the adjusted base rent and again add to it the next year's adjustment. If you were always to use the original base rent net of any rent inclusion, electric or other type of components and figure the additional rent for that escalation each year, based on a comparison of the current year's deflator index to the first year index, you would have a fair reflection of the intended purpose.

Additionally, some landlords, I am sure quite by accident, adjust the base year with the previous year's results of the calculation, except the calculation is based on a comparison of the current year to the base year each time. Believe it or not, I have seen clauses that are read in that way which causes the base rent and even a marginally inflationary period to actually exponentiate. Similarly, such exponentiating equations have found their way to applications on some line items of items in the operating expense clauses, such as the management fee. These are subtly written and rarely understood by lawyers and laymen but must be guarded against.

Escalations in Summary

I guess if you are responsible for the facilities move, and you want to keep your job, you just have to make sure with respect to escalations of the following:

1. Your firm is only paying for its proportionate share of actual taxes paid by the building on the building and not on two football fields attached to some church or city leased, or owned property on the combined tax lot, or on a garage which is built in the building but is used by everybody publicly.
2. If taxes go down on the building that your escalations do not go up by the same amount of the tax saving for the landlord in the base year.
3. If the building is being operated and there is an operating expense escalation that you are only paying for appropriate operations of the building and not buildings in the same tax lot, garage and public parking space, whether or not in the building, to manicure and landscape other parcels which will be built on later, capital improvements for the three-floor cafeteria installed by the landlord in the building to service another tenant, or similar retail space to serve the public, capital or other expenditures paid by the landlord to cure defects, violations or hazardous situations or more than 120% of the overall building escalations.
4. That you only pay for your electricity, heat and moving costs not more than three times.
5. That the deflator index formulation does not allow creeping or galloping profit increase, because it is applied to all of the base rent including the electricity factor, all of which are growing on their own nicely from year to year.
6. That your administrator discovered that you are paying escalations not only for other tenants but prior to occupying the premises and maybe even signing the lease.
7. That there is a miscalculation in your taxes or operating expense and that you are not allowed to cause it to be adjusted.

8. That you are paying taxes even though the landlord is not.
9. That you thought that porters' wages were people who picked up your suitcases at the train station and brought them to the office and you found that those charges were also included in your lease.

CHAPTER 21

SUBORDINATION

This is a wonderful topic. This is an issue found in leases that to most lawyers and lay people is about as esoteric and uninteresting as condemnation although it is much more likely to happen in this economic environment, and when it does happen, much more likely to cause heartburn. In essence, there are different interests in real estate and different priorities in the right to own and control real estate. An owner of a real estate interest can encumber its interest by entering into a lease and thereby having the tenant's interest be superior or paramount to the owner's interest. Somewhere in the chain there can occur somebody with an interest greater than the owner's and earlier in time and therefore superior or paramount to the tenant's interest. These are usually ground lessors under a ground lease, fee mortgagees on the ground and leasehold mortgagees on the lessee's interest under a ground lease. There can also be other underlying leases such as building leases, or leases of sections of the building such as a retail space. It can become more complicated than that but this is sufficient for our discussion.

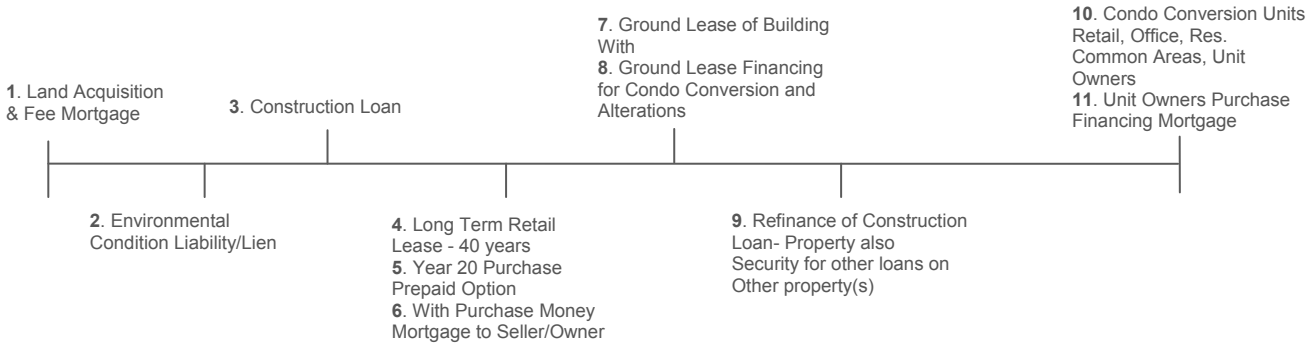
A lease entered into, and in some jurisdictions recorded, prior to a ground lease or any type of mortgage is superior to that title interest. My only concern is when a lease occurs after a ground lease, space lease or mortgage or when a lease requires an otherwise superior lease to become subordinated to and therefore junior or subservient to the otherwise inferior interest in that same real estate. This is done by an agreement called a subordination agreement which allows a landlord to cause a tenant to make its particular lease junior or inferior to those otherwise non-superior documents which occur after the execution of the lease. What can happen is when those interests in real estate, which are superior or are contractually made superior through subordination, exercise their right to ownership in the event of default under their particular document they can take the interest in real estate, in most jurisdictions, and completely invalidate the particular lease which has been subordinated. This can leave a tenant in an extremely uncomfortable position of having otherwise a perfectly valid lease that the tenant is performing under invalidated and tenant thrown out of the premises, not only with the loss of its furniture and fixtures, but also possibly with the obligation to restore the premises to the condition required by the lease at the end of the term. Since the lawyers discovered this possibility, they also discovered a cure, and that is for those holders of superior title document interests in real estate such as fee ownership or lessor's interest under superior leases to enter into an agreement which allows the tenancy to remain in place and undisturbed, provided the tenant continues to perform under the terms of its lease and accepts the landlord through a concept called attornment as the landlord under its lease.

These agreements are called non-disturbance agreements. There are similar agreements for foreclosing mortgagees who come into title and thereby wipe out the subordinated lease, and those are called recognition agreements. These agreements used to be quite simple and merely require that the tenant perform under the terms of its lease, or in some instances perform under the larger obligations and terms of the lease above it in the event that the particular lease was a sublease, and attorn to the superior title interest holder thereby agreeing to perform and accept the owner as landlord.

These days it is no longer simple, and there are many caveats, prerequisites and limitations to the obligations of the superior title holder when they come into the chain of title as the landlord under a lease. Without limitations once the non-disturbance is exercised and there is attornment by the tenant under the lease to the new title holder, the obligations of the landlord which are required in order for the landlord to continue to receive rent sometimes are limited or obviated completely. These must be carefully reviewed. For instance, if a lease allows a tenant to take additional option space in future years and requires the landlord to prepare the premises to the condition required in the lease as well as to perform certain work or give credits or abatements, many non-disturbance agreements state that the landlord will otherwise be the landlord but will not have to undertake any obligations for additional space or additional costs or to perform obligations of the landlord which were not performed under the lease prior to the succession of the superior document holder to the landlord's position.

There are many other limitations and subtle erosions of the tenant's rights found in these documents, and those who say that that can be left to the attorney to review may find themselves in a very difficult position later in the term of the lease. How would you like the job in this environment of having to explain to your client if you are a facilities manager (or lawyer for that matter), why it is you just spent $45,000 negotiating a lease, another $60,000 in engineering and architectural design and another $65,000 in preliminary construction only to find out that the landlord just lost the building to a foreclosing mortgagee from whom you only had a very limited non-disturbance agreement which put you in a position of having to complete all the construction yourself at your cost without receiving the $40 per square foot work credit and that you could not terminate the lease or find yourself in a position where your lease is terminated and you cannot recoup those costs? I think you might consider yourself subordinated in your next career life.

As a parting shot at subordination and the dangers of superior interests and superior interest holders, I recently ran into some text in a “killer lease” that subordinated the particular lease to the normal superior interests such as lenders and ground lessors. It then went on to subordinate the existing lease to future lenders for construction or conversion of the building and then to any change in the character of the building to condominium ownership and the lenders to those condominium purchasers of units as well as the unit purchasers. Imagine if you were to have leased 10 floors and had options on 5 more. Upon the conversion to condominium, you could find out that you now had 10 landlords rather than one if purchasers of the condominium units each purchased one floor. Also there would be 5 landlords that owned the future option floors and may not wish to honor the option rights in the lease for future delivery of their floors. They may not even have to given the complexities of the language in the particular lease subordinating the rights of the tenant. The complexity of this structure created by the layerings of future subordination of the existing lease looks quite like this time line diagram that I used for a presentation recently at a law school.



You will note that as the additional future superior interests begin to accumulate, unless great care is taken by the tenant to preserve its interests, they can be overpowered by the interests of the future owners and lenders. Care has to be taken that all future superior interest holders are required to and actually do, recognize the rights of the tenant and the lease and also agree not disturb those rights and to recognize and perform the obligations to the tenant. This is clearly not a topic to dwell on for beginners or even those that are not title experts, but mentioning these concerns here should help some poor tenant avoid being burned and losing rights and even the lease and improvements.

CHAPTER 22

SECURITY

This is clearly a misnomer. Security is what the facilities director thought he had when he saw the nice premises in the beautiful building and felt cozy about moving in. This clause also has nothing to do with the fact that you feel you have contracted for certain benefits and services, but what has really happened is you have contracted to pay certain rent on the chance you may occupy your premises and get certain services without any particular guarantees.

This is really a section that deals with the security of the landlord at night when he knows that in the event that you may stumble and fall on the several thousand potential default obligations of a tenant under the lease, he will be comfortable because he has some months worth of additional rent prepaid in a deposit called security. Of course the tenant's concern is to minimize security or at least to cause its impact on its balance sheet or at the bank to be felt as little as possible. There are several ways to minimize the impact of security requirements of the landlord. The one that merely shifts the reflection of the security is by an undertaking or a guarantee of an affiliated or unaffiliated company or person for a finite amount of the obligation of payment or performance under the lease. Another way is to deposit securities that have a discounted price, but at maturity equal or exceed the security amount. Another way is to deposit securities equal to the face amount with coupons or interest either going to the landlord or to the tenant as negotiated. Another way which is most popular is the issuance of a sight letter of credit in a form which is generally referred to as clean and evergreen from the tenant's bank to the landlord. The last way of course is to provide cash which should be in a segregated trust account, naming the tenant, benefiting the landlord and insured with interest accounted for and flowing in the agreed manner.

Once you have decided the amount and the manner of the security, how it is dealt with by the landlord in the event of default and the timing should be carefully negotiated. For instance, a landlord should not have the right to draw down security unless all of the notice periods and grace periods for cure of the default have occurred. Additionally, if security is allowed to be pulled under the terms of the lease only so much thereof as is required to cure the default should be allowed to be withdrawn, and it should be fully accounted for and only applied in a reasonable manner strictly in accordance with the terms of the lease.

A tenant should never deposit security designated as rent payments in advance for some particular portion of the term. This does not carry the same protection as security deposited as security to be held in trust and to be applied as is appropriate. Additionally in the event of the sale of the building, these two types of deposits will be treated differently and only if properly delineated and maintained by the landlord will the tenant be assured of receiving credit for the money deposited. In the event of partial draws of the deposit, the tenant should be notified in advance, have a full accounting and be allowed to replenish the security in the manner provided under the lease. Careful attention should be given to see that there are no liquidated damages where the security is applied and whether or not there are actual costs associated with it. Lastly, any assignment of the security should only go from one landlord to

another landlord and only occur provided the preceding landlord assumes the obligations to deal with the security in the manner required under the lease. I see many instances where facility managers have lost their client security as well as their job security by not giving careful scrutiny to security deposit sections of leases.

CHAPTER 23

QUIET ENJOYMENT

This paragraph will have little to do with the hollering that will go on between landlords and tenants and other noise during the term of the lease. This is a legal term of art that has to do with the tenant enjoying its premises, both the benefit of the premises and the ability to operate its intended business in accordance with the terms of the granting without interference from the landlord, and, if written right, from anyone else. Unfortunately these clauses are not written right for a variety of reasons. Assuming by now you know not to care what the reasons are but to get it right, I will take a few moments to try and help the reader through the arcane taverns of the importance of this small clause.

Quiet enjoyment means if you perform under your lease and pay your rent that you should be able to do with the premises what you are allowed to do with the premises under the lease for the entire term without anybody else interfering. Anybody else, as we have discovered, means the landlord, people with superior titles such as fee owners, ground lessors or space sublessors and also includes fee and leasehold mortgagees and others who have liens and rights of foreclosure on the building in which the lease should be sacrosanct. There are priorities and timing differences which do not necessarily allow a lease to receive all of this quiet enjoyment protection, and many clauses for those reasons do not give you the full protection you are entitled to.

One must make sure that if rent is paid that the obligations of the landlord to perform are unconditional and that if the lease is otherwise subordinate to other superior interest holders, that non-disturbance and recognition agreements are received as necessary from those other interest holders and properly recite the protection expected, and this clause then must provide that the quiet enjoyment will be enjoyed without hindrance from any of those people or anyone else claiming through landlord, under landlord or otherwise. In the event of a breach to this clause, the limitation of the landlord's liability to the interest of the landlord in the building or any exculpation of liability is totally inappropriate since at that particular time there probably will not be any interest in the building and probably something has occurred that should bypass that limitation in any event.

A landlord cannot quibble greatly with this because the clause only gives rise to damages which may be paid only if the landlord has money and/or the building. Beware of consultants, brokers, instant geniuses and experts and other lawyers who may decide that this clause is merely boiler-plate. That term should mean to any facilities manager when he hears it that the facilities manager will be the one boiled on the plate if the clauses are not carefully scrutinized, even though they look beautiful because they are preprinted or highly engraved on a nice piece of parchment paper. They hurt just as much no matter how nicely or formally they are presented.

CHAPTER 24

WORK LETTER

Work Letter is the name given to either a serious exhibit or the last section of a lease that either deals with the work to be performed by landlord and/or tenant in the premises, or sometimes better reviewed from the prospective of the work not to be performed by anybody except at large cost in the demised premises. Work letters are the least understood and the most dangerous of lease components which rank in the level of understanding of the rent inclusion electric clauses, but are guaranteed to cost more money, more time and waste more careers in more fields.

This section is probably the single most acclaimed section of a lease for causing the downfall of the largest number of facilities directors over the last ten years. Same with architects. The reason for this, I suspect, is that a work letter usually tells what you can find in your demised premises that already exists, such as the basic core of the building and the shell of the building, together with, in non-layman and generally quite specific terms of art, a description of the electricity or, better stated at this point, the power deliverable to the floor (as opposed to delivered or existing at the floor), heating, ventilating and air conditioning (if provided at all) deliverable to a point outside the demised premises, fire and alarm systems deliverable to a point at the demised premises, sprinklerization if any, lights and other equipment if provided, water columns and hot and cold water, and any waste pipe systems. The way these things are written bear little resemblance to what I just said.

Usually, you find the work letter is made up of two concepts. The first concept is what the tenant has to do to provide plans for approval of the landlord and how to deal with the basic work and any unusual work that is going to be included in the premises, as well as penalties, delays and cooperation language. The other section of the work letter deals with what is available or already exists. Usually what exists is in dimensions, numbers, measurements and quality schedules. What will be given, which is usually called building-based standard materials, usually deals with what is available to be provided by landlord and in what quantities in order to be utilized within the demised premises. Two things should be very carefully focused on in the work letter discussion at this point. The first is materials, which does not discuss labor to incorporate the materials in the premises. Materials also do not necessarily represent that all of the materials that are necessary for that particular component are included. For a component for instance which is a door, you need a frame, hardware which includes hinges, doorknobs and doorjambs, together with the door. The cost to incorporate all those materials and actually hang the frame and door is usually not described. This must be ascertained together with unusual field conditions in case you need taller or shorter doors than in most premises.

The next issue addressed usually in a backhanded way is that this is the only place in a lease that you will find, without fail, everything being based on a truly carpetable square footage area. As you might notice on some premises, if there is a loss factor approaching 30%, you will only be getting approximately 68 to 70% of the materials and labor you think you are for your premises which you understand to be larger than it is. These three tiny omissions are probably the largest source of problems for tenants. A tenant usually brings its architect and engineer and tenant improvement

coordinator consultant in after the lease is either fully negotiated or fully executed. That is a very bad time to find out that what the landlord says he is providing in the way of materials and possibly labor is far short of what is necessary to complete the premises.

Additionally, all the grand ideas that the tenant had to have beautiful doors, unusual windows, angular partitions, etc. are usually blown out of the water at that point in time when the architect explains in the budget process that the landlord's charges for these types of work are so astronomical as to make even completing the premises in a standard way a difficulty as opposed to a given. Checking, pricing and evaluating the work letter deficiencies really is something that should be done at the beginning of the lease negotiation. As a matter of fact, savvy tenants have their work coordinators, architects and engineering consultants in place at the time that multiple premises are being evaluated as candidates for the move. At that point, the comparison of what we call apples to apples can be accomplished since the work letter itself can constitute 125 to 150% in the average of the first year's charges for the premises.

As you will note, this exceeds all rents, escalations and the entire move cost of furniture, fixtures and equipment. Careful analysis of these deficiencies and negotiation by counsel together with the construction team can save hundreds of thousands of dollars very easily, even on a 15 to 20,000 square foot space. There is no justification whatsoever for not bringing the team together with counsel prior to negotiation of specific leases. This is merely penny wise and the loss of value through negotiation of the work letter is immense.

The other type of work letter content is where you have a very simple work letter that states that the landlord agrees to build the premises to the specifications and drawings, either appended to the lease or as agreed to by landlord and tenant. The only safe way is to do the plans, layouts and specifications prior to signing the lease. This is quite easy since the work can be based on preliminary layout and preliminary architectural plans with specifications for unusual materials, such as doors or lights. The other specifications will be the power load capability, the heating, ventilating, air conditioning, water, etc. to be utilized by the tenant. This is not a substitute for the negotiation of the requirements throughout the term of the lease contained in the body of the lease in the services section; this merely deals with the delivery of the initial construction of the demised premises at initial occupancy.

If you have properly written the work letter that we call a turn-key, then there will be no arguments as to the quantities or quality of the materials, any cost with respect to labor, or whether landlord will add supervision, general conditions or profit calculations to the basic building standard costs. There will also be no arguments as to who is responsible to deliver what premises at what time, or the condition of the premises when delivered. Additionally, charges for freight elevators, hoisting or after time work will not be of issue if written properly. In this type of agreement, the time of delivery, penalties or costs associated with delays in work or failure to deliver it in an appropriate time are all issues that have been dispensed with.

In a turn-key agreement, not only does the landlord have all those obligations, the fixed rent and escalations (if you were smart enough to require both) will not commence until the period after delivery of the premises which is called the operating abatement. Otherwise it is a construction and operating abatement mixed together which can be eroded by delays in the landlord's work or in the tenant's work. As we have discussed earlier, it is important to delineate abatement periods for construction and for operation in the event that the landlord is not obligating itself to deliver the premises in any particular condition for the initial occupancy.

Assuming the best case scenario, that is, that the landlord is agreeing to provide all materials and all labor for a fixed sum, or is providing it at no cost to tenant without pricing being determined, and is

further agreeing to deliver the premises completed in accordance with the tenant's plans and specifications and otherwise the condition required in the lease on a specified date, then the issue of a construction abatement is not important since the landlord will be utilizing the time for construction as it sees fit. What is important is that the landlord's work does not otherwise encroach upon or erode the operating abatement. This can happen due to landlord delays, force majeure or long delivery times or failure to deliver orders for materials.

The only other consideration, after you have insured that there is no encroachment of the construction on your operating abatement period, is that the tenant comply with all the requirements of the landlord in order for the landlord to meet the timetables for construction. Those sorts of delays that are caused by the tenant include late or failure of delivery of the working drawings and plans required by landlord from tenant in order to build the premises, the ordering by tenant of unusually unique materials that will have a long time between order and delivery and may also be of the type that cause additional labor and unusually precise work to occur in order to incorporate them into the project, scope changes of the project by tenant which make the character and utilization of the premises significantly different than anticipated in the original drawings, and a large number of change orders of a tenant that do not otherwise change the scope of the design or the utilization of the premises, but rather result from tenant changing its mind on where it wants its wall socket, switches and partitioning. These changes and delays are usually referred to as tenant delays, and will cause the operating abatement period to erode and may also impact both on penalties and additional costs for the job which will be required to be paid by the tenant.

Facilities managers have learned to isolate the user groups of their corporations from the landlord and contractors during the design and build phase, because user groups usually form committees that have fine tuning and additional requirements and requests that occur throughout the construction period. It is mentally interesting to see how a committee involved at the user level can cause a project to change in scope dramatically and run the bill up sometimes as high as 250% of the planned construction cost and cause the abatement period to erode at an alarming rate. There are even some examples where these changes and their impact on the building process have caused penalties to occur which are staggering in proportion to the otherwise significant construction cost. These penalties and costs have been responsible for quite a few tenants being unable to occupy their premises due to their inability to fund the impact cost on their work.

No matter what type of work letter you encounter, attention should be given to compliance with those time requirements and specific working requirements of a tenant set forth in the work letter and also requiring specific time periods for the landlord to comply with. Usually landlords do not undertake to review the tenant's plans within 10 business days and to review resubmitted plans that had been partially rejected within 3 business days. Unless you take the time to require landlord to have time periods and quality performance standards, it will be difficult, if not impossible, when the tenant is charging up tenant delays to be able to adjust them or reduce them, because of landlord's contribution to the delays or additional costs. All these things must be focused upon in order to have an orderly reconciliation at the end of the work for who caused what to whom, and what was the cost associated therewith.

One will also encounter from time to time a landlord that takes a very aggressive hands-on interest in the plan and specification process and may cause the plans to be rewritten and amended for debatable items. Landlords traditionally will attempt to cause the plans to conform with local fire laws and building codes, but there are times when landlords will have special requests. Landlords generally do not take responsibility for the design and specifications of the premises, leaving that to the tenant's architect. However, if a landlord elects to partially reject plans or specifications in order to modify a

specific item, the landlord should then take responsibility for the plans and specifications and the impact on the construction job and the ability to obtain certificates of occupancy resulting from this intervention. Most work letters do not cause landlord to have any responsibility whatsoever or even be deemed to be representing that the plans and specifications, when approved, will work in the building or comply with any building type regulations. These responsibilities should be reviewed critically with assignment of responsibility, whether it is a turn-key operation or the tenant is building the premises to suit, to see that those who intervene and cause changes have responsibility for such changes.

Another issue which occurred in a modified turn-key was where the landlord agreed to do whatever work was required by the tenant, had certain building standard materials, and fixed the price of labor at the request of the tenant, but then gave a credit, not representing that the credit would fully defray all the costs of tenant for its build out. If the tenant has been savvy by having its counsel and construction team work out the pricing of the building standard materials and labor, seeing that sufficient materials will be provided for the idea behind the structuring of the premises and a bidding process, or an ability to fairly price out in a non-profit way the work other than building standard, which is usually called tenant's extra work, is imperative. Approval of tenant's extras also should be carefully reviewed so that the long lead time or other cost increasing and abatement period eroding concepts do not surface later in the construction.

If you have taken the time during negotiation to carefully negotiate and prescribe how the premises is to be delivered for receiving construction in the body of the lease, both in compliance, hazardous materials, conditions which would be violations and violations of building, zoning and fire law requirements, then discussing what gets put into the premises by whom, and at what cost and during what period, leaves you 90% complete in your process. The thing that is missing is when all else fails and the premises has been under construction for three times as long as you expected, and it appears for whatever reason, including landlord's intervening bankruptcy, that the premises will not be completed, the tenant then should have what we call a blow-out date, or a date after which the tenant can terminate the lease for failure of landlord to complete the premises. If this is the case, you also have to account for any rentals that may have occurred, and any work payments and materials incorporated into the premises of tenant. Some tenants also wish to take over under a self-help rule and complete the premises and have credits for the costs plus interest carry against the rentals. This is particularly helpful when the landlord finds itself in a bankruptcy situation, but the building is otherwise viable.

This is the conclusion of what I consider the compartmentalization approach to getting your hands around building out and moving into the newly demised premises. If you have properly caused the premises to be delivered for the construction process, and carefully delineated who builds, with what materials, at what cost and in what time period, then you only have to deal with the impacts that occur during the construction process which cause non-compliance with building or zoning or inability to use. Then the process will be which of the architect, the engineer, the construction entity, tenant or landlord has caused the premises to fail to be able to meet the standard of performance required by tenant or to obtain the necessary certification of completion such as a certificate of occupancy. At that point, all of those parties will be pointing fingers at each other, but it will be reasonably able to be determined if you have criteria and benchmarks for the beginning of the process and standards at the end to see who has stepped out of those.

Unless you have carefully dealt with the delivery of the premises or the condition at the end and described who has what responsibility for what work in the middle portion, called the construction phase, it will be totally impossible to assign responsibility and therefore liability for increased costs, delays and penalties. Additionally, if there is simultaneous access to the premises for work by tenant

during the time that the landlord is doing a turn key construction operation, you will find yourself in a very difficult position trying to sort out the responsibility for impacts possibly caused by tenant's contractors working simultaneously in the construction critical path with landlord's contractors, absent these standards and attention at the beginning and end of the process.

Unless you have a great deal of experience in the construction phase, and that does not mean doing it once or twice over a ten year period, I would suggest that you have in addition to your architect and your general contractor or construction manager, a project management and construction consulting coordinator who in essence is a very experienced facilities manager that does not work on a full time basis as permanently employed by any particular company, but is hired by a company that is anticipating a move to come in-house on a project fee basis and consult on the areas such as reviewing architects, use of the premises, reviewing the lease with the lawyer, supervising and coordinating with the contractor, designing and purchasing telecommunication systems, telephonics and other in-house facility requirements and actually coordinating and retaining the moving company to move and set up the new premises.

At this writing there are very few people like that. Most are what are referred to as tenant move coordinators. Tenant move coordinators only coordinate the actual moving of the furniture, furnishings and equipment from one premises to the next. Architects generally coordinate the design and construction phase and sometimes the selection and installation of the telephonics and otherwise, but do not do this in-house. They of course have their own bias and would lose their independence if they did it in-house and they would not be very good watch dogs of themselves anyway. A consultant such as this, whose primary responsibility is to work with the client both for the use of the user group and the people who are responsible for the overall facilities move cost, usually runs about $20,000 to $45,000 or translated to space between $1.00 and $3.00 per rentable square footage of space leased per job. It has been my experience that the few of them that are employed from job to job and move from client to client have saved four and five times their actual costs per project. Now that some of those are joining forces and are actually turning into companies to provide this service without having to move from employer to employer, the state of the art is becoming considerably better, and the breadth of their services considerably more consumer friendly. These people and these companies are considered reasonable expenses both to save money and to increase job security for facilities managers.

CHAPTER 25

THE THEME

The most successful and enjoyable projects I have ever worked on have been with clients with large space needs who have had the foresight and wisdom to bring their total team together prior to negotiation of a lease. As you have now seen, it is impossible to negotiate a lease without dealing with the essential business terms on a comparative basis from premises to premises, no matter how many candidate premises are being reviewed, and without reviewing services, construction needs, location requirements, characteristics of construction and the condition of the building which will impact on overtime service charges, escalations as the build deteriorates and real estate tax competitiveness.

There are so many things to review which all cost more than $1.00 per square foot per year over the term of the lease that to look at them after site selection has occurred and a lease has been negotiated is merely to commence damage control after the intercontinental ballistic missile has accidentally been launched. These people on these projects to me are misguided missiles just waiting to ascertain the increased costs and difficulties at the conclusion of the project. Sometimes these costs do not surface until several years after a tenant has moved into its premises. Many companies should be more sensitive to this process instead of looking at it as a mystery as to why their escalations and operating costs and extra cleaning costs are so high, and their overtime, HVAC and elevator costs keep coming in, they should look at the process holistically and also charter the performance of the move and the selection of the lease and attendant costs thereto, prior to the selection of the premises and until three years after move-in. If done, this would be a most telling and precise story of the performance of a facilities manager. Most facilities managers are very fortunate that no one has tracked this kind of performance except at very large companies with very sophisticated departments.

I recognize that this is not an exhaustive treatment of all issues which will arise in negotiating a commercial lease, even though some of you may have thought it was quite exhausting. What I am attempting to do in this book through these examples is to generate a critical and systematic approach in the methodology of the reader, preparing the reader for a critical way of thinking while methodically reviewing leases. If I can instill the critical analysis so that you are not lead down a rosy lane, and at the same time have provided some of the more frequently used methods of exacting large sums from tenants, then most other types of created thievery can be ferreted out through the same routine of critical review and analysis. As a parting thought, in commercial real estate and commercial leasing specifically, there in many jurisdictions are no obligations to deal fairly or be reasonable, especially with respect to assignments and subleasing. Fair dealing and reasonableness as well as caveat emptor when coupled with the absence of requirements for fair dealing or reasonableness of conduct or consents is deadly. Much has been written on these topics, especially for “cross border” entrants into the United States market for the first time. Those coming to do business in the U.S. from countries that do not accommodate the doctrine of caveat emptor, or “let the buyer be ware”, assume fair dealing and honesty/reasonableness and are often damaged by relying on this. Also, this publication is not a substitute for competent and experienced legal representation.

Some writings on topic can be found on my educational web page www.leasingnyc.com by clicking on the tabs for the Swedish-American and German-American Chambers booklets. Below is a Glossary of Common Real Estate Terms that will be helpful and a checklist of issues to be addressed for planning and needs when looking for properties or leased space. I also am attaching a survey that was researched some years ago polling the various jurisdictions to see which ones required "reasonableness" and "Uniform Commercial Code – reasonableness" for their real estate transactions and which were like New York – "the wild west"!

Internet searches can provide other valuable resources. We particularly recommend the "New York City Commercial Leasing" website at both www.leasingnyc.com and www.officeleasingusa.com for additional resources, market information and publications and seminars on the subjects covered in this work.

For an extensive treatise on the subject of drafting and negotiation of commercial leases, we recommend the two-volume (approximately 3,000 pages) reference work Negotiating and Drafting Office Leases, published by Law Journal Seminars-Press, October 1995 - 2011, (Library of Congress ISBN 1-58852-061-7) which is also available at www.leasingnyc.com and www.officeleasingusa.com under the "Additional Resource" tabs for research. The treatise is up-dated two times per year by supplements and is in current use as course book for several classes at the New York University Graduate School and Real Estate Institute. However, this is only recommended for the advanced practitioner, commercial broker/institutional property manager, certified public accountants or legal counsel.

In closing, I hope to have sensitized the beginner and possibly the more experienced to the dangers of the Commercial "Killer" Lease Forms. I hope you "Navigate the Dangerous Shoals" well!

Common Real Estate Terms

Abatement of Rent or Additional Rent – Delayed commencement of rentals or relief for periods of time of the obligation to pay rentals such as during the initial preparation of leased space or during a fire or casualty or loss of use.

Acceleration of Rent Obligations – A contractual remedy for failure to perform by a tenant or purchaser when in default of obligations or as a condition event agreed to by the parties when future obligations to pay rent and possibly additional rentals become immediately payable.

Additional Rentals – Additional payment obligations in addition to the Fixed or Base or Annual Rent specified in the Lease. Additional rents or other charges called additional rentals may be payments to reimburse the landlord for costs to prepare the leased premises, operate the property or leased space or such costs as insurance and taxes.

All-in Costs – Common usage is for planning or budgeting and conveys the understanding that all costs, including "soft costs", "planning and design costs", "hard costs" or rather materials and equipment and fixturing" as opposed to labor or professional costs, and generally any other expenditure when all added together with the items anticipated fulfill the delivery of the property or commissioning thereof into intended use. Additional costs include construction terms of art such as "supervision", "over-head" and "contractors or managers profit" and landlord's add on assessments sometimes referred to as "loads".

Alterations – Any changes to property or space. These can be repairs, additions, replacements or improvements. Alterations can be cosmetic, decorations or significant additions or demolitions and reconfiguration to property. Alterations can be structural which means changing certain load bearing components of the building structure. Alterations can not only change the appearance and structure but can also impact on a particular use or character of planning or zoning regulation of the building or improvement causing legal and regulatory impacts and compliance with building and use laws as well as fire and safety laws.

Allocation – The formulation of attributing a portion of an amount, payment, cost or expense to different categories, benefits or persons or properties.

Area, Floor Area, Carpetable Area, Allocable Area, Rentable or Rented Area and Usable Area – these are easy terms to adopt to compare and differentiate space being purchased or leased in a transaction. Other than the term "Floor Area" which is a zoning and architectural term of art (meaning area counted as space on a floor for purposes of bulk and height building and construction regulation and limitation), the other terms help in the analysis of the financial and operational efficiencies and economies of scale of space when comparing needs to costs and to other comparable candidate properties. For instance "Rentable Area" can be defined to mean the agreed to measurement of the square foot area to be paid for and it may be a fictional or designated area or one "deemed to be" for purposes of applying rental rates. The actual "Rentable Area" might well be the space demised to the tenant or purchased by the buyer when measured under agreed to space measurement protocols or prevailing methodology standards of computation in the region of the property or space. "Carpetable Area" might be considered by some to be the portion of the "Rentable Area" that can be actually stood

upon or walked upon and carpeted. “Usable Area” may be the “Carpetable Area” plus areas like shelf space over setbacks of buildings which can not be walked on but maybe cables, wiring or even books can be placed upon. Areas that benefit the space leased for instance but found elsewhere in a property rather than within the leased space may be allocated to the leased property as providing a service or benefit to that leased space along with the costs associated with that “Allocable Area” and even rent costs applied to such space. Breaking down and understanding the various areas and measurements of space in a property for purchase or lease is very helpful to do and dangerous to ignore when comparing candidate properties for occupancy and needs of operation or financial or operational suitability or feasibility.

Arbitration – An alternative method of dispute resolution mechanism in a forum other than a governmental judicial system or court. Also sometimes referred to as ADR or alternative dispute resolution.

“As-Is” “Where-Is” – The conceptual disclaimer of representations with respect to condition or legal compliance of the leased space or property for sale and all contained in it. The concept of “as-is” is generally taken to mean “as you see it” or “as it exists at a given time whether seen or discoverable” or rather a disclaimer of responsibility by the seller or lessor for the general operation status or condition of the item. The concept of “where-is” when coupled with “as-is” is particularly dangerous to a purchaser or lessee of property since it implies the possibility of location non-conformity or non-compliance with legal requirements as well as disclaimer of general condition of the improvement, fixture or contents of the property or leased space. It can also be a disclaimer of the legality of the entire building or structures in relation to other structures, land placement and even to the general area such as a use which was allowed or a location of fixtures which were allowed by laws no longer applicable and even in violation of newer laws.

Assignment – The transfer of the rights to the lease or property or contract by the possessor of the rights. The transfer does not necessarily relieve the transferring party of its contractual obligations nor confer all benefits to the transferee.

Audit Rights – Rights of a party to review and confirm costs or expenditures of another party. In many jurisdictions the tenant or purchaser does not have the audit right or right to confirm the costs and expenditures or even investments in the property of the other party unless granted expressly and completely in the contractual document.

Brokerage Article or Provision – A provision in a contract of sale or lease representing the parties dealing with or employment of a real estate broker or salesperson and the assignment of the obligations to pay such brokers. The provision generally contains a representation by each or just one of the parties that there have been no other dealings or employments of others than the listed broker and an undertaking or indemnity to protect the other from other brokerage claims for compensation with respect to the sale or leasing transaction. The indemnity can be for reimbursement for duplicate commissions or fees as well as legal defense costs or loss of transaction impacts. These are very serious and dangerous clauses and must be reviewed carefully and understood.

“Build to Suit” or “Turnkey” – is the general term of art for delivery condition of a property or leased space in conformity with specifications of functionality, physical and operational performance and legal compliance. The parties generally in many jurisdictions intend to have a seller or landlord construct or alter a property or space so completely to the needs and specifications of the purchaser or lessee so that the purchaser or tenant can literally “turn the key in the lock” and move in to a property or space that fits the needs of the occupant and functions as required and is permitted and legal in all respects specified in the lease or contract of sale.

Business Interruption and Rent Insurance – relates with insurance for loss of use of a property or space and the impact on the occupants operations and income with respect to the business interruption insurance and the loss of rental income for a lessor with respect to the owners rent insurance coverage.

Common Area Maintenance or CAM – charges or expenditures for maintaining, repairing, operating and in some cases improving areas of a property used in common by all occupants.

Capital Costs and Disbursements – Disbursements of funds for or relating to a building structure or its major systems serving the building, such as elevators, heating and cooling systems, ventilation systems, wiring, electrical, communication and monitoring systems, fire and safety systems, plumbing and sewer and piping systems. Capital disbursements are an accounting characterization of funds disbursed for long term alterations or additions to improvements and properties which are materially large in amount and for items which have a life of benefit to the property exceeding the current annual period. Generally these disbursements better or improve a property or, if a repair or replacement, are of significant enough amount or scope as to be a reconditioning of the component of the property. These types of costs are considered in the accounting community by those without bias towards the benefit of an owner, seller or landlord, to be ownership responsibility costs of the owner/seller or landlord and not undertaken or reimbursed as rentals or otherwise by purchasers or tenants.

Cash Flow, Accrual and Tax Analysis – Different methods of evaluating the funding and timing of payment of costs of property and operations and the impacts on the financial condition and balance sheet reflection thereof. These different types of timing and impact analyses of a real estate purchase or lease are customary for brokerage and institutional management firms to provide and critical for the through understanding of any transaction and for the comparison of alternative candidate transactions and properties over various holding and operation periods.

"Caveat Emptor" – Latin phrase meaning "Let the Buyer Beware." When considered in relation to applicability to a purchase of property or lease of space and the resulting "papering or documenting of the transaction" a party must be aware that they in many jurisdictions can not rely on any "as-is" or "where-is" conditions being proper, legal or even suitable and that the other party to the transaction may not be under any obligation to provide any information or representations with respect to any aspect of the property. It is also important to understand that the "papering of the transaction" is itself a term of art in many jurisdictions to imply that one of the parties, such as the landlord in a lease and seller in a sale transaction, will document the deal in a light most favorable to itself and its position. It is not uncommon to receive documents for an intended transaction containing all of the rights and benefits conceivable for the benefit of the party "papering" the deal and issuing the documents and few of the benefits and rights of the other party as requested by that party during negotiations. It being the duty and responsibility of the other party to protect its needs through careful review and alteration of the documents for its benefit.

Certificate of Occupancy – a certification, temporary or permanent, of a governmental regulatory entity authorizing the particular use, floor loads and types of operations and density of a building, improvement, land and/or leased space. The permit or certificate to occupy a building, land or space had different effects if each jurisdiction and may be required to be obtained or applied for by an owner in one jurisdiction, an occupier or a tenant or lessee, depending on the legislation, regulation or statute. Architects are the best to review the certificates of occupancy (the "C of O") and advise the attorney and company of the suitability, legality and alteration ability with respect to the property under consideration. There should be no assumptions make during the feasibility or due diligence review and discovery of the property by the purchaser or lessee since this permitability or suitability and legality of the status of the property can not be assumed or relied upon for candidate properties.

Commencement – the beginning or operative coming into existence of a right, obligation or measurement period under a transaction document. There are many commencements in transaction documents. For instance, commencement of the rental payment obligation, commencement of the erosion of the abatement of rent period, commencement of the obligations and duration thereof and commencement of the insurance of obligations or application of impacts on the terms themselves by other commencements. Some commencements are difficult to appreciate and even gauge, like the beginning of the life of a contract or lease that states it is "made" or effective at or on an "as-of" date. This may be a date other than the actual day and time that the document(s) is signed. The "as-of" date can relate to a previous period prior to the execution day of the documents and affect the parties obligations even prior to the time they begin negotiations. The results being early erosion of an abatement period, an early payment of rent, an early increase in an obligation or change in term and a responsibility of a party to a transaction for a condition or obligation with respect to the property which was not intended. Commencements of all types in purchase and sale contracts and leases should be carefully analyzed and drawn on a time line so as to ascertain the effect and impact on the party's obligations and timing of discharging them or funding them.

Compliance Article – a provision of a contract or lease which sets forth the status or obligations of the parties with respect to the condition of a property with respect to legal and regulatory requirements and the responsibility for the continued or pre-existing compliance or non-compliance of the property or occupancy at and use of the property. Obligations and rights usually dealt with in such clauses include certificates of occupancy, structural and alterations legal, fire and safety compliance, zoning, types and manner of occupancy and use of the property and environmental issues. These clauses and articles should be fully understood and also sketched on the time line of commencements in order to fully understand the various responsibilities and obligations /rights with respect to the property and space.

Connectable Load – In calculating electrical surcharge expenses, the amount of appliances and machines that are on Premises that can be connected and can consume whether or not these appliances or machines are operational.

Connected Load – the calculation of the electrical energy being needed by the electric consuming appliances and equipment wired or plugged into the electrical system at a space or property. The connected load or consumption can be a variable measurement based on the running, startup or idling needs and use of the connected consuming device. Connectable load is different and sometimes is referred to as the amount of load that can be connected based on capacity of the wiring to deliver or sometimes is used to mean all devices in the space or at the property if working and connected and functioning within specifications of variable operation and use periods. These are terms for engineers to address and to be discovered prior to purchasing the property or leasing the space. Basically it is important to know what can be plugged in or connected or wired to the electrical system of the building within the systems capacity to legally and safely furnish the energy load. "Incremental Connectable Load" is an unusual hybrid of the two definitions and has an extremely unfair utilization and cost impact on a tenant when a survey is done annually of the electric consuming devices found in space and priced by the landlord for additional rent to be paid by the tenant.

Construction Fund, Tenant Fund, Tenant Improvement Fund ("TI Fund") or Allowance(s) – the funds to be provided, utilized or applied by one or more of the parties to the property transaction usually for compliance with a delivery condition or the alteration of the space for the initial occupation of the property by the user. There is no implied or understood expectation by the providing party that the particular fund or allowance is sufficient to accomplish the needed result and such funds and conditions of the property must be understood by the party with the intended needs.

Delivery Condition – the legal, physical, qualitative, quantitative and status of compliance condition of the real property or title or use right with respect to the interest or right in property being delivered or granted. This includes observable and hidden conditions as well.

Ejusdem Generis – a legal or judicial standard or rule of reading and interpretation of writings that provides that "where general words follow an enumeration of persons or things, by words of a particular and specific meaning, such general words are not to be construed in their widest extent, but are to be held as applying only to persons or things of the same general kind or class as those specifically mentioned" or where words later following which are more specific and detailed may be construed to modify or control the earlier more general text. Leases and contracts of sale can be 100s of pages long and have exhibits, schedules and related rules and regulations which control them or are controlled by them. Transaction deal terms can be set forth in one location of a document or in another document altogether and be modified or delineated intentionally or by accident. All documents must be read and reviewed to work together to effect the intended result.

Escalations – additional rentals or charges found in a lease which can be increases in amounts by formulae or periods or can be amounts when compared with previous similar amounts from periods to periods. Such as the real estate taxes for the first year of a property lease when compared with tax amounts to be paid for later years. Common charges for operating and maintaining a property when compared year to year can escalate and the increases charged as additional rent operating expenses. "Pass-through" escalations is in many jurisdictions intended to imply that the landlord is just passing through the actual increases in operating costs from the beginning of the measurement period to be defrayed or reimbursed by the tenant. The implication is that the pass-through is calculated comparably from year to year under fair standards and does not include duplicative charges, hidden profits or other fees or benefits to the landlord. In many jurisdictions the implication will not protect the tenant and document language must be included to do so.

Estoppels or Estoppel Certificate – is a document provided required certification of a party, usually a tenant, that certain facts and conditions exist, certain payments have been made and the status of obligations, terms and conditions of the relationship between the landlord and tenant at the time of the issuing of the Estoppel. When issued, the estoppel operates to bind the issuing party and be relied upon by the receiving party and others such as lenders and mortgagees if so provided in the documents and contracts. Estoppels can operate as amendments to existing documents and waivers of rights and terms and therefore are very serious and dangerous certifications.

Floor Loads – a measurement or regulatory limitation of weight bearing ability of floors in structures. The measurement may be by "live load" or "dead weight" and can be by impact of dropping an object from altitude as well. It is important to know the limitations of space and property structurally as well as by regulation (such as certificates of occupancy) to assure the ability of the property to safely and legally house and support the operations of the occupant.

Hazardous Materials and Substances – substances and materials which are dangerous or toxic to the environment and which are typically regulated by states and municipalities as well as the Federal Government by laws such as the Comprehensive Environmental Response, Compensation and Liability Act of 1980 (CERCLA), the Clean Water Act, the Solid Waste Disposal Act or the Toxic Substances Control Act and Leaky Underground Storage Tank acts.

Holdover Article – deals with the remaining in the leased space or sold property after the right so to do has terminated or expired. These articles and clauses have pricing penalties and indemnification obligations for the defaulting party and must be carefully reviewed.

HVAC - Heating, Ventilating, Air Conditioning – systems providing cooling, ventilation, circulation, air quality and filtration, and heating to a space of entire property.

License Agreement – a lesser right than a lease and generally for a shorter occupancy or use period and generally terminable by the granter of the license at will. This varies from jurisdiction to jurisdiction.

Limitation of Liability or Exculpation Article – a provision which limits a party's liability or directs satisfaction of payment of liabilities from a limited source. Landlords and sellers of properties generally limit their liability for misrepresentation or failure of performance to the property or lease benefits and tenants and purchasers attempt to limit their liability for failure to perform to downpayments, security deposits or entity assets.

Loss Factor – the number representing one minus a ratio of the delineated stated size of the rented or rentable area set forth in the lease divided into the carpetable area. Or rather the % of the area stated as being rented that can not be utilized by the occupant. So if a tenant is leasing 1000 rentable square feet as set forth in the lease and can only occupy and walk on 800 square feet, there is a 20% loss factor. Loss factors in New York City for multi-tenanted floors approaches or exceeds at times 50%! Caveat Emptor!

Nondisturbance, Subordination and Recognition Agreement – is a document contained relationship among a tenant and those parties with superior rights of title ownership or occupancy to the tenant and the arrangement and contracting for the preservation of the tenant's occupancy and possession of its lease rights during the term of the lease when a landlord, ground lessor or sublessor lose their title rights to the property or space.

Offset Right or Rent Credit Clause – the right of a tenant or purchaser to exercise self help to credit against monies it is required to pay or offset against rentals it is required to pay, the payments from the seller or landlord to such purchaser or tenant set forth in the transaction documents to be paid to it or as a remedy or protection of the tenant or purchaser to recover default costs and damages caused to the purchaser or tenant by the non-performing landlord or seller.

Operations, Continuous Sales and Open for Business Covenants – are clauses or provisions which require the occupant to be open for business continuously during the prescribed hours and days of operation and conducting the stated use in the space. Sometimes they also specify the amount of area within the space for the type of use.

Operating Expenses and Provisions – most fairly stated, operating expenses and provisions for the payment or reimbursement of such, deal with the recording of all disbursements for the maintenance, repair and operations of the property. They can be on a cash flow basis or on an accrual basis and can also include improvements, betterments, additions and renovations and conversions. Care must be given to these clauses for intended financial impact and concern with respect to ownership types of costs.

Permitted Uses and Mandatory Uses – the restriction or permission to conduct types of use operations in a space or at a property. These restrictions can be contained in Certificates of Occupancy and in lease provisions. They can be mandatory or permissive, but are rarely a representation of ability to use the property under prevailing laws.

Pre-existing non-conforming or non-complying – usually deals with the rights legally to use space or continue to use space for operations when the laws or regulations no longer permit the use. For instance when zoning or building codes change but a certain old use is continuing. The old continuing use is called a "grandfathered use" because it pre-existed the legal change. Sometimes the term is used

to describe a non-compliance with a law or a violation of law which a tenant or purchaser does not wish to be at risk for when the law needs to be complied with such as when a new tenant moves in or when someone wishes to make alterations or obtain permits for the building or space which is non-complying or non-conforming. Pre-existing non-complying issues usually cost a lot of money later and the triggering events must be understood as well as the cost when the event occurs.

Premises or Demised Premises – a delineation of the space in the lease agreement or contract of sale. It can be very specific and legal or general or by reference such as a sketch or hand drawing attached to the document. Much care must go into the understanding of the actual portion of the property being demised or conveyed and the rights and obligations inferred from the description or drawing. Many unintended results occur when thought is not given to the description of the property or space and the impact on obligations and rights of the parties to that space and areas around it.

Radius Clause – a limitation on a party with respect to an area around the property under the transaction agreement. A radius clause can require activity or use in a geographic area or prohibit a use or activity in a geographic area. Commonly these provisions are contained in manufacturing and retail sales documents and reciprocal easement agreements among property owners or tenants.

Relocation Article or Clause – a provision that can cause or mandate that a tenant relocate to other space in a building or complex and the election of the landlord and will delineate at which parties cost as well as the time of the relocation. Such clauses can also mandate a continuance of operations at both locations for a period of time or an interruption of operations. These clauses can have major detrimental impact on parties.

Restoration and End of Term Obligations – provisions that set forth the condition of the property or space at the surrender or end of the term of the lease or use. Great care and attention to these little clauses found very late in the documents or even in the rules and regulations is recommended. If space or property is leased in a demolished condition, the clause can operate to cause the tenant to give the space back in the same condition. If a structural alteration was effected during the term, that alteration may need to be removed and the property restored at very great expense.

Signage, Signs and Directory Listings – rights to have signs on the building, in the building, on the floor, in the elevator, on the door and in a building or complex directory or sign board or pylon. Signage and sign rights or directory rights are very fundamental and essential to operations and laws of many jurisdictions do not imply a right to signage in excess of that set forth in a transaction agreement or lease. Permission in a document does not imply legal rights to signage under zoning, building codes or landmark regulations.

Statute of Limitations – a period within which rights must be enforced under laws. Leases and contracts for sale also have clauses that are referred to as contractual or "mini-statute of limitations" which are contract periods that prescribe when disputes or claims must be made by parties. For instance some clauses state that a bill for additional rent or operating expenses issued by a landlord must be objected to within 20 days or deemed conclusive and correct.

Survival Obligations and Clauses – these are the reverse or opposite of the Statute of Limitations clauses and their operation may cause obligations which might ordinarily end with the expiration or termination of a lease of contract of sale to continue for a period of time or indefinitely. These clauses impact considerably on the liabilities and insurability and must be understood.

Work Letter – differs from Tenant Allowance, Landlord Fund or Tenant Installation Allowance Fund. A work letter is a customary term of art in many jurisdictions which describes the amount and possibly quality and legal compliance of the delivery condition of the space to be delivered by landlord and

finished as set forth in the work letter. The work letter can be described by price or amounts of linear or square or cubic feet of work. A favorite technique of a landlord is to provide a certain number of electrical outlets and doors per number of linear feet of partitions to be provided by landlord under the work letter. Elsewhere in the work letter or rules for construction in the building, the landlord may limit the amount of demising and linear partitions which can be contained in an amount of space or per floor of the building. There have been many times that the work letter when read alone seemed to provide the quality and character of space to meet the operation needs of the tenant only to cause a big surprise when the drawings of the tenant were later submitted for the landlord to lay out and build.

Internet searches can provide other valuable resources. We particularly recommend the "New York City Commercial Leasing" website at both www.leasingnyc.com and www.officeleasingusa.com for additional resources, market information and publications and seminars on the subjects covered in this work.

For an extensive treatise on the subject of drafting and negotiation of commercial leases, we recommend the two-volume (approximately 3,000 pages) reference work Negotiating and Drafting Office Leases, published by Law Journal Seminars-Press, October 1995 - 2011, (Library of Congress ISBN 1-58852-061-7) which is also available at www.leasingnyc.com and www.officeleasingusa.com under the "Additional Resource" tabs for research. The treatise is up-dated two times per year by supplements and is in current use as course book for several classes at the New York University Graduate School and Real Estate Institute. However, this is only recommended for the advanced practitioner, commercial broker/institutional property manager, certified public accountants or legal counsel.

Checklist of Broker Services

National or international presence and capabilities

Experience with special use or business needs

Data on regional resources, workforce, education skills

Economist on team

Engineering and architectural staff resources

Construction expertise and project administration

Bulk purchasing volume discounts

Property management expertise and staff

Financial and capital resources

Leasing compliance and administration services

Rentals and additional rentals/escalation audit services

Retail, manufacturing and other permit experience

Tax and governmental benefits applications and programs

Cross-border capabilities and understanding

Business line understanding

Financial data and information analyst

Representations concerning conflicts of interest, competitors, sellers/landlords

Reputation of loyalty and integrity

Checklist of Property Needs

Special location and transportation needs; 24-hour needs; after hours loading, shipping, receiving

Use and zoning as of right: manufacturing, assembly, warehouse, retail and sales, public assembly or teaching

Special floor loads

Electrical needs

Air conditioning special needs

Ability to alter or make improvements

Special uses and use districts

After hours heat and air conditioning

Building Certificate of Occupancy and use

Taxes and special district taxes

Rights for expansion and exit

Rights for affiliates and related companies and "co-producer" occupancy

Communication needs

Landmarks or other limitations on construction and alterations

Environmental issues

Truck or railroad delivery and shipping access (side track)

Highway and trucking access

Additional land improvement areas and access

Landlord or seller integrity and reputation for performance

Additional Resources:

Internet searches can provide other valuable resources. We particularly recommend the "New York City Commercial Leasing" website at both www.leasingnyc.com and www.officeleasingusa.com for additional resources, market information and publications and seminars on the subjects covered in this work.

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Appendix "A"

Cross Border and Caveat Emptor Concerns

Excerpts from German-American, Spanish-American and Swedish-American Chambers

Booklets on How to Find your First U.S. Leased Property

I. How to Acquire Your First U.S. Business Space - Structuring for Success

Real estate transactions in the United States can be surprising for many Spanish business persons. It can be a revelation for experienced executives to find out, first-hand, how the same straightforward and logical acts, usual and appropriate in Spain, can, when done in the United States, result in surprising and unintended, but considerable, financial and legal consequences.

For example, consider the fictitious Spanish executive sent to New York City by the parent company in Spain to explore possible locations for a flagship retail store – the first to be opened in the United States as part of the parent company's global expansion strategy. After a day spent in exploring different New York neighborhoods, the executive sees an attractive street-level vacant store with a sign taped to the window: "Available: For Rent/Purchase" and indicating a name and phone number to call "For More Information". Based on what is able to be seen from outside, the executive thinks that this store may be perfect for the company and the executive calls and sets up a meeting with the person whose name and phone number were listed on the sign in the vacant store's window. During this telephone conversation, the executive expresses interest in the property, discloses the affiliation with the parent company, and provides a general idea of the intentions with respect to acquiring space. The executive then goes on to express interest in seeing the inside of the store and asks about the rent, how long the property is available for leasing and whether it is in good condition or there is work to be done in the space to accommodate the business contemplated by the Spanish employer. The person on the phone provides the information requested as well as some information about the market in general, and offers assurances that this particular property is in "great shape". An appointment is made to see the property and the conversation is concluded with expressions of interest all around and thanks expressed by the executive for the information that has been provided on the market in general and on this space in particular.

Unbeknownst to the executive, this initial contact will determine the nature of the company's relationship with this property as well as with every other property the executive may see or about which the executive may acquire information or descriptive materials.

There are many variations on the "initial contact" scenario described above: For example, if, instead of being vacant, the space was occupied by an ongoing business, the Spanish executive probably would have had a face-to-face conversation with someone at the store itself; if, on the other hand, the space was vacant, but it was part of a property under development, the executive most likely would have spoken with someone who had been placed in the space for the express purpose of responding to inquiries, and possibly also, if a telephone call was also placed by the executive, to the person whose name and number appeared on the sign. No matter what the particulars, the effect of the initial contact is the same. By the time the Spanish executive has concluded the initial conversation about the space -- regardless of intentions – the executive (depending on the exact words exchanged) has inadvertently triggered a host of legal and financial liabilities for the company and perhaps even its parent company back at home. At the very least, the executive has effectively waived the company's rights to employ a broker that has been deliberately chosen, one whose loyalty the executive has specified to be undiluted by conflicts, and one who will provide only the specified services needed at prices that have been fully negotiated, or even discounted, as appropriate. A further result of the initial contact is that the executive has effectively caused the cost of this real estate transaction to have increased considerably, without having gotten a commensurate added value.

Additional consequences of such a conversation during such an initial contact also depend on, among other things, the place where the conversation and the property are located (here, we are assuming New York City) and the identity and function of the person with whom the executive has had the initial conversation. If the executive spoke with the landlord's broker, the executive has most likely retained the broker as the company's broker, and perhaps even, depending on the exact words, as its "exclusive" broker for this property requirement or other properties or locations. If the broker is employed by the landlord, the executive has placed the company in the less-than-desirable position of having brokerage representation that will be compromised by the broker's pre-existing loyalty to the landlord. It is important to note that the landlord's interests are not aligned with to tenant's needs on many issues, including the condition of the property, about which the executive specifically enquired. Any oral declaration made by the broker (or by anyone for that matter) that the property is in "great shape" cannot, in fact, be relied on to protect a tenant or purchaser from the consequences of latent or hidden defects in the space or in the building, or issues of legal compliance affecting both, which will not be apparent from even the most exacting visual inspection.

If the executive spoke with an owner or landlord, the executive may have not triggered an immediate brokerage liability for the company, but the executive has, equally unknowingly, created an additional expense for the company, because the company will now need to employ a broker to act as a consultant to represent it on issues that ordinarily would have been dealt with the broker acting as its broker. (The tenant's or purchaser's broker's fees are customarily paid by the landlord). The landlord, who has "found" the executive without benefit of any broker, will (understandably) refuse to pay for the services of any broker other than the one the landlord already employs. In fact, in such a situation the landlord will further protect itself in the lease or the contract of sale, as applicable, by providing in the applicable document that the tenant or purchaser will be responsible for any claims made by any broker other than the landlord's own. In addition, the executive has also disclosed or registered the identity of the company, and perhaps even the parent company, as a "party interested" in the property, thereby making that interest very public. The timing of such a disclosure of identity and/or interest should always be controlled by the tenant or purchaser. This is valuable strategic information that should be used and distributed only when appropriate to obtain maximum leverage and impact. In addition to making an inadvertent commitment to that property and the broker or owner by such disclosure of information, it may well have an adverse affect on the company's bargaining position.

If the executive's conversation was with a representative of the current occupant of the premises, a somewhat less likely occurrence, other different, but no less significant, legal and financial consequences will follow, with predictably problematic effects. This could include, among other things, the possibility of a claim by a third broker, that third broker being the broker employed by the current occupant offering the property for sale or lease.

While there can be a great many different initial contact scenarios and a great variety of consequences, what is important to remember here is that as a direct result of one simple conversation, intended purely to gather information without further commitment, the Spanish executive almost certainly has incurred significant liabilities and responsibilities for and on behalf of the company for brokerage commissions and/ or consulting fees, placed the company in a disadvantageous position by being represented by a broker with divided loyalties, and caused the significant erosion of the strong bargaining position that may have been enjoyed by the company. In addition, the Spanish executive's company, and possibly the related and affiliated Spanish companies may also be affected with unintended consequences since now it may be considered to be "doing business" in New York, and, as a consequence, subject to the jurisdiction of the Courts of the State of New York for tax purposes as well as for purposes of other liabilities. Once the company enters into a lease or a contract to purchase property in New York, it will doubtless subject itself to the jurisdiction of that state; however, the timing of the decision to "do business" in New York, and consequently be subject to the courts of that state, should be controlled by the company and should be undertaken deliberately when the company is fully prepared for the consequences, not as here, with the company finding itself in a serious situation for which it is not yet prepared or yet structured itself.

Our example of the fictitious Spanish executive was designed to illustrate -- in the simplest terms -- what could happen as a result of a single initial "exploratory" conversation or visit to a property. In reality, it is possible, even likely, for an executive whose mission is to understand and seek out properties in a United States real estate market, to have many such initial exploratory conversations with a variety of different parties about multiple candidate properties and possibly in several additional cities before finally returning home to report. The total financial and legal impact of all these multiple conversations could be so significant as to foreclose, or at least temporarily postpone, the company's expansion plans because these actions may have inadvertently made the space acquisition too risky or too expensive to accomplish.

However, that situation is not at all inevitable, and, with the kind of thoughtful pre-planning that is described in this booklet, including making use of the checklists provided, it can be avoided, and the real estate and related corporate transactions be carefully structured to successfully acquire the property and minimize legal and financial liabilities to the tenant or purchaser.

The purpose of this booklet is to provide a guide to Spanish companies or individuals that have decided to do business in the United States and are seeking to purchase or lease office, warehouse, manufacturing or retail store space for their business. It covers the entire process of acquiring space, including how to find the property by finding and employing a broker, and how to determine the appropriate nature and scope of the broker's employment as well as how to secure additional services from the broker and the pricing of such services. This booklet also describes the principles involved in contracting for the property, whether purchasing or leasing, and the kinds of protections that should be built into the documents to protect the purchaser or tenant from assuming liabilities inappropriate to the levels of risk and ownership inherent in the transaction. In addition, it will address what is involved in fixing up the property so it will be suitable for the specific purpose of the occupant All of these aspects of the transaction will be considered in the context of allowing the purchaser or tenant to do what it needs to do to be successful in running its business and still avoid costly hidden traps and missteps

resulting from not following customary business practice in the United States or from peculiarities of United States law.

Although we have prepared this booklet principally as a guide to real estate matters, it will also address, on a more limited basis, related corporate issues raised in structuring the U.S. business in order that it may hold or acquire the property or the lease and, at the same time, minimize its liabilities, and the risk of exposure to liabilities of the home company in Spain. It will also review relevant Federal and state real estate and cross-border tax concerns of Spanish companies holding real estate interests, guaranteeing obligations or otherwise "doing business" in the United States. And, it will discuss some of the more striking cultural differences between Spain and the United States and common attitudes, assumptions and approaches that the Spanish business person will most likely encounter when doing business in the United States.

We note that it is essential that the process of acquiring space for the new United States–based business is not undertaken until the form and structure of the new business has first been determined and established, so that the appropriate legal safeguards are in place by the time the representative of the Spanish company is ready to take action in the United States, or, at a minimum, by the time the Spanish company is ready to commence business operations in the United States. As shown in our example, without such careful planning, once that representative comes into the United States the representative may unintentionally trigger liabilities that can stretch across the Atlantic to cause the home company in Spain to be exposed to those liabilities as well.

II. What to Expect When You Do Business in the United States:

Differences in Expectations and How These Affect Deal Formulation

The many shared values between the United States and Spain are an important part of why many Spanish companies are so comfortable and successful in the United States. However, there are significant differences in expectations and approaches as well. It is extremely important before beginning the process of a real estate transaction in the United States to understand the custom and practice that surrounds the way business is transacted -- including the nature of the formal and informal relationships that come into existence among the various participants in the transaction -- in order to avoid inadvertently misunderstanding the dynamic of the interaction, and, as a result, losing the deal, or, even worse, making the deal and winding up being hurt badly as a result of incurring unintended or unanticipated liabilities.

The Importance of Caveat Emptor

In the United States, the principle underlying most business transactions is “caveat emptor” -- or “let the buyer beware”. This phrase is a warning to the buyer or tenant that in the transaction to follow it will get just what is offered by the seller or landlord, and nothing more. In fact, what the buyer or tenant will actually get is only what is put into the written document signed by both parties that memorializes the transaction, that is, the contract of sale or the lease. Moreover, since the seller or landlord is under no legal duty to disclose all of the relevant information about the property, what it appears that the buyer is offered may be very different from what is, in fact, actually offered, and, thus, what it will ultimately get. Accordingly, if the buyer or tenant wants or needs something more or something different from what the owner or landlord is offering, it must ask and negotiate for what it wants or needs and then confirm that the needs are properly reflected in the transaction documentation. The common practice in the United States is that every seller or landlord negotiates for nearly every aspect in a real estate transaction and expects that the prospective tenant or purchaser will negotiate as well. In a real estate transaction in the United States, the parties understand that the first offer is simply a starting point, and nothing more; it is not intended to be the “best” offer, nor even a “fair” offer.

For example, consider the condition of the property, a fundamental component and a very material part of a real estate transaction. In the United States, “as is/ where is” is the standard condition in which property is offered for sale or for rent. This means the property is offered in the condition in which the purchaser or tenant sees it --- or more accurately, the condition in which it presently exists, which may in fact be quite different that what is revealed by simple observation. There is no obligation incumbent upon the landlord to voluntarily disclose to the prospective seller or tenant the condition of the property, whether that condition is appropriate for the purchaser’s or tenant’s purpose or whether it can legally be made so. In fact, the condition of the property is nearly always highly negotiated, with the extent of the negotiations being a function of the bargaining power of the parties. The tenant or purchaser can develop a more favorable bargaining position by having a thorough understanding of the property through its investigatory due diligence and professional physical inspection of the property. The parties negotiate for the “physical” as well as the “legal” condition of the property. Thus, the tenant or purchaser will seek assurances for the physical condition of the property (what is seen as well as unseen) to be appropriate to allow the business to be conducted. Accordingly, the tenant or purchaser (and its architect, engineer, and counsel) will be concerned with things like the sufficiency of

the electrical capacity of the building and the premises, the strength of floors, and the functionality of mechanical and other building systems serving the premises.

In addition, the tenant or purchaser will seek assurances that the owner has complied with relevant laws that affect the property, and will seek information as to the state of title of the property. In this situation, the tenant or purchaser would need to be concerned with, among other things, whether the owner has complied with laws concerning safety, including fire safety and the presence of certain hazardous materials at the premises, and laws concerning the upkeep of the appearance of the premises and/or the building if the building is "landmark" property and required to meet specific requirements under the appropriate preservation law. In addition, it is up to the tenant or purchaser (and its counsel) to do the research and be satisfied that there are no zoning or comparable laws or regulations that will prohibit the tenant or purchaser from conducting its business in the particular building or the premises. Finally, the purchaser or often the tenant (depending on the nature of the lease) must research and understand the status of the owner's title to the property, and as appropriate, secure title insurance as to the quality of the title granted. This process of negotiating with respect to the legal condition of the property may be surprising to Spanish busines spersons, inasmuch as the practice in Spain is very different: In Spain most items affecting the legal status of the property have been established and disclosed to the prospective purchaser or tenant by requirement or operation of law before the property is ever actively marketed.

The goal of tenant's or purchaser's negotiations with respect to the condition of the property, is, through their attorneys, to insist on certain written "covenants", "warranties" and "representations", which are formal statements of the existence or absence of a state of facts, or promises with respect to particular aspects of the condition of the transaction or the real property that is the subject of the transaction, or other similar protections for their clients. Thus, if a purchaser or tenant wants to be sure that it will acquire a space that is in the condition which is appropriate and required for the conduct of its business, those conditions must be specified, must be agreed to and "represented" or "covenanted" or "warranted" to by the seller or landlord, and, in all cases, must be made part of the written agreement or lease. Such expected conditions must also then be confirmed and proven by investigations, testing and proper "due diligence" studies and efforts. This principle applies as well with respect to the type of business that the tenant or purchaser expects to conduct at the property. It is possible for there to be limitations on the uses to which a property may be put or even prohibitions against specific uses. These limitations on use may found in the deed by which the property is transferred or in applicable zoning laws, or both. There may even be a restriction in the deed (or other conveyance) on a particular piece of property being used for a particular stated purpose even though it is permitted by law. The tenant's or purchaser's real estate attorney, architect or zoning specialist should be the resource to which the tenant or purchaser turns to find all of this out -- it should in no event rely on the assertions of the seller or the landlord. Moreover, and as discussed further below, the seller's or landlord's assurances or representations, whether they concern the physical or legal aspects of the property, will not be of any real value to the tenant or purchaser unless that have been put in a form that is enforceable, and, in the appropriate circumstances, secured by collateral.

The principle of caveat emptor is also applicable in transactions that involve brokers and the commissions they can earn for finding a property as well as the services they offer with respect to the property and the process of establishing the prices of those services. A licensed commercial real estate broker, being bound by a code of ethics unique to that profession and subject to the oversight of governmental authorities, is required to disclose to a prospective tenant or purchaser of property whether it represents the landlord or any other client whose interests are adverse to or competitive with the prospective tenant. Although dual loyalty of a broker may be permitted under the applicable ethical

guidelines, the reality is that the level of loyalty that will be shown to a prospective tenant or purchaser will pale against that provided to the property owner. Consistent with caveat emptor, the prospective tenant or purchaser will not know the level of loyalty it will be getting from its broker unless it asks before retaining the broker as to the existence and scope of any relationship with the landlord and others.

Before the broker is retained is also the time to find out if the broker is representing clients who are competitors of tenant or purchaser, or if there is any other situation existing that would dilute the broker's exclusive loyalty to tenant. The dangers of retaining a broker who also represents a competitor are far from theoretical. The broker, as part of understanding the space needs of the company, can't help but be aware of its long-term strategic expansion plans, financial and operating budgets, and sometimes even more. Understand that while brokers are required to act within certain ethical parameters, brokers are not bound by the same confidentiality constraints as lawyers; there is no "broker-client" privilege. A client's proprietary or other information will not be protected as "confidential" unless the written brokerage agreement specifically provides that is the case. Consider a situation where the unique needs of a product line require an equally unique "special use" property, of which, by definition, there can be only one. Certainly, the knowledge of the availability of such a property is very valuable and it is information that should not be shared with a competitor. Thus, the goal for the tenant or purchaser must be to get the broker's exclusive loyalty in addition to the broker's expertise. Put another way, if the tenant or purchaser wants the exclusive loyalty of the broker, it must be bargained for, and the written brokerage agreement must so state. This notion of bargaining for exclusive loyalty of the commercial real estate broker is another peculiarity of the real estate transaction in the United States. The amount of the commission that the broker earns for "finding" a property for the tenant or the purchaser and when and how it is to be paid is also subject to negotiation and is often highly negotiated.

Negotiating is similarly necessary and appropriate when the tenant or purchaser attempts to ascertain, select and price the level of services it wants from its broker. In the United States, there are no "standard" prices for brokers' services; they are established by the give and take of negotiation. Although formulas for calculating the prices for brokerage services do exist (for example, the "Lehman formula") the resulting calculations can vary widely depending on various factors. While the fundamental nature of the services offered by many brokerage firms may appear similar, each firm has its own unique way of packaging, and thus pricing, its services. And while the broker may advise as to the availability of services generally, the process of negotiation is truly the only sure way for the tenant or purchaser to get exactly the services needed and to pay what is, in fact, appropriate. The process of negotiation is also an effective way to establish a long-term brokerage relationship which would include services (and prices for them) which address long- term needs, such as those pertaining to relocations and exit strategies, all of which should be incorporated into the written brokerage agreement. Having a successful long-term relationship with a broker can be valuable on a number of levels; an experienced broker that has been with the company as it has grown can also provide valuable input in the process of developing a company's long term geographic expansion strategy.

It is not unusual for tenants and purchasers to unknowingly forfeit their ability to negotiate, and thereby give up all the advantages that will come with it, including the chance of making a good deal and obtaining the best information and levels of services. This can happen all too easily. Initiating the process -- even informally – of looking at properties, meeting people and/or discussing the prevailing or customary pricing or terms offered by the owner may in all likelihood trigger the commencement of a legal business relationship regardless of the intentions of the purchaser or tenant. Thus it becomes essential that all discussion of employment, commission, services and pricing be designated as such

and that all of these subjects are covered in appropriate depth and detail before the business relationship is formalized, otherwise there is the very real possibility of unintentionally employing a broker on the terms that may have been stated during such discussion, and those terms may turn out to be for the lowest level of loyalty and the highest commission rate with the highest price for the lowest level of services.

As a general rule, it is wise to recognize that the notion of caveat emptor remains fundamental to law and business in the United States, although with respect to certain specific and highly regulated areas, it has become somewhat less so. Today, in nearly every aspect and phase of a real estate transaction the United States -- the physical condition of the property, the quality of ownership, priority of rights, levels of brokerage services, to name just a few -- caveat emptor still applies in some way, depending on the jurisdiction of the transaction.

The Necessity for Complete Written Agreements

In the United States, in general, and in real estate matters in particular, a legal document, whether it is a contract or a lease, is drafted to explicitly set forth and articulate all of the rights and responsibilities of the parties with respect to the particular real estate transaction and property interest at hand. The document is expected to address and to cover all foreseeable eventualities. It will be the first place to which the parties turn to clarify a perceived ambiguity or to resolve a difference of opinion with respect to the transaction. A good rule to remember is this: If the issue is important enough to discuss, it is important enough to be included in the document.

This approach is very different from the prevailing approach in Spain, where comparable legal documents in a real estate transaction are generally perceived as and drafted to be an overview, executive summary or a broad outline of that transaction. For example, in Spain it is not unheard of for a commercial lease to be not much more than a page or two; in the United States it is not unusual for a commercial lease to be 80-to-100 pages -- without counting various schedules and appendices and ancillary large reference documents, all of which relate to and affect the rights and responsibilities set forth and embodied by the commercial lease itself.

This Spanish approach, so effective in Spain, will not be effective in the United States. There are significant consequences in the United States of having a document that does not carefully and thoroughly address all issues or concerns of the parties, or one that contains any significant ambiguity. Relying on such a document can result in the disputed items being resolved through litigation, which is an unpleasant, expensive and time-consuming process. Litigation may result, in the worst case, in the dispute being “resolved” in court by a judge who may fill any gap or ambiguity in the documents with reference to common or case law, which, often, due to the influence of caveat emptor, is unfavorable to a purchaser or tenant.

In addition, in the United States since nearly all documents in a real estate transaction are very heavily negotiated, there is yet another departure from common Spanish practice. In the United States, the custom and practice is that the first draft of a document will in nearly all cases, be drafted by the landlord’s or seller’s lawyer, and be drafted to strongly favor the drafter. (In fact there is much case law in the United States concerning the rules of construction or interpretation of written contracts or other documents, that stands for the proposition that because of this usual practice, judges will consider any differences of opinion as to the meaning of the final document in a light least favorable to the drafter, who is presumed to have had more control over its wording.) What this means for the prospective tenant or purchaser (and its counsel) is that the first draft of a contract of sale or lease will have a significant bias towards the drafter and will not

necessarily represent the deal as the parties have negotiated it – in fact, it may be very far from what was discussed between the parties. This tactic can also be used as a very effective negotiating strategy.

Other drafting techniques can also be part of the negotiating strategy, and some can have a very bad affect on and even eliminate rights that have been bargained for. For example, under accepted principles of contract drafting, the later occurring or written and more specific reference will be deemed to modify or overrule the earlier and vaguer one. These drafting techniques are common in the negotiations and drafting of the deal. Thus, a right referred to early on can be wiped out by specific reference that appears later in the document. Experienced commercial real estate practitioners are familiar with this technique and will be able to spot it and effectively neutralize it.

Depending on the approach and attitude of the individuals involved, it is not unusual for there to be many rounds of drafts until the deal as originally understood and agreed on by the parties is accurately reflected in the documents. While the landlord's attorney customarily does the drafting -- historically the most time consuming and therefore expensive part of the transaction -- a tenant, or its counsel, who does not understand or have experience with this common practice in commercial real estate and thus, has not developed a strategy and tactics to counter it, can easily waste a lot of time and money reviewing and attempting to negotiate multiple drafts without either significant progress or any favorable result for its client. Today widespread use of computers and word processing in the legal profession has eliminated much labor intensive activity associated with the landlord or owner's cost of negotiation, such as typing and retyping a document, with the result that the landlord's or owner's cost of negotiating have gone down significantly.

Litigation as the Principal Dispute Resolution Mechanism

Business persons from Spain as well as those from other countries often remark on what has been described as the "litigious" nature of society in the United States. The frequent resort to the courts to resolve disputes in the United States represents a different approach than the more amiable and informal manner in which business conflicts in Spain are usually resolved. Accordingly, it is crucial when doing business in the United States to keep and maintain scrupulous records and careful documentation of any and all agreements, representations and the like, since an agreement based on "a handshake" is not generally sufficient to be enforceable in the courts. (The biggest and most meaningful and most potentially dangerous exception to this principle is the ability to orally employ a broker, which we have discussed earlier.) Generally, in order to be able to enforce the rights contained in them that have been bargained for, agreements must be in writing and signed by the parties, and they must conform to certain specific legal formalities. If those agreements contain "representations", these representations must be in writing as well, and, as a practical matter, they are often secured or collateralized.

The significant differences in approach that distinguish a real estate transaction in the United States from one in Spain should not in any way imply that most individuals in the United States are less than reliable or trustworthy. In our experience we have found people in the United States, for the most part, to be straightforward. But invariably, disputes will arise, and when they do, whether the dispute arises as a result of intentional or unintentional circumstances, in the United States the mechanism that is relied on as being the best and most effective way of enforcing broken promises or resolving disputes is the court system. And the courts will look for clear and complete written and signed documents and factual authenticity in their adjudication of disputes.

Conclusion

As a result of the unique and particular ways in which the legal and business conditions in the United States interrelate in commercial real estate transaction, successfully initiating and concluding a commercial real estate transaction is very different in the United States from the way it is in Spain. Understanding those differences and avoiding the problems that they potentially present is indeed a challenge. However, armed with the appropriate knowledge and experienced advisors who will insist on legal and commercial protections, the Spanish company can avoid the obvious as well as the not-so-obvious pitfalls, and complete a commercial real estate transaction that will successfully establish its presence in the United States.

III. Finding Your Broker and Finding Your Property

To find the property or rental space that is right for your business, you will, in nearly all cases, require the services of a commercial real estate broker. Brokers can provide their clients with access to their inventory of available properties or space, as well as to provide them with valuable information as to the financial and non-financial terms with respect to the prevailing commercial real estate transactions in a particular market. It should be noted that Brokers can greatly assist in the inspection and engineering review of candidate properties and provide feasibility analysis and comparisons not only on efficiencies and conditions, but on the financial impacts long term so as to compare the candidates more uniformly. Brokers also can model or analyze the financial implications of the real estate transaction, from the initial costs to the projected long-term costs of holding the space. This information and analysis is crucial to understanding the transaction and how it relates to the tenant's or purchaser's business plan.

Brokers are regulated by governments, and must be duly licensed by the jurisdiction (the state, and/or municipality) in which they are operating. Licensing is the government's way of ensuring that the broker has met certain prescribed standards of education, experience and knowledge, and is committed to function on a specified ethical level. In addition, the broker is subject to the oversight of the state licensing authority, so that in the event there is a dispute between the client and the broker, there is a clear process available to resolve any such dispute and to enforce the mandated resolution.

Assembling the Team

Finding a suitable commercial real estate broker is a very important part of assembling the team that will participate in the selection and preparation of the new space. In fact, assembling the team is a really part of the planning phase of the space search process, which also includes getting prepared and educated before going out to the real estate market. The team also needs to target the location of operations as well as the use needs for the space. The team should be headed by a representative of the business entity that is looking for the space who knows and understands the criteria for the space decision. The space criteria should be determined by the business that is looking for the space in advance of assembling the team. The Facilities Manager, responsible for the space needs of the business, including space planning, use layout and technological and other service capacities, must provide the general, operational and crucial input.

In addition to a broker who is experienced in the market area where the business is to locate, the team should include, at a minimum, a real estate lawyer who is familiar with commercial leasing (or acquisitions, as the case may be) and with the local real estate market and the laws of the area; an architect who is familiar with local laws and building codes, the facilities manager, if any, or a project manager, an engineer, and if there is a technical aspect to the project, and whatever other additional consultants may be necessary, based on the space criteria previously determined for the project.

What the Broker Does: Finding, Negotiating and More

The most important function of the broker is to put the tenant or purchaser together with a property that is suitable for the particular needs of the project or business seeking to acquire the space. The broker can screen out the properties to exclude those which do not meet the tenant's or purchaser's criteria.

The broker is "key" because in the world of commercial real estate, Landlords or Sellers of property do not always list all of their properties in a way that may be accessed directly by the tenant or purchaser. The broker can provide an entrée to properties that the tenant or purchaser would not have otherwise had the opportunity to see, or even know of. The experienced professional broker also brings knowledge of market conditions, including the reputations and history of landlords and sellers and their properties. Even if a tenant or purchaser is lucky enough to find what appears to be an "appropriate" property without a broker, an experienced professional broker can and will help the tenant or purchaser and its lawyer in negotiating the transaction, since these brokers are familiar with issues that are typically concerns of a commercial tenant or purchaser.

Most commercial landlords or sellers -- certainly the larger ones -- will have brokers (and lawyers) of their own, and it is very often the case in the United States that the principals do not negotiate face-to-face at the inception of the deal. In fact, it is often the brokers, each with their respective "wish lists" supplied by their respective clients, who begin the negotiations by preparing a written "term sheet" or "letter of intent". This is a self-proclaimed non-binding document that serves to establish the broadest outlines of the transaction. Sometimes each side will prepare a term sheet; often they will not match up. But, whatever the form, the term sheet stage is where the negotiation process begins in earnest.

Less frequently used, but often adopted by larger commercial users of space with commensurately larger bargaining power, is the Request For Proposal, or "RFP" process. This can be a very effective method by which a strong tenant or purchaser initiates serious negotiation. In its simplest form, the tenant, through its broker and in consultation with its architect, engineer, lawyer and other members of its team, provides to various landlords its requirements with respect to the space it needs, e.g., the type of space, duration of the proposed lease, a range of acceptable rentals etc. Landlords respond to such a request with what they call their "best offer", which the tenant may select as a starting point for negotiations. Brokers, with their experience and knowledge, are important participants in this process as well.

In the United States it is customary for the landlord or seller to pay the fees or commission of the purchaser's or the tenant's broker. These fees can be considerable, and are generally calculated by applying an agreed-upon percentage against the amount of each year's rent (or, in the case of a purchase, the purchase price). Not surprisingly, brokerage fees, too, are subject to negotiation, and where they are substantial, they can be highly negotiated. Negotiated reductions in brokerage fees may be applied against and reduce the costs of other brokerage services.

An effective broker can and will do more than finding and negotiating for a space or property for a tenant or purchaser. Many larger brokerage firms are "full-service firms" that also provide, for additional fees (that are, once again, negotiable) certain additional specialized services in addition to finding and negotiating space or property. For example, brokerage firms may offer services to monitor and manage the construction of the new space, assist in planning the move to the new space, and assist in monitoring and/or auditing certain ongoing financial and or contractual aspects of the transaction such as lease charges or other obligations. These services can be very valuable, especially if the leasing or purchasing entity (or its parent) does not have a facilities management department, or has one that is not experienced in the management of space in the United States. Retaining a full-service brokerage firm can be an effective way of helping an existing facilities management department in understanding and learning the techniques of how properties in the United States are managed.

Finding Your Broker

The commercial real estate lawyer can be very helpful with the selection and employment of the broker. As seen through the example at the beginning of this booklet, the law concerning the employment of a broker

is not at all intuitive, and, as a result, it is all too easy -- even for experienced business persons -- to find themselves in situations that they did not at all intend. Since real estate brokers can be employed orally, such oral employment of a broker can and will generate problems in addition to the obvious issues relating to the uncertainty of what the terms of employment are. For example, merely by having multiple conversations it is possible to inadvertently employ multiple brokers, and, as a result, create liability for commissions to each and every broker so employed. Obviously, this can have disastrous consequences since no landlord wants to incur responsibility for multiple brokerage commissions, which can make a transaction too expensive to ever come into existence. As discussed earlier, landlords will protect themselves from the possibly of liability for multiple brokerage commissions with respect to the same transaction in the contract of sale or the lease by requiring that the purchaser or tenant indemnify it if any such claims are asserted and "hold it harmless" from the related costs and expenses.

The search for the "right" real estate broker is one that can be effectively orchestrated and managed by the experienced commercial real estate lawyer either through recommendations based on personal experience, or through the RFP process, the same process that was discussed earlier as being a sound methodology for finding property to purchase or to lease. In managing the RFP process, the experienced commercial real estate lawyer will help to develop and communicate the search criteria to certain select brokers, which are of an appropriate size and scope to be considered for employment by the prospective tenant or purchaser. Those search criteria will take into account what services the tenant or purchaser will need (such as project management or engineering) in addition to having the broker find and negotiate the purchase or lease of the property. The purchaser or tenant, through its lawyer, will request various candidate brokers to offer their specified services at specified fees, all of which will be subject to negotiation in the brokerage agreement that the lawyer subsequently drafts. In this manner it will be absolutely clear under what set of specific services a broker is being retained, including the amount and timing of the commission, and which services will be provided and for what price. Since fees are negotiable, depending on what is needed and in what volume, it may be possible to negotiate substantial discounts. In addition to discounts on pricing, the written brokerage agreement will be negotiated by the real estate lawyer to provide appropriate legal protections for the tenant or purchaser, such as indemnifications in cases of claims by other brokers, which is an all too frequent occurrence. A written agreement is also a way of ensuring that the broker is obligated to and will work together with the attorney, architect, engineer and other members of the tenant's or purchaser's team. This will help to secure the broker's participation during the "due diligence" investigation period, which is the time provided to the purchaser to investigate any issues concerning the property, as well as with respect to any physical investigation of the space itself.

Using a the experienced commercial real estate lawyer to locate a suitable broker and contract for appropriate services may be done by the lawyer acting on behalf of its client, but without disclosing the client's identity at such time, a technique which may be very effective especially with respect to larger entities which want more control over when they publicly disclose the existence of their plans for expansion or other sensitive information.

No matter which technique is employed, searching for an experienced commercial real estate broker and contracting for its services is a process that should be undertaken and completed well in advance of looking at properties. In this way, the purchaser or tenant can be assured that its property needs will be addressed confidentially and to its exact specifications, and no unforeseen liabilities will occur.

Finding Your Property: Space Criteria and Costs

The initial criteria for space may have been carefully developed by the business entity and its parent; however, there may be refinements and other considerations that need to be taken into account in

moving these criteria to the final form in which they will be used by the broker in the search for the space. These criteria will include the location, the permitted use(s) for the property and the type of space required. For example, for a retail tenant, it will need to consider whether to consider, among other venues, space in a large regional mall, strip mall or downtown shopping center. If the decision is to be downtown, the next choice is ground floor or second floor. If the decision is to be in a mall, other questions for consideration are whether the tenant wants to occupy an "anchor" position, be near or away from competitors or to be a non-anchor tenant or even to be a "stand-alone big box".

In addition to refining location criteria, which will result in differing financial impacts, there are other considerations affecting the space criteria where the financial impact can be dramatic, not all of which are always immediately apparent. These considerations relate to the condition of the property; the effect of applicable zoning and use regulations as well as the effect of alterations either mandated or limited by applicable law. Certainly, the condition of the property is crucial and will also have considerable financial ramifications. For example, upon a visual inspection the observer can see whether a space appears nearly ready for tenant's occupancy and the conduct of its business, or whether it will need more than just a paint job to put it in shape. However, while a property may appear to look good, without a thorough engineering and architectural inspection, there is no way to tell whether there may be latent (or other hidden) defects in or affecting the space, such as "floor load" or other structural issues, or whether there is asbestos or other hazardous material that is required to be remediated (a highly costly process) or whether electrical wiring must be replaced, or whether or to what extent other work must be done to bring the space into compliance with applicable safety, fire, insurance or other applicable law. (This latter assumes that the tenant or purchaser will be responsible for conditions in the space which pre-existed its presence, an obligation the commercial real estate lawyer will negotiate hard to remove. Nonetheless, it is possible, depending on the way the lease is negotiated, to require that the landlord deliver the property to the tenant or the purchaser in a "delivery condition" that is in compliance with applicable law, as well as providing that applicable building systems servicing or at the premises are in good condition and working order. The tenant's or purchaser's subsequent alterations, however, may uncover hidden problems which can trigger a different level of compliance under the lease or applicable law, with a considerable increased expense, or even prevent the intended use of the space. This is the reason why a thorough inspection by the architect and engineer (and maybe even an environmental hygienist) is essential before making a decision to take the space. Understanding the condition of the property will help a tenant or a purchaser to make informed choices and enable the lawyer to negotiate the lease and ancillary documents so that they will not create unexpected financial or other surprises once construction of the space begins. The complex and multiple issues surrounding the condition of the property become particularly important inasmuch as most properties, whether for lease or sale, are offered in a condition described "as is/where is". Accordingly, it is crucial to understand exactly what that means, both literally and financially, in all circumstances.

Zoning and use regulations can prohibit the tenant's or purchaser's intended use of the space. Even if that use is permitted at the time the lease or contract of sale is signed or possession of the property is taken, it is still possible for a subsequent law to be enacted after tenant takes the space that would in fact stop the tenant from using the space for the purpose which it intended. Generally, such a scenario would not affect the tenant's rent obligation under its lease nor its obligation to go forward with the transaction -- whether it is a purchase or a sale -- unless its lawyer has insisted on the appropriate legal protections in the transaction documents which will operate to prevent the tenant or purchaser from getting "stuck" with a property from which it is unable to conduct its business. Another effective way for the tenant to protect itself from this problematic and financially devastating situation is to have the Landlord do the construction or built-out of the premises as a "turn-key" or "build-to-

suit" space, as will be discussed later in this booklet. Both of these terms have the effect of putting the responsibility for compliance with applicable zoning and other laws squarely on the Landlord.

Laws such as the Americans With Disabilities Act, which, for the benefit for individuals with disabilities, prescribe (among other things) exact dimensional requirements with respect to ingress and egress of a space as well as other related requirements within the space, or landmarks' preservation laws, which require that changes to designated "landmark" buildings or buildings within designated "landmark" neighborhoods may not be significantly altered without prior approval of a designated governmental agency, and may make every detail of such an alteration subject to the prior approval of that governmental authority. These and other such laws can have significant financial ramifications and need to be understood before making any decision on a property.

IV. Construction and Alterations: How to Plan for and Make Changes to Your Property

Generally, in commercial leasing, it is most unusual for a tenant to simultaneously sign its lease and get possession of the property. This is because often at the time the lease is signed, the space may be occupied by another tenant whose lease is yet to expire, or because work must be done in the space to prepare it for tenant's occupancy. It is highly unusual, if not downright impossible, for a tenant or a purchaser to find a space that, without some further changes or alterations, perfectly meets the physical requirements that the tenant or purchaser has for its business. The new space may just need some "cosmetic" sprucing up, like a new paint job, or it may need extensive repairs or even to be totally demolished and reconfigured and specifically fixtured, so that the space can meet the requirements dictated by the specific business to be conducted in that space.

Landlords understand this, and accordingly, part of what is negotiated in a lease is what construction or other alteration work will be done in the space, and by whom. This division of responsibilities and the related economic information about initial alterations is found in specific lease sections and, in addition often found in a detailed addendum to the lease known as the "work letter". All of this is highly negotiated.

In general, once a tenant and its team have done the due diligence investigation and understand the economic implications of the nature and condition of the space, and, having this information, decide to take that space, the negotiation process begins again. It is at this time that the lawyers take their most active out-front role in the lease negotiation and drafting process especially with respect to the work letter.

The Work Letter: A Roadmap for Construction

The Work Letter will specify in great detail the nature of the construction that will go on in the space. Among other things, it will provide a detailed description of what will be in the space (referred to as the "core and shell" or the "base building") when it is delivered by the landlord. This would include, among many other things, the extent of electricity, heating, ventilation and air-conditioning ("HVAC"), waste pipes, alarm, fire/safety, sprinkler and other building system services that are to be delivered to the space. It will also specify who is paying for the construction being done in the space and exactly how such payment is being made. Payment is often made by way of a "tenant allowance", or an amount that is provided by landlord and gradually paid out by the landlord as the construction progresses and the requirements contained in the lease are met. This, as well as every aspect of the work letter is highly negotiated. This is because every aspect of the work letter translates directly into an economic effect; conceptually, there is, by definition, a direct and consequential financial impact built into each item. The landlord will generally offer the space "as is/where is", while the tenant will try to negotiate that the space be delivered in the condition which minimizes both the construction work required to be done by the tenant, and the tenant's potential liabilities. Any negotiations concerning the work letter must include consultation with and input from the tenant's accountant and tax advisor inasmuch as there are significant tax implications depending on how the tenant's allowance is structured.

Depending on what has been negotiated, the construction will usually proceed in accordance with one of two negotiated scenarios: Either the landlord or the tenant may do the construction. If the tenant does the construction, the space will be delivered to the tenant in the agreed-upon condition often called "delivery condition" and the tenant, utilizing its tenant allowance, will construct the space in

accordance with tenant's plans and specifications that have been previously approved by the landlord. If the landlord does the construction, it will deliver the space, fully built out in accordance with plans and specifications agreed to by the tenant, and ready for the tenant to move into and begin to operate its business. This latter scenario is often referred to as a "turn-key".

The date the rent obligation under the lease (the "rent commencement date") begins is established based on who is responsible for the construction in the space. Most simply put, when the landlord constructs the space, the rent commencement date will begin once the Landlord has notified the tenant that it has completed the construction. If the tenant is doing the construction, it is given a period of time during which the construction must be completed. The dates are subject to "landlord delays" and "tenant delays" both of which are carefully defined and highly negotiated. Also highly negotiated are abatements of or special lower rates of rent or electricity to be effective only during the construction period.

Generally, in the case of larger properties, it is most usual for the tenant to do the construction and for the landlord to provide the tenant's allowance. In the case of smaller tenants and smaller properties often the landlord itself will do all of the construction of the space. Which scenario is negotiated is a function of economics and related experience; smaller tenants often find it easier and more economical to have the landlord deal with the construction and absorb the financial results of delays from unforeseen events during the construction period. Larger tenants may be more experienced with and thus better equipped to deal with the construction process and the risks involved, as well as with their own special and often unique construction needs with which landlord has little or no familiarity. Great attention should be paid to the details of the construction process, since construction is a place where there can be numerous hidden costs and liabilities. The services of an architect, engineer and project manager are invaluable here.

For example, while the cost of constructing and building out a space to accommodate and office or retail store can be considerable, it will be increased many times over if the tenant does not understand, before the construction commences, whether it has sufficient air conditioning or electric power in the space to accommodate the occupants and equipment, or whether it will be faced with the necessity of later installing, at its own expense, supplemental air conditioning units. If tenant finds out too late, (that is, during the construction period after the lease is signed), that it will have to install supplemental air conditioning, it may not have negotiated required permission from the landlord for such an installation. In addition, the tenant may not have bargained for sufficient electrical capacity to operate such supplemental units, and it may not have budgeted for the costs involved, both immediate and annually or more frequently occurring. Furthermore, the tenant would be unprepared for the delays in construction resulting from this new-found knowledge, which would not suspend its obligation to begin paying rent on the space in accordance with the terms of the lease. Careful inspection by tenant's architect and engineer – before the lease is signed – will insure that the tenant understands that its construction or subsequent alterations may unearth violation conditions, or even worse, conditions that may turn into violations as a result of the new construction being initiated. While no tenant can reasonably expect to be fully protected from unforeseen events, the consequences of these unforeseen events can be understood, and protections for the tenant or purchaser can be negotiated by the lawyer and built into the lease or purchase documents so that unpleasant and costly surprises will be minimized, if not eliminated altogether.

The Construction Team and What it Does

If the tenant is going to be responsible for building out the space, the tenant will need a construction team. The tenant's construction team must include, at the very least, its architect and designer, broker,

commercial real estate lawyer, and project manager and or facilities manager. The facilities manager is usually found in-house in the tenant entity or some corporate affiliate; the project manager is generally an "outside" person; however, their function is the same. The facilities manager or project manager is the point of coordination of the project. The importance of the project manager of facilities manager cannot be understated. The facilities manager or project manager has been trained to understand space needs and adapt space so it will most efficiently function for the user and the occupants. The facilities manager will also integrate applicable technology into the space. Accordingly, the skills, knowledge and experience that the facilities manager or project manager brings to the project enables that person to appropriately review, evaluate and suggest appropriate modification of the plans and specifications that have been developed by the architect and designer. This review and evaluation will ensure that the plans and specifications accommodate all of the needs of the tenant's business operation, including compliance with appropriate laws relative to zoning, safety and landmark preservation, as applicable. If the tenant has no in-house facilities manager, or does not have one with sufficient experience in real estate in the United States, many brokerage firms offer project management services for a fee. As discussed earlier in this booklet, these scope and cost of these services may be negotiated for as part of the process of retaining the broker.

Once this review and evaluation of the tenant's plans and specifications is completed and the tenant's construction team is satisfied with the plans and specifications, they must be submitted to the landlord, where the plans and specifications will then be reviewed by the landlord's construction team. This review by the landlord may also generate changes which may need to be resolved through negotiation. Note that all of this review (and any resulting negotiation) should take place before the lease is signed. After the lease has been signed by the parties and the tenant is legally committed to the space, the tenant automatically loses most of its bargaining power.

Once the plans and specifications are approved by the landlord, the tenant will send them out for bid by contractors which the tenant will consider to perform the construction work. Often the broker and the commercial real estate lawyer can provide meaningful input from their own experiences with particular firms as well as such firms' reputations in the market. Usually a construction manager or general construction consultant will also assist with this initial selection process. The tenant's team will compare and evaluate the bids and the tenant will decide on a construction firm to execute the final approved plans and specifications. Usually the landlord will want to approve the tenant's choice of construction company or general contractor. This is because the landlord is understandably concerned about the experience and reputation of whomever will be working in its building. Moreover, if there are disputes with the general contractor (or its subcontractors) even though the landlord may not be a party to whatever agreement the tenant has, the general contractor (or its subcontractors) have legal recourse against the landlord's building, as well as against the tenant, and can (as permitted by New York statutory law) assert a "mechanic's lien" on the building, which will have significant legal implications for the landlord, including the possible judicial foreclosure of that lien.

The tenant's plans and specifications (and required drawings) will also be submitted to the department of buildings of the municipality in order to obtain the required permits. No construction may commence without the required permits. In addition, the municipality will require certain inspections at the conclusion of construction, and will issue various documents, such as the "Certificate of Occupancy", which may be temporary or permanent, without which the tenant cannot occupy the property as altered.

The lawyer again becomes quite actively involved drafting and negotiating the appropriate agreements between the tenant and the general contractor. Often these are "form" agreements prepared by the American Institute of Architects, but they are still negotiable. The tenant's lawyer will build into the

agreement the best protections that can be negotiated for the tenant to minimize the risks of construction. To the extent there are subcontractors, they will have their own contracts with the general contractor, with which they have a legal relationship. They generally have no legal relationship with the tenant.

Of course, no construction can begin until the lease is signed and the tenant's insurance that has been negotiated for in the lease, is in place and tenant has provided appropriate evidence of such insurance to the landlord. The lease will provide that the tenant is required to provide a variety of types of insurance policies, depending on the nature of the property and the scope of the project, to cover various eventualities, including claims and damages with respect to the tenant's own property (first party liability) and claims and damages with respect to the property or person of others (third party liability). In addition, there are particular types of insurance policies or bonds that the landlord will insist on to cover the period during construction. The landlord will specify in the document the types of policy and the amounts of coverage as well as the criteria to be met by the tenant's insurance carriers. In addition to any review or evaluation made by the tenant's lawyer during the lease negotiation, this section, as well as the sections of the lease that cover the tenant's indemnifications (which are expected to be covered by the tenant's insurance) should be carefully reviewed by the tenant's (in-house) risk manager or insurance consultant, to make sure that the insurance requirements stated in the lease are appropriate to the tenant and the scope of its project, and will coordinate with any existing insurance coverage that tenant already has.

Timing and Coordination

It is clear that the process of getting a property, negotiating a lease and developing plans is a complex and multifaceted one; each aspect of this process has a lot of "moving parts" and each has considerable expense associated with it. As noted above, the process of drawing up plans and getting approval from the landlord – which is not inexpensive – needs to be accomplished before the lease is signed, so it takes place simultaneously with the lease negotiations. Therefore, it is essential that early on, before fully committing resources to a piece of property or a space, the tenant evaluates -- on an ongoing basis -- the likelihood that the deal will be actually be brought to fruition before the tenant goes too far and commits significant resources with respect to any of the space planning and lease negotiating issues. This can be accomplished by the tenant involving its team early on. The interaction of the team on their various issues will quickly cause "deal-breaking" issues to surface, and once that happens, the business decision of whether to commit to the property, or to consider another one can be made quickly and any losses can be minimized enabling the tenant to move on to something better suited to its needs and financial parameters.

Finally, the Move In

This final step in the project -- the move-in -- is no less complex than the steps which preceded it. Depending on the geographical factors (that is, the "from/to" part of the equation), the number of persons involved and the extent of furniture, fixtures and equipment, not to mention retail stock, many tenants consider the move-in as a virtually separate project. Accordingly, many tenants (with sufficient budgets) hire a separate move-in coordinator to coordinate the movement of people and equipment over the applicable period of time. Other tenants utilize the project manager or facilities manager for this function. In addition, larger entities may also look to their in-house corporate communication resources to coordinate the communications to employees about the move and, if appropriate, their public relations resources, to communicate information about the move, and the entry into this new market, to their

various public constituencies outside the company. Brokerage firms may also provide this move-in service; the pricing must be addressed at the time when the firm is considered for employment.

The acquisition of space in the United States is a process that must be carefully managed and monitored by a deliberately chosen experienced and professional team. However, the most important message that this booklet offers is that the process of entering the United States real estate market and beginning a business in the United States is sufficiently complex to not be left to chance. In addition to understanding the dimensions of the process and the project, careful planning must inform the entire project from beginning to end in order to help ensure a successful entry of the Spanish business into the United States.

V. Corporate Structuring for U.S. Based Operations

Planning and Structuring to Enter the U.S. Market

As has been discussed in the earlier sections of this handbook, when the business decision is made to enter the U.S. market, structuring to limit liabilities to the operating assets to be exposed and deployed for the U.S. venture is properly implemented at start up of entry and at commencement of operations in each location in the U.S. Pre-planning and attention to and accommodation of the various state laws and the federal requirements should also occur at this point. In addition to limiting liability for operations by selecting a proper limited liability entity for incorporation or formation, segregation of commercial assets such as trademarks, patents, copyrights and long term real property assets which are not to be exposed to operations liability would be prudent. These valuable assets can be held in non-related entities to the operations ownership and leased or licensed to the operating companies on a commercially comparable basis.

In order to limit risk and minimize liability with respect to operations or resulting from disaster or other casualty, a commercially responsible insurance program should be implemented to deal with operations risks, products liability and losses of real assets from fire, casualty or other disaster. While the concepts of insuring operations and protecting persons and assets through acquisition of proper types and amounts of insurance such as Commercial General Liability, Directors and Officers and Fire, Casualty and Legal Liability Policies are beyond the scope of this handbook, counsel can assist in the selection of insurance risk consulting advisors and insurance brokers as well as selection of the best insuring companies and types of policies. Insurance tends to be an after thought by many companies and seriously considered first when required by third parties such as landlords, banks other contracting parties when entering into transactions. However, insurance is best considered in the formation stage as a companion to other strategies to appropriately limit liability and secure operations and assets.

The following sections will introduce and compare the types of limited liability entities available for consideration such as Limited Partnerships, Limited Liability Companies and Corporations and also discuss some differences in benefits and treatments from the legal, accounting and tax perspectives.

Operating Entities and Limitation of Liability

The major business consideration (as opposed to tax consideration) in choosing the form of a business entity is to limit to the entity itself all liabilities arising out of the operation of the entity's business or the assets it uses in its business, including the office or facilities that it leases. The result of this is that if an appropriate limited liability entity is chosen and it is managed properly, neither its owners nor its management should be at risk for the entity's liabilities. Various state laws allow limitation of liability to corporations, limited liability companies and passive partners in certain forms of partnerships.

A Spanish company that decides to conduct business in the U.S. should consider establishing a wholly owned U.S. entity, through which to conduct the business. Depending upon the type of business the Spanish company intends to conduct in the U.S., there are several types of entities to choose from. Just as under Spanish law, the sole owner of a sole proprietorship (unipropietario) has unlimited personal liability for all the debts and obligations of the business, and income from the sole proprietorship is reported on the owner's personal tax returns.

Ordinarily, a general partnership (sociedad colectiva) does not have limited liability under state law. As under Spanish law, the partners are jointly and severally liable for all debts and obligations of the partnership business.

One way to circumvent the personal responsibility of a partner in a general partnership is to form a limited partnership (LP) (sociedad en comandita por acciones). A limited partnership limits liabilities for some partners but not others. A limited partnership must have at least one partner who is a general partner with personal liability for all the debts of the limited partnership, and at least one partner must be a limited partner with limited liability. The personal liability of the general partner in a limited partnership can theoretically be limited if the general partner is a corporation, which has limited liability (see below). Generally limited partners are investors in the partnership, but are not actively engaged in the management of the partnership's business which is the responsibility of the general partner.

Certain professionals (for example lawyers, architects, dentists and doctors) may organize themselves as limited liability partnerships (LLPs) which in terms of structure are general partnerships with the tax attributes of a general partnership. However, in general, the LLP partners are not personally liable for the debts, liabilities or obligations of the partnership, except for their own professional malpractice. In addition to LLPs, professionals may organize themselves into professional corporations (PCs), and professional limited liability company (PLLC). Like an LLP, these entities insulate their owners from business debts and liabilities, but not from liability for professional's malpractice, or depending on state law, certain other acts of partners.

Generally the owners of the corporation or a Joint Stock Company (sociedad anónima) incur no personal liability for the actions of the corporation unless the corporate veil is pierced or transfers of funds or assets are made to the owners rending the corporation insolvent, and then, under certain circumstances, the owners of the corporation can become personally liable for the corporation's debts and obligations.

A limited liability company (LLC) (sociedad limitada) takes advantage of both the benefits of a corporation and a partnership. An LLC is not considered to be a separate tax paying entity so profits or losses can be passed through to the owners without taxation of the business itself and all the owners are protected from personal liability.

Some Legal Factors to Take into Account When Starting a Business in the U.S.

Typically Spanish companies choose to conduct business in the United States through wholly owned corporations incorporated in one of the states of the United States. The corporate form of legal entity has tax and legal advantages. A U.S. corporate subsidiary will normally shield its Spanish parent from liability for federal and state income taxes. A corporate subsidiary also offers its parent a degree of flexibility in determining where income will be recognized for tax purposes through, subject to the Internal Revenue Service's rules on transfer pricing, sales of goods and services to and from the subsidiary, charging the subsidiary license fees for technology, or charging the subsidiary for management services.

Corporations are also the favored vehicle for conducting business in the U.S., because there is a time tested body of corporate law to guide corporations with respect to management structure and business governance. Delaware is the favorite state for incorporation. It is the home for most publicly held companies in the U.S., and therefore its statutory and case law is comprehensive and up to date.

Also, Delaware does not have a corporate income tax, and with good planning the annual Delaware Franchise Tax and related fees payable by a U.S. subsidiary can be as low as $60 per year.

To ensure that the parent will be protected as fully as possible from claims arising out of the U.S. subsidiary's business, it is imperative that the U.S. subsidiary be operated separately from the Spanish parent. It should have its own board of directors responsible for corporate policy decisions. Transactions between the U.S. subsidiary and its Spanish parent should be on arms length commercial terms. If the U.S. subsidiary is operated as a separate entity, except as noted below, the Spanish parent will not be legally responsible for the liabilities of the U.S. subsidiary, even if the U.S. subsidiary becomes insolvent.

However, a Spanish parent should be very cautious about walking away from an insolvent subsidiary. In a bankruptcy proceeding creditors of the subsidiary will examine very closely all funds transfers from the subsidiary to the parent, whether for purchases of services or goods, license fees, amortization of loans, dividends, interest or otherwise, with a view to obtaining a court order voiding such payments and compelling repayment by the parent for the benefit of the creditors. Spanish manufacturers selling goods or equipment through their U.S. sales subsidiaries are subject to products liability claims by individuals who are killed or injured while using the products, even if the products were sold by the U.S. subsidiary. Products liability exposure should be taken very seriously, as manufacturers may be liable for very large amounts as damages even in cases where the products are "state of the art" and no negligence is shown in connection with the design, manufacture or operation of the products (i.e., strict liability).

Following is a check list of items that should be considered in connection with setting up business inside of a corporate subsidiary.

THE PURPOSE OF THIS CHECKLIST IS TO BRING TO YOUR ATTENTION SOME OF THE FACTORS THAT SHOULD BE TAKEN INTO ACCOUNT WHEN STARTING A BUSINESS IN THE UNITED STATES. IT DOES NOT PURPORT TO BE COMPLETE AND IS NOT INTENDED TO RENDER LEGAL OR TAX ADVICE, WHICH SHOULD ONLY BE OBTAINED ONLY FROM QUALIFIED EXPERTS FAMILIAR WITH ALL THE FACTS AND CIRCUMSTANCES RELEVANT TO YOUR PARTICULAR SITUATION.

A. Statutory Regulation.

1. Product Design. As is the case in Europe, the United States and many of the states have laws specifying safety or health standards that classes of products must meet, such as the Flammable Fabrics Act which sets flammability standards for fabrics and the Food and Drug Act that regulates the sale of pharmaceuticals. If your product has to comply with statutory standards in Europe, be sure to check whether there are similar standards in the United States. Unfortunately the European and U.S. standards are frequently different, which may require specially designed versions of your product for the U.S. market. There are also U.S. laws that have labeling requirements that companies starting a business in the U.S. should take into account.
2. Protection of Employees. The United States has laws that govern safety in the workplace (e.g., The Occupational Safety and Health Act), provide for minimum hourly wages and mandatory overtime pay and protect employees against discrimination in the workplace. There are laws that protect employees and applicants for employment against harassment or discrimination based upon race, color, ancestry, marital status, religion, sex, sexual

orientation, national origin, citizenship status, pregnancy, age, medical condition or disability. Many companies develop employee manuals that contain the rules governing their workers and workplaces to ensure that all employee related matters are dealt with legally and in a consistent manner. Compared to many European countries, it is easy in the United States to terminate a person's employment. Unless there is a contract of employment, people are employed on an at will basis. An employer is free to terminate an at will employee at any time for any reason that is not covered by the anti-discrimination laws referred to above. Unless an employer has a severance pay policy, there is no legal requirement that an employer make severance payments to a terminated employee. Except for Social Security which provides a modest income for retirees, the United States does not have any mandated pension or retirement plans. Some larger companies have defined benefit or defined contribution pension plans. Many employers have deferred compensation arrangements known as 401(k) Plans, which permit participants to make tax deductible contributions to the Plan. Many 401(k) plans also provide for employer matching contributions. An individual's interest in a 401(k) plan is taxed as he/she withdraws from the plan during retirement. The Employee Retirement Income Security Act provides for standards that employee health and retirement plans, including 401(k) plans, must meet.

3. Taxes. Every U.S. entity is required to obtain a taxpayer identification number from the Internal Revenue Service prior to the commencement of business. It is imperative that a newly organized subsidiary be guided by an experienced tax accountant from the outset to ensure that it collects and pays federal and state income taxes required to be withheld from employees' wages and social security and Medicare taxes, that it pays its employer taxes for social security, and that it pays its estimated income taxes when due. Failure of companies to pay withholding and payroll taxes can result in personal liability for company officers. Companies that sell goods at retail will have to register with the states in which their retail outlets are located and collect and remit sales taxes collected on their sales. The United States does not have a V.A.T.

B. Insurance.

1. Business Insurance. Consult with an experienced business insurance broker about establishing an insurance program for you new corporation. The business will require insurance covering (1) losses, damage and destruction to owned or leased property from fire, casualty and theft, (2) liabilities for death, personal injury and property damage arising from occurrences on the new corporation's business premises or otherwise resulting from its business activities, (3) death, injury or property damage caused by it automobiles and trucks, (4) products liability arising from claims based on death, injury or property damage caused by the new corporation's products (i.e., product liability insurance), (5) business interruption, and (6) directors and officers liability. As mentioned above, a parent corporation is subject to lawsuits for products liability claims. Therefore, product liability insurance should also cover the parent company. Given the large judgments often rendered in the United States in products liability cases, it is also recommended that the parent company confirm that the amount of its excess liability insurance is sufficient.

2. Legally Mandated Employee Insurance. Most states require businesses to cover their employees with worker's compensation insurance for job related injuries, unemployment insurance to provide payments to employees who are terminated or laid-off and short term

disability insurance for employees who are unable to work due to a disabling accident or illness.

3. Other Employee Insurance. It is typical, but not legally required, for U.S. companies to have group life, medical and long term disability policies covering their employees. Many companies require their employees to pay part of the premiums for these coverages.

C. Immigration.

1. Visas. If you intend to send someone from Spain to manage the U.S. business, he/she will have to obtain a visa that permits him/her to work in the U.S. and to bring his/her family members to reside with him/her in the U.S. Normally the visas are issued outside the U.S., so it is recommended that the question whether employee visas will be required be assigned a high priority before personnel transfers are made and that guidance on dealing with visa issues be obtained prior to setting up the U.S. operation.
2. Employment of Illegal Immigrants. It is estimated that there are about 11,000,000 illegal aliens in the United States. An illegal alien is a person who (a) is not a U.S. citizen and (b) is in the United States without a valid visa. Many menial jobs in the U.S. are done by illegal aliens. Many illegal aliens have counterfeit identification cards and work permits, so it is not always obvious what a person's legal status is. It is against U.S. law for an employer to knowingly hire a person who is not a U.S. citizen. U.S. employers are required to check to make sure that all their employees are allowed to work in the U.S. As indicated above, some visas permit work in the U.S. The Immigration and Naturalization Service also issues work permit to certain aliens. It may be necessary for the new corporation to consult a lawyer to ensure that when it begins to hire it is complying with the immigration laws.

D. Written Contracts – Their Importance.

As indicated in the discussion on commercial leases, contracts in the United States go far beyond just describing the business terms of a transaction. Contracts in this country are used to shift risk from one party to the other or to share risk where in the absence of a contract it would fall solely on one party. Also, as indicated in the commercial lease discussion, the United States is a culture where caveat emptor still applies in many types of transactions, so the contract is an instrument by which parties protect themselves by requiring representations and warranties and indemnities from the other parties. In sum, in American business a good contract protects a party by spelling out in detail the parties' obligations during the term of the contract under all circumstances that are likely to occur instead of leaving it to them to work out issues on an ad hoc basis as they arise. One reason for this approach is that when things go wrong in a business transaction, litigation is likely to ensue. Litigation is very expensive, time consuming and emotionally draining. It should be avoided if possible. A good contract is one way to avoid it.

The United States legal system is largely derived from the British common law with sprinklings of French law (e.g. Louisiana) and Spanish law (e.g., California, Arizona and New Mexico). The laws of the United States consist of statutes enacted by the federal and state legislatures and a large body of case law. Case law is law derived from written judicial decisions applying and interpreting statutes and/or prior cases with reference to the matter then before the court. Case law has the same force and effect as statutory law. Contracts are often negotiated partly with reference to avoiding or mitigating the effect that statutory or case law would otherwise have on the transaction. For example, the Uniform

Commercial Code, which has been adopted by all the states with slight variations, provides that in a sale of goods there is an implied warranty from the seller to the buyer that the goods are merchantable and fit for a particular purpose. Typically these implied warranties are disclaimed in the standard terms and conditions of sale used by sellers and the seller's own warranties, including the duration of the warranty period and remedies the specified by the seller, will apply.

Depending on the nature of your business, you should consider meeting with your lawyer before you start up to review the advisability of preparing contract forms for use in your business. These might include employment agreements, confidentiality and non-competition agreements for employees, invention rights agreements for employees, terms and conditions of sale for your products, installment sale contracts, security agreements, equipment leases, technology and software licenses and sales rep agreements. These contract forms can enable a company to exercise a degree of risk management over its business relationships and transactions instead of having statutory or case law determine the outcome when things go wrong.

VI. Sensitivity to Taxes and Treaties when selecting Real Estate Holding Entities

Effective Tax Planning for the Ownership of U.S. Real Property Interests

The organizers of a new business entity must decide on the most beneficial structure from both a tax and legal perspective at the time that the venture is created. While the approach from a legal perspective is reduce or minimize exposure to liabilities, other legal considerations must also be taken into account. They may include future transfer considerations, equity ownership and financing, term of existence, as well as state and local reporting and complexities.

However, the income tax planning of a new venture is of significant interest to an investor who is not familiar with the considerations under the U.S. income tax code.

There are two general choices for the ownership of real estate interests in the United States. Realty interests can be owned in either an unincorporated entity or in the form of a corporation. There are variations to these two general choices, but ultimately the choices reduce to those two. The tax rules of operations, and the filing requirements are different depending on the choice.

The use of an unincorporated entity has several variations as well, depending on the number of owners, and the desire to obtain limited liability for the venture. An unincorporated entity that has more than one owner, is referred to as a partnership, which can be constructed as a general partnership, a limited partnership or a limited liability company. Limited partnerships are referred to as LPs. Limited liability companies are referred to as LLC's. There is no designation for entities created as general partnerships. General partnerships provide no limit on the liability of the owner. Risk of loss is not limited to the assets of the venture; the owners are totally liable for any potential loss. LPs provide limited liability to the limited partners of which there must be at least one. This structure requires that there be a general partner, who has no limit as to risk of loss.

In the late 1990s, there emerged a new form of ownership referred to as the LLC. The LLC is a hybrid form of entity. It operates under the tax code as an unincorporated entity but provides insulation from liability to the same extent as a corporation. The LLC does not require more than one owner, unlike either form of partnership. Such LLCs are referred to as single member LLCs. Single member LLCs are often used by a single owner who may own multiple properties. By holding only one property in each LLC the liability risks are further isolated.

The most significant trait of an unincorporated entity in any of the above forms is that the entity does not pay tax on profits derived from operations or gains from sale. The owners are responsible for the income taxes imposed on profitable transactions. Unincorporated entities are referred to as either pass-through or conduit entities. Entities that have more than one owner are required to file income tax returns for partnerships, and to apportion the tax attributes to the partners. Thus general partnerships, limited partnerships and multi owner LLCs are all required to file an income tax return for the venture. Single member LLCs are considered to be disregarded entities under the tax code and the tax attributes are reported directly by the sole owner.

Alternatively, real estate interests can be held in regular corporate form. U.S. corporations are referred to as C Corporations under the U.S. tax code. The issue of taxation for corporations that own real estate interest directly ultimately becomes the same as ownership using unincorporated entities, since profits or gains from those forms of ownership pass through to the owner and the tax is paid at

the owner level. Thus a corporation that owns real estate interests, either directly, or through either a partnership or single member LLC, pay the same tax on profits or gains. Realty interests owned by foreign corporations, either directly or through any of the pass-through entities are subject to taxation under a different tax scheme than U.S. Corporations.

In the event a US Corporation is owned "upstream" by a foreign entity which provides capital or debt financing, there are commonly known tax considerations for review of the interest rates associated with such funding or loans referred to as "Earnings or Income Stripping" and experienced tax advise should be sought out for the planning of the loans or capital funding and coordinating of offshore treaties and tax laws with tax requirements and laws in the United States.

Much is written about the capital gains tax under the U.S. tax code. However, to U.S. corporations, there is no difference in tax rates for income derived from operations, referred to as ordinary income, or derived from gains on sale referred to as capital gains. Ownership of real estate interests in U.S. entities are taxed at the same rates as non real estate activities. State tax considerations need also be taken into account as the rules of taxation vary from state to state in the United States.

IRS Circular 230 Disclosure: To ensure compliance with requirements imposed by the IRS, please be advised that any U.S. federal tax advice contained in this booklet and work (including any attachments) is not intended or written to be used or relied upon, and cannot be used or relied upon, for the purpose of (i) avoiding penalties under the Internal Revenue Code, or (ii) promoting, marketing or recommending to another party any transaction or matter addressed herein. While this work is intended to raise issues to be addressed when entering the U.S. market to conduct operations and business, it is not intended to be tax or legal advise and the authors advise seeking experienced tax and legal counsel with respect to all matters discussed in this booklet.

Further Resources

This booklet was designed to be an introductory resource for the Spanish company attempting to acquire its first real estate location for its first successful entry into the U.S. markets. It will also be useful for those Spanish companies whose first entry was not everything that they expected. It describes, in narrative form, the process surrounding the acquisition of space, whether by purchase or leasing, in the United States, as well as the multiplicity of issues generated by it.

Appendix "B"

Doctrine of Reasonableness and Fair Dealing Research

MUST A COMMERCIAL LANDLORD ACT REASONABLY WHEN RESPONDING TO A REQUEST BY A TENANT UNDER A LEASE TO ASSIGN OR SUBLET?

Research by Nazar Kahn (2005-6) for John B. Wood

INTRODUCTION

The common law considered lease to be a conveyance in property and thus subject to property law principles.[1] Under this approach, the tenant held an interest in the property and was responsible for the rents and other obligations for the full term of the lease.[2] A declining majority of states use the conveyance approach in resolving disputes between landlords and tenants. Under the common law approach, a landlord may arbitrarily and unreasonably withhold consent under an unqualified provision in the lease prohibiting assignment or subletting of the leased premises without the landlord's consent.[3] The rationale for this approach is that restrictive covenants against assignment or subletting the leased premises during the term of the lease is a positive indication that the landlord wanted to reserve to himself the right to choose his own tenant, a right which to him might be of great significance or consequence.[4] Such a right would be of no value if the landlord is duty bound to accept a subtenant selected by the tenant for the balance of the unexpired term of the lease.[5] Furthermore, a commercial tenant wishing to soften the effect of this unilateral control can demand to have engrafted on the consent provision "which consent shall not be unreasonably withheld."[6]

In some common law states where the issue, whether a landlord may arbitrarily and unreasonably withhold consent under an unqualified provision in the lease prohibiting assignment or subletting of the leased premises without the landlord's consent, has not been litigated, the landlord may arbitrarily refuse consent on theory that the landlord is under no duty to mitigate damages.[7] Since the landlord is under no duty to mitigate damages, he may arbitrarily reject a suitable subtenant, sit back and allow the leased premises to remain vacant, and hold the defaulting tenant liable for the entire rent under the lease.[8]

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1 61 U. Pitt. L. Rev. 559 (2000).
2 *Id*.
3 *Gladliz, Inc. v. Castiron Court Corp*., 677 N.Y.S.2d 662 (1998).
4 *Manley v. Kellar*, 94 A.2d 219, 220 (Del. Super. 1952).
5 *Id*.
6 *First Federal Savings Bank of Indiana v. Key Markets, Inc*., 559 N.E.2d 600, 603 (Ind. 1990).
7 *Enoch C. Richards Co. v. Libby*, 10 A.2d 609, 610 (Me. 1940).
8 *Adams v. Graham Stave & Heading Co*., 135 So. 198, 199 (Miss. 1931).

Unlike the common law, a strong and increasing minority of states regard the lease as a contract and subject to the general contract principles.[9] The minority rule, applying different contract principles, prohibits a landlord from arbitrarily withholding consent under an unqualified provision in the lease prohibiting assignment or subletting or the leased premises without the landlord's consent.[10] The rationale for the minority rule is largely based on the contract principles. First, every contract has an implied covenant of good faith and fair dealing.[11] Some minority rule jurisdictions have used this principle and argued that where a lease requires the tenant to secure the landlord's consent prior to any assignment or subletting, the landlord is under a duty to act in good faith and not unreasonably withhold consent to a proposed assignment or subletting.[12] Second, a well established contract principle requires a landlord to mitigate his damages.[13] Some minority rule jurisdictions have applied this principle and held that where a defaulting tenant abandons the leased premises and produces a ready, willing, and suitable subtenant to assume obligations under the lease, the landlord is under a duty to accept the suitable subtenant and mitigate his damages.[14] Third, the Restatement (Second) of Property § 15.2 prohibits a landlord from arbitrarily and unreasonably withholding consent to a proposed assignment or subletting unless such a right is freely negotiated and expressly stated in the lease.[15] Some minority rule jurisdictions have expressly adopted the Restatement (Second) of Property § 15.2 and prohibited landlords from withholding consent unless such right is reserved in the lease.[16] Finally, some minority rule jurisdictions have rejected the common law rule because of public policy reasons.[17] It is argued that a landlord should not be allowed to unreasonably withhold consent to a proposed assignment or subletting because the necessity of reasonable alienation of commercial building space has become paramount in our ever-increasing urban society.[18]

This article examines state laws as they apply to the following issues: (1) May a landlord arbitrarily and unreasonably withhold consent under an unqualified provision in the lease prohibiting assignment or subletting of the leased premises without the landlord's consent; (2) Must the landlord's refusal to consent to assignment or subletting be based on reasonable grounds where the lease provides that consent shall not be unreasonably withheld; and (3) Can a tenant freely assign or sublease the leased premises without securing the landlord's consent where the lease has no provision regarding assignment or subletting? Almost all the cases cited in this article are commercial cases or the rulings therein are applicable to commercial leases.

ALABAMA

Under Alabama law, a landlord may not arbitrarily withhold consent under an unqualified provision in the lease prohibiting assignment or subletting of the leased premises without the landlord's consent.[19] In *Homa-Goff Interiors*, the lease at issue contained a provision restricting the tenant's right to assign or sublease all or any part of the demised premises without the landlord's written consent.[20] The

9 *Fernandez v. Vazquez*, 397 So. 2d 1171 (Fla. App. 1981).
10 *Homa-Goff Interiors, Inc. v. Cowden*, 350 So. 2d 1035, 1038 (Ala. 1977).
11 *Warner v. Konover*, 553 A.2d 1138 (Conn. 1989).
12 *Kendall v. Ernest Pestana*, 709 P.2d 837 (Cal. 1985).
13 *Gordon v. Consolidated Sun Ray, Inc*., 404 P.2d 949, 953 (Kan. 1965).
14 *Aurora Bus. Park Assocs., L.P. v. Michael Albert, Inc*., 548 N.W.2d 153, 157 (Iowa Sup. 1996).
15 Restat 2d of Prop: Landlord & Tenant, § 15.2 (1977).
16 *Warmack v. Merchants Nat'l Bank*, 612 S.W. 2d 733 (Ark. 1981).
17 *Funk v. Funk*, 633 P.2d 586 (Ida. 1981).
18 *Id*. at 587.
19 350 So. 2d at 1038.
20 *Id*. at 1037.

Supreme Court of Alabama rejected the majority rule and held that such a provision in the lease doesn't give the landlord a right to unreasonably and capriciously withhold his consent to a sublease or assignment.[21] The Court rationalized its view by stating that the ever-increasing urban society of modern times requires a reasonable alienation of commercial building space.[22]

Where the lease provides that consent shall not be unreasonably withheld, the landlord's refusal to consent should be based on reasonable grounds judged under a test applying a reasonable commercial standard.[23] Furthermore, a landlord's refusal to consent is arbitrary and unreasonable if the landlord places conditions as prerequisites to the landlord's consent.[24] The reasonableness of the landlord's consent is a question of fact to be determined by the jury.[25]

Alabama has retained the common law rule that in the absence of a restrictive provision in the lease, the tenant can freely assign or sublease the leased premises without the landlord's consent.[26] Restrictive provisions on alienation are disfavored by the law and are strictly construed in favor of the tenant.[27]

Finally, Alabama has adopted the Restatement (Second) of Contracts § 205 which requires an obligation of good faith in the performance or enforcement of all contracts including assignment & subletting.[28] Furthermore, Alabama law gives the landlord the same right to enforce his lien against the subtenant or assignee that the landlord had against the original tenant.[29]

ALASKA

Under Alaska law, a landlord may not arbitrarily withhold consent under an unqualified provision in the lease prohibiting assignment or subletting of the leased premises without the landlord's consent.[30] In *Hendrickson*, the Supreme Court of Alaska held that no-assignment and subletting clauses do not give to the landlord an absolute right to control assignments of his property.[31] Where the landlord's consent is required before an assignment can be made, he may withhold his consent only where he has reasonable grounds to do so.[32] While a restraint on alienation without the consent of the landlord is valid, such consent cannot be withheld unreasonably unless a freely negotiated clause in the lease gives the landlord an absolute right to withhold consent.[33]

Where the lease provides that consent shall not be unreasonably withheld, the landlord's refusal to consent must be based on reasonable grounds.[34] In *Norville*, the Supreme Court of Alaska adopted the "commercially reasonable standard".[35] The Court argued that while it is unreasonable for a landlord to withhold consent in order to charge a higher rent than he originally contracted for, withholding consent

21 *Id.* at 1038.
22 *Id*.
23 *Id*.
24 *Chrysler Capital Corp. v. Lavender*, 934 F.2d 290, 294 (U.S. App. 1991).
25 *Id.* at 293.
26 350 So. 2d at 1037.
27 *Id*.
28 Code of Ala. § 7-1-304 (2005).
29 Restat 2d of Contracts, § 205 (1981).
30 *Hendrickson v. Freericks*, 620 P.2d 205 (Alas. 1980).
31 *Id*. at 211.
32 *Id.*
33 *Id*.
34 *Norville v. Carr-Gottstein Foods Co*., 84 P.3d 996 (Alas. 2004).
35 *Id*. at 1002.

to a sublease because a proposed subtenant would compete with other businesses in the center and thereby potentially affect the landlord's relationship with other tenants is a reasonable ground for withholding consent.[36]

Where the lease has no provision regarding assignment or subletting, a tenant can freely assign or sublease the leased premises without requesting the landlord's consent.[37] While the general policy against **restraints on alienation** of property does not totally prohibit **restraints,** the validity of such a **restraint** in a particular case is greatly reduced because the law disfavors and interprets such restraints narrowly.[38] Finally, the Alaska Code[39] imposes an obligation of good faith in the performance or enforcement of all contracts or duties including leases and subleases.

ARIZONA

In Arizona, a landlord may not arbitrarily withhold consent under an unqualified provision in the lease prohibiting assignment or subletting of the leased premises without the landlord's consent.[40] In *Campbell*, the Arizona Court of Appeals departed from the Common Law rule and held that a landlord cannot unreasonably withhold consent to assignment or sublease unless the lease gives the landlord an absolute right to do so.[41] The Court held that in the absence of Arizona authority on an issue, Arizona courts will follow the Restatement of the Law.[42] Thus the Court adopted the rule in section 15.2(2) of the Restatement (Second) of Property (1977) which provides: "A restraint on alienation without the consent of the landlord of the tenant's interest in the leased property is valid, but the landlord's consent to an alienation by the tenant cannot be withheld unreasonably, unless a freely negotiated provision in the lease gives the landlord an absolute right to withhold consent".[43]

Where the lease provides that consent shall not be unreasonably withheld, the landlord's refusal to consent to assignment or subletting must be based on reasonable grounds.[44] In *Tucson Medical*, the Arizona Court of Appeals held that a landlord's reason for refusing consent to an assignment or sublease, in order for it to be reasonable, must be objectively sensible and of some significance.[45] The Court stated that good faith reasonable objections may include the subtenant's inability to satisfy the terms of the lease, the subtenant's financial irresponsibility or instability, the subtenant's unlawful use of the premises, or the unsuitability of the subtenant's business for the premises.[46] On the other hand, a landlord's refusal to consent to an assignment or subletting because the landlord is unsatisfied with the low rent provided under the existing lease is unreasonable.[47]

Where the lease has no provision regarding assignment or subletting, a tenant can freely assign or sublease the leased premises without securing the landlord's consent.[48] The Court in *Tucson Medical* held that in the absence of an express prohibition by lease or statute, each tenant has the unrestricted

36 *Id.*
37 *Hendrickson*, 620 P.2d 205.
38 620 P.2d at 210, Restat 2d of Prop: Landlord & Tenant, § 15.2 (1977) (comment a).
39 Alaska Stat. § 45.01.203 (2004).
40 *Campbell v. Westdahl*, 715 P.2d 288 (Ariz. 1985), *Tucson Medical Ctr. v. Zoslow*, 712 P.2d 459 (Ariz. 1985).
41 715 P.2d at 292.
42 *Id*.
43 *Id.*
44 712 P.2d at 462.
45 *Id*.
46 *Id*.
47 715 P.2d at 294.
48 712 P.2d at 461.

right to assign or sublet at will.[49] The generally accepted rationale for this rule is that restrictions against alienation are not favored by the law and are strictly construed against the landlord.[50] Finally, the Arizona Commercial Code imposes an obligation of good faith in the performance or enforcement of every contract including assignments and subleases.[51] This rule was emphasized in *Campbell* and *Tucson Medical* where the Arizona Court of Appeals held that in every agreement there is an implied covenant of good faith and fair dealing so that neither the landlord nor the tenant may do anything that will injure the rights or interests of the other to the agreement.[52]

ARKANSAS

Until 1981, Arkansas followed the Common Law rule allowing a landlord to arbitrarily withhold consent under an unqualified provision in the lease prohibiting assignment or subletting of the leased premises without the landlord's consent.[53] This rule was abandoned in *Warmack v. Merchants Nat'l Bank*.[54] In *Warmack*, the Arkansas Supreme Court adopted the Restatement (Second) of Property § 15.2 rule which says: *"A restraint on alienation with the consent of the landlord of the tenant's interest in the leased property is valid, but the landlord's consent to an alienation by the tenant cannot be withheld unreasonably, unless a freely negotiated provision in the lease gives the landlord an absolute right to withhold consent."*

Where the lease provides that consent shall not be unreasonably withheld, the landlord's refusal to consent to assignment or subletting must be based on reasonable grounds.[55] The landlord's refusal to consent is arbitrary and unreasonable if it is made without fair, solid and substantial cause or reason.[56] Where the lease has no provision regarding assignment or subletting, a tenant can freely assign or sublease the leased premises without asking for the landlord's consent.[57] The rationale for this rule is that restraints on alienation of the lease inhibit the maximum use the leased property and are considered against public policy.[58] Such restrictive provisions in the lease are disfavored and are strictly construed against the landlord.[59]

CALIFORNIA

The majority rule, allowing commercial landlords to arbitrarily and unreasonably withhold consent to an assignment or sublease where there is no express leasehold provision to the contrary, was followed in *Richard v. Degan & Brody Inc*.[60] and *Hamilton v. Dixon*.[61] The Court of Appeal of California in *Cohen v. Ratinoff*[62] and *Schweiso v. Williams*[63] disagreed with the *Richard* and *Hamilton* ruling and

49 *Id*.
50 715 P.2d at 291.
51 A.R.S. §47-1203 (2004).
52 715 P.2d at 293, 712 P.2d at 261.
53 *Ft. Smith Warehouse Co. v. Friedman-Howell & Co*., 163 S.W. 175 (Ark. 1914).
54 612 S.W. 2d 733 (Ark. 1981).
55 *Id*. at 735.
56 *Id*.
57 Restat 2d of Prop: Landlord & Tenant, § 15.1 (1977).
58 *Id*.
59 *Id*.
60 5 Cal. Rptr. 263 (1960).
61 214 Cal. Rptr. 639 (1985).
62 195 Cal. Rptr. 84 (1983).
63 198 Cal. Rptr. 238 (1984).

held that where the lease provides for assignment or subletting only with the prior consent of the landlord, a landlord may refuse consent only where he has a good faith reasonable objection to the assignment or sublease, even in the absence of a provision prohibiting the unreasonable or arbitrary withholding of consent to an assignment of a commercial lease. Finally, the California Supreme Court in *Kendall v. Ernest Pestana*[64] took note of these conflicting decisions and adopted the minority rule.

The Court in *Kendall* held that where a commercial lease provides for assignment only with the prior consent of the landlord, such consent may be withheld only where the landlord has a commercially reasonable objection to the subtenant or the proposed use.[65] Furthermore, where a tenant has the right to sublet under common law, but has agreed to limit that right by first acquiring the consent of the landlord, the tenant has a right to expect that consent will not be unreasonably withheld.[66]

The *Kendall* Court also held that where the lease provides that consent shall not be unreasonably withheld, the landlord's refusal to consent to assignment or subletting should be based on reasonable grounds.[67] Some of the factors that the jury may take into account in applying the standards of good faith and commercial reasonableness may include financial responsibility of the proposed assignee, suitability of the use for the particular property, legality of the proposed use, need for alteration of the premises, and nature of the occupancy.[68] On the other hand, refusing consent to sublet solely on the basis of personal taste, to charge a higher rent than originally contracted for, convenience, or sensibility is not commercially reasonable.[69]

Where the lease has no provision regarding assignment or subletting, a tenant can freely assign or sublease the leased premises without securing the landlord's consent.[70] The *Kendall* Court held that the law favors free alienability of property, and California follows the common law rule that a leasehold interest is freely alienable.[71] Provisions in the lease limiting the free alienation of property such as provisions against assignment are disfavored and must be strictly construed.[72]

Finally, the California Supreme Court in *Kendall* emphasized the rule that in every contract there is an implied covenant that neither party shall do anything which will have the effect of destroying or injuring the right of the other party to receive the fruits of the contract.[73] Where a contract confers on one party a discretionary power affecting the rights of the other, a duty is imposed to exercise that discretion in good faith and in accordance with fair dealing.[74]

COLORADO

In *Basnett v. Vista Village Mobile Home Park*, the Colorado Court of Appeals adopted the Restatement (Second) of Property § 15.2(2) (1977) and held that a landlord cannot withhold consent to assignment or subletting unreasonably unless a freely negotiated provision in the lease gives the landlord an

64 709 P.2d 837 (Cal. 1985).
65 709 P.2d at 849.
66 709 P.2d at 845.
67 *Id*.
68 *Id*.
69 *Id.*
70 *Id*. at 840.
71 *Id.*
72 *Id*.
73 *Id*. at 844.
74 *Id*.

absolute right to do so.[75] This ruling was reaffirmed in *Cafeteria Operators L.P. v. AmCap/Denver Ltd. Pshp*. where the Colorado Court of Appeals held that Colorado follows the rule that without 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.[76]

Where a provision in the lease provides that consent shall not be unreasonably withheld, the landlord's refusal to consent to assignment or subletting must be based on commercially reasonable grounds.[77] Considerations based on personal taste, convenience, or sensibility is arbitrary and is not proper criteria for withholding consent.[78] The test is whether a landlord has reasonably refused to consent to a sublease based on factors that relate to a landlord's interest in preserving the value of the property, and whether a reasonably prudent person in the landlord's position would have also refused to consent.[79]

Where the lease has no provision regarding assignment or subletting, a tenant can freely assign or sublet the leased premises without securing the landlord's consent. This proposition is supported by the Restatement (Second) of Property § 15.1 which is adopted by Colorado.[80] Colorado courts have also applied the principle of good faith and fair dealing in cased involving assignments and subleases.[81]

CONNECTICUT

Where a lease contains a provision simply stating that the landlord's consent to an assignment or subletting is required, the landlord may refuse consent and his reason is immaterial.[82] On the other hand, where the terms of the lease also provide that the landlord's consent to an assignment or subletting will not be arbitrarily withheld, the landlord may not arbitrarily refuse his consent.[83] This ruling in *Robinson* was put into doubt by the Connecticut Supreme Court ruling in *Warner v. Konover*.[84] While accepting the common law rule that a landlord can arbitrarily refuse to consent to an assignment under a lease provision requiring prior consent,[85] the *Warner* Court held that the landlord's refusal to consent in such a case could be held unreasonable because of the good faith and fair dealing doctrine.[86] The Court adopted the Restatement (Second) of Contract § 205 and held that the duty of good faith and fair dealing applies to commercial leases and both the landlord and the tenant is under an obligation to deal with one another in a manner consistent with good faith and fair dealing.[87] Thus under Connecticut law, a landlord may arbitrarily withhold consent under an unqualified provision in the lease prohibiting assignment or subletting of the leased premises without the landlord's consent. At the same time, arbitrary refusal to consent under such a provision could be held unreasonable because it may violate doctrine of good faith and fair dealing.[88]

75 699 P.2d 1343, 1346 (Colo. 1984).
76 972 P.2d 276, 278 (Colo. 1998).
77 *List v. Dahnke*, 638 P.2d 824 (Colo. App. 1981).
78 *Id*. at 825.
79 972 P.2d at 279.
80 Restat 2d of Prop: Landlord & Tenant, § 15.1 (1977).
81 699 P.2d at 1346; 972 P.2d at 278.
82 *Robinson v. Weitz*, 370 A.2d 1066 (Conn. 1976).
83 *Id*. at 1068.
84 553 A.2d 1138 (Conn. 1989).
85 *Id*. at 1140.
86 *Id*. at 1141.
87 *Id.* at 1140.
88 *Id.*

Where the lease provides that the landlord may not arbitrarily withhold consent, the landlord's refusal to consent to assignment or subletting must be based on reasonable grounds.[89] While financial reliability of the proposed subtenant may constitute a reasonable ground for refusal to consent, refusing consent in order to charge a higher rent is not considered a reasonable ground to refuse consent.[90] Finally, by adopting the Restatement (Second) of Contracts § 205, the Connecticut Supreme Court imposed an obligation of good faith and fair dealing in the performance or enforcement of all contracts including assignment & subletting.[91]

DELAWARE

Section 5101(b) of the Delaware Code provides all legal rights, remedies, and obligations under any agreement for the rental of any commercial rental unit shall be governed by general contract principles.[92] Furthermore, every duty under the Delaware Code, and every act which must be performed as a condition precedent to the exercise of a right or remedy under the Delaware Code, imposes an obligation of good faith in its performance or enforcement.[93] It could be argued that since the Delaware Code and the general contract principles impose a duty of good faith and fair dealing, a landlord is under a duty to use reasonable care in rejecting a proposed subtenant. This argument, however, contradicts the Delaware case law.

In *Manley v. Kellar*, the lease contained a covenant that the tenant would not assign or sublet the leased premises without the written consent of the landlord.[94] When the tenant presented a ready, willing, and able subtenant to assume the obligation of the lease, the landlord refused consent and rejected the proposed subtenant.[95] The tenant argued that the landlord was under a duty to accept the proposed subtenant and mitigate his damages.[96] The Superior Court of Delaware held that the restriction against the tenant subletting or assigning the leased premises during the term of the lease is a positive indication that the landlord in case of a vacancy caused by the tenant wanted to reserve to himself the right to choose his own tenant, a right which to him might be of great significance or consequence.[97] Such a right would be of no value if the landlord is duty bound to accept a subtenant selected by the tenant for the balance of the unexpired term of the lease.[98] Furthermore, assuming arguendo that the landlord arbitrarily and unreasonably refused to accept the subtenant produced by the tenant, the landlord is not liable to the tenant and is under no obligation to search for and obtain a subtenant in order to mitigate his damages.[99] The *Manley v. Kellar* case has not been overruled and is good law in the state of Delaware.

Applying the general principles of contract, where the landlord and the tenant expressly agree that the landlord will not unreasonably withhold his consent to a proposed assignment or subletting, the landlord is under a duty of good faith to accept a proposed subtenant otherwise acceptable and suitable

89 370 A.2d at 1068.
90 553 A.2d at 1141.
91 553 A.2d at 1140.
92 25 Del. C. § 5101(b) (2005).
93 25 Del. C. § 5104 (2005).
94 94 A.2d at 220.
95 *Id*.
96 *Id*. at 221.
97 *Id*.
98 *Id*.
99 *Id*.

for the leased premises.[100] Delaware recognized the common law rule that restraints on the alienation of property are not favored and are against public policy.[101] They are strictly construed and not implied unless expressly stated in the contract.[102] Therefore, in the absence of a covenant in the lease restricting assignment or subletting, the tenant is free to assign or sublet the leased premises without the landlord's consent.[103]

FLORIDA

The first Florida case that squarely addressed the issue of whether a landlord may arbitrarily refuse consent when a lease provision expressly provides that the tenant shall not assign or sublease the premises without first obtaining the landlord's consent was *Fernandez v. Vazquez*.[104] Criticizing the majority approach, the *Fernandez* Court held that where a tenant retains the right to sublet or assign the lease under common law, but agrees to limit that right by first acquiring the landlord's consent, the tenant is justified to expect that the landlord will not withhold consent arbitrarily.[105] Thus for the first time, Florida recognized the rule that a landlord may not arbitrarily and capriciously refuse consent to an assignment or subletting of a commercial lease which provides that a tenant shall not assign or sublease the premises without first acquiring the written consent of the landlord.[106]

The *Fernandez* Court also emphasized the rule that where the lease contains a provision requiring that consent shall not be unreasonably withheld, the landlord's right to refuse consent to an assignment or subletting must conform to commercial reasonableness.[107] Whether the landlord's refusal to consent was reasonable or arbitrary is an issue to be determined by the jury.[108] The factors that may be considered in reaching a decision include the financial responsibility of the proposed subtenant, the legality of subtenant's business, the type of occupancy, the type of business, or the need for alteration of the leased premises.[109] On the other hand, refusing consent solely on the basis of personal taste, convenience or sensibility or in order that the landlord may charge a higher rent than originally contracted for are arbitrary reasons failing the test of commercial reasonableness.[110]

Where the lease has no provision regarding assignment or subletting, a tenant can freely assign or sublease the leased premises without first securing the landlord's consent.[111] The *Fernandez* Court restated the common law rule that the law favors free alienation of property and a tenant has the right to assign his leasehold interest without the consent of the landlord.[112] Finally, the *Fernandez* Court held that a lease constitutes a contract and is subject to the contract principle of good faith and commercial reasonableness.[113] Thus every lease has an implied covenant that imposed a duty of good faith and cooperation on the landlord and the tenant.[114] Where this duty of good faith and cooperation

100 25 Del. C. §§ 5101(b) & 5104.
101 *Tracey v. Franklin*, 67 A.2d 56, 59 (Del. 1949).
102 *Id*.
103 *Id*.
104 397 So. 2d 1171 (Fla. App. 1981).
105 *Id*. at 1174.
106 *Id*.
107 *Id*.
108 *Id*.
109 *Id*.
110 *Id*.
111 *Id*. at 1172.
112 *Id*.
113 *Id*. at 1174.
114 *Id*.

is violated by the landlord's arbitrary refusal to consent to an assignment or subletting, the landlord has breached the contract and must face the consequences of that breach.[115]

GEORGIA

One of the first Georgian cases that discussed the issue of whether a landlord may arbitrarily withhold consent under an unqualified provision in the lease prohibiting assignment or subletting of the leased premises without the landlord's consent was *Stern's Gallery of Gifts, Inc. v. Corporate Property Investor Inc*.[116] In *Stern's Gallery*, the Georgia Court of Appeals praised the minority rule of holding the landlord to a standard of good faith and commercial reasonableness.[117] While the *Stern's* Court described and praised, in lengthy discussion, the jurisdictional trend toward adopting the rule that a landlord may not arbitrarily and capriciously refuse to consent to an assignment or subletting of a commercial lease which provides that a tenant shall not assign or sublease the premises without first acquiring the written consent of the landlord, the *Stern's* Court failed to adopt this rule as the law of Georgia.[118] As a consequence, the Georgia Court of Appeals in *Vaswani v. Wohletz*[119] explicitly held that in Georgia a landlord may arbitrarily withhold consent under an unqualified provision in the lease prohibiting assignment or subletting of the leased premises without the landlord's consent.[120]

Where the lease provides that consent shall not be unreasonably withheld, the landlord's refusal to consent to assignment or subletting should conform to the standard of good faith and commercial reasonableness.[121] In addition, under the common law rule disfavoring restraints against the free alienation of property, a tenant is free to assign or sublease the leased premises without securing the landlord's consent in the absence of a provision in the lease restricting assignment or subletting.[122] Finally, under the *Stern's* holding, it seems that a lease constitutes a contract and is subject to the principles of good faith and commercial reasonableness.[123]

HAWAII

Under Hawaii law, commercial leases and covenants therein are governed by the general contract principles.[124] Therefore, it can be argued that the implied duty of good faith and fair dealing embodied in every contract is applicable to covenants in a lease contract. Thus where a provision in the lease prohibits assignment or subletting without the consent of the landlord, the landlord is under a duty to act in good faith and in fair manner when refusing consent to a proposed assignment or subletting. Furthermore, it seems that Hawaii courts have adopted the Restatement (Second) of Property § 15.2 rule which prohibits the landlord to unreasonably refuse consent to an assignment or subletting unless a freely negotiated provision in the lease gives the landlord an absolute right to do so.[125]

115 *Id*.
116 337 S.E.2d 29 (Ga. App. 1985).
117 *Id*. at 37.
118 *Id*.
119 396 S.E.2d 593 (Ga. App. 1990).
120 *Id*. at 594.
121 337 S.E.2d at 36.
122 *Shiver v. Benton*, 304 S.E.2d 903, 906 (Ga. 1983).
123 *Id*.
124 *Food Pantry v. Waikiki Business Plaza*, 575 P.2d 869, 877 (Haw. 1978).
125 *Kapiolani Commercial Ctr. v. A&S Partnership*, 723 P.2d 181, 184 (Haw. 1986).

Where the lease expressly provides that the landlord shall not unreasonably withhold his consent to a proposed assignment or subletting, the landlord covenants to base his refusal to consent on legitimate commercial grounds.[126] The violation of such covenant gives the tenant the right to sue for damages or terminate the lease.[127] Finally, restraints on the alienation of property are not favored by the law and are strictly construed.[128] The reason for the rule against **restraints** on alienation is a public policy favoring freedom of commerce in property, and the idea that the free alienability of property fosters economic and commercial development.[129] Therefore, where a commercial lease is silent on the issue of assignment or subletting, the tenant is free to assign or sublet the leased premises without the landlord's consent.

IDAHO

The major Idaho case that addressed the issue of whether a landlord has an absolute right to withhold consent to a proposed assignment or sublease where the lease gives the tenant a right of assigning or subleasing upon the consent of a landlord was *Funk v. Funk*.[130] In *Funk*, the lease provided that the tenant shall have the right to assign or sublet the leased premises provided the consent of the landlord is first obtained.[131] Upon the tenant's legitimate request to sublet the leased premises, the landlord refused to consent under any circumstances unless the tenant agreed to certain modification of the lease.[132] The *Funk* Court rejected the majority rule and held that a landlord may not unreasonably refuse to consent to an assignment or subletting of a commercial lease which provides that a tenant shall not assign or sublease the premises without first obtaining the consent of the landlord.[133] The court justified its ruling by adopting the minority rationale that the necessity of reasonable alienation of commercial building space has become paramount in our ever-increasing urban society.[134]

While the *Funk* Court admitted that there may be legitimate reasons for a landlord to withhold consent, no public policy is served by giving the landlord a right to arbitrary refuse to consent to an assignment because of whim, caprice, or to extort a higher rent.[135] Where the lease contains a provision stating that the landlord's consent shall not be unreasonably withheld, the landlord's right to refuse consent must conform to a reasonable commercial standard which does not include the landlord's arbitrary considerations of personal taste, sensibility, or convenience.[136]

A tenant may freely assign or sublet the demised premised in whole or in part in the absence of restrictions placed thereon by the lease provisions or by the statute.[137] This common law right is only limited to prevent the tenant from assigning or subletting the demised premised to be used in wasteful or injurious manner.[138] A lease is a contract containing an implied covenant of good faith and fair

126 *Id.*
127 *Id*.
128 *Association of Owners v. Honolulu*, 742 P.2d 974, 983 (Haw. App. 1987).
129 *Id*.
130 633 P.2d 586.
131 *Id*. at 587.
132 *Id*. at 588.
133 *Id*. at 589.
134 *Id*.
135 *Id*.
136 *Id*.
137 *Id*. at 588.
138 *Id*.

dealing.[139] Therefore, a landlord must act reasonably and in good faith in withholding his consent to a proposed assignment or subletting.[140]

ILLINOIS

Under Illinois law, where the lease prohibits assignments or subletting without the prior consent of the landlord, the landlord cannot unreasonably withhold consent to a proposed assignment or subletting.[141] At the same time, whether the landlord's refusal to consent was reasonable or arbitrary depends on whether the tenant tendered a subtenant who was ready, willing, and able to take over the lease and who met reasonable commercial standards.[142] To constitute an arbitrary refusal to consent, the landlord need not expressly refuse to consent since a refusal to even consider a request to a proposed assignment is unreasonable and capricious.[143]

Where the lease provides that consent shall not be unreasonably withheld, the landlord's refusal to consent to assignment or subletting must conform to reasonable commercial standards.[144] Since the financial responsibility of a subtenant is an important factor, the landlord is within reason to refuse a subtenant who is insolvent, of dubious financial responsibility, or has a poor payment record.[145] To show that a landlord unreasonably rejected a proposed subtenant, the burden is on the tenant to prove that the proposed subtenant met reasonable commercial standards.[146]

Where the lease has no provision regarding assignment or subletting, a tenant can freely assign or sublease the leased premises without securing the landlord's consent.[147] Restraints on alienation are void even though they are limited in time because such restraints pose social and economic disadvantages to the public and the only benefit that often accrues from such restraints is the satisfaction of the capricious whims of the conveyor.[148]

A lease is a contract subject to the implied covenant of good faith and fair dealing.[149] Since both the landlord and the tenant is under a duty of good faith and cooperation, a landlord's arbitrary refusal to consent violates this covenant and thus the lease.[150]

INDIANA

The major case discussing the issue of whether a landlord can arbitrarily withhold consent under an unqualified provision in the lease prohibiting assignment or subletting of the leased premises was *First*

139 *Cheney v. Jemmett*, 693 P.2d 1031 (Ida. 1984).
140 *Id*. at 1035.
141 *Jack Frost Sales, Inc. v. Harris Trust & Sav. Bank*, 433 N.E.2d 941, 949 (Ill. App. 1982); *Arrington v. Walter E. Heller International Corp*., 333 N.E.2d 50, 59 (Ill. 1975); *Reget v. Dempsey-Tegler & Co*., 216 N.E.2d 500, 503 (Ill. 1966); *Scheinfeld v. Muntz TV, Inc*., 214 N.E.2d 506, 510 (1966); *Wohl v. Yelen*, 161 N.E.2d 339, 342 (1959); *Mowatt v. 1540 Lake Shore Drive Corp*., 385 F.2d 135, 136 (1967).
142 433 N.E.2d at 949.
143 *Id*. at 943.
144 *Id*. at 946.
145 *Id*.
146 *Id*.
147 *Gale v. York Center Community Cooperative, Inc*., 171 N.E.2d 30, 33 (Ill. 1960).
148 *Id*.
149 161 N.E.2d at 343.
150 *Id*.

Federal Savings Bank of Indiana v. Key Markets, Inc.[151] The trial court in this case ruled that a landlord may not unreasonably withhold consent to an assignment or subletting notwithstanding the fact that the lease does not contain a provision stating that consent shall not be unreasonably withheld.[152] The Court of Appeals agreed with the trial court and held that a landlord is under a legal duty not to unreasonably withhold consent in the absence of limiting language in the lease.[153] On appeal, the Supreme Court of Indiana overruled the appellate and trial court rulings and held that absent a provision in the lease stating that the landlord's consent shall not be unreasonably withheld, the landlord is not required to pass the test of reasonableness and may refuse consent without any explanation.[154] Where the lease contains a provision requiring the consent of the landlord, the landlord is in control and has the power to accept or reject a proposed assignment or subletting.[155] A tenant wishing to soften the effect of this unilateral control can demand to have engrafted on the consent provision "which consent shall not be unreasonably withheld."[156]

Where the lease provides that consent shall not be unreasonably withheld, the landlord's consent to assignment or subletting must be based on reasonable grounds.[157] What is reasonable or unreasonable depends on factors such as: (1) the financial responsibility of the proposed subtenant (2) the business character of the proposed subtenant (3) the need for alteration of the leased premises (4) the nature of the occupancy and (5) the legality of the proposed use.[158] On the other hand, personal taste, convenience, sensibility, or demanding higher rent constitutes arbitrary reasons failing the tests of commercial reasonableness.[159]

Where the lease has no provision regarding assignment or subletting, a tenant can freely assign or sublease the leased premises without securing the landlord's consent.[160] It is a common law rule that restraints on alienation are not favored and in absence of limiting language in the lease, the tenant has the right to assign or sublet freely.[161] Finally, while Indiana law recognized the general contract covenant of good faith and fair dealing, this covenant is irrelevant in cases involving a landlord's refusal to consent to an assignment or subletting in the absence of limiting language.[162] Where the lease does not provide that the landlord's consent shall no be unreasonably withheld, the landlord is not required to pass the test of good faith and reasonableness and could refuse consent without any explanation.[163]

IOWA

It is the establish law of Iowa that when a tenant wrongfully abandons the leased premises, a duty is imposed on the landlord to use reasonable diligence to re-let the leased property and minimize the

151 532 N.E.2d 18 (Ind. App. 1988).
152 *Id*, at 20.
153 *Id*.
154 559 N.E.2d at 603.
155 *Id*.
156 *Id*.
157 *Id.*
158 *Id*.
159 *Id*.
160 *Id*.
161 *Id*.
162 *Id*.
163 *Id*.

resulting damage.[164] By implication, this rule dictates that where a tenant's default is imminent and he produces a subtenant willing, ready, and able to assume the obligations of the lease, the landlord is under a duty to mitigate his damages and not arbitrarily refuse such suitable subtenant.[165]

A landlord and tenant may set their obligations in the lease document.[166] Where the lease provides that the landlord shall not unreasonably withhold consent to a proposed assignment or subletting, the landlord is under contractual obligation not to arbitrarily refuse consent to a proposed assignment or subletting.[167] Finally, restraints on the alienation of property are not favored and strictly construed to limit its negative results.[168] Therefore, in the absence of a provision in the lease restricting assignment or subletting, the tenant is free to assign or sublet the leased premises without the landlord's consent.

KANSAS

The law in Kansas is that where a tenant abandons the commercial property and notifies the landlord of the breach, the landlord is under a duty to make a reasonable effort to secure a new tenant and mitigate his damages.[169] Where the landlord seeks redress for the wrong of the tenant, the landlord is required to do whatever he reasonably can and improve all reasonable opportunities to avoid the consequences and to lessen the damage.[170] Where the landlord fails to respond to inquiries in renting the abandoned commercial premises and discourages prospective tenants, the landlord has failed to use reasonable efforts to mitigate damages.[171] The Kansas Supreme Court has acknowledged that the rule in Kansas is in conflict with the majority rule followed in the United States, but that Kansas has so long declared and so consistently followed the minority rule that it has become a rule of property and should not now be overruled.[172]

Kansas recognizes a lease to be a contract and subject to the contract principles.[173] Therefore, where the landlord agrees not unreasonably withhold his consent to a proposed assignment or subletting, the landlord is under contractual duty to base his refusal to consent on reasonable commercial grounds. In addition, a restraint on the alienation of property is against public policy and is strictly construed against the party imposing the restriction.[174] Therefore, in the absence of a clause in the lease prohibiting assignment or subletting, the tenant is free to assign or sublet the leased premises without the landlord's consent.

164 *Reinking v. Goodell*, 133 N.W. 774, 778 (Iowa Sup. 1913); *Roberts v. Watson*, 195 N.W. 211, 213 (Iowa Sup. 1923); *Benson v. Iowa Bake-Rite Co*., 221 N.W 464, 467 (Iowa Sup. 1929); *Friedman v. Colonial Oil Co*., 18 N.W.2d 196, 198 (Iowa Sup. 1945); *Aurora Bus. Park Assocs., L.P. v. Michael Albert, Inc*., 548 N.W.2d 153, 157 (Iowa Sup. 1996).
165 *Id*.
166 *Id*. at 156.
167 *Id*.
168 *Prichard v. Department of Revenue*, 164 N.W.2d 113, 119 (Iowa Sup. 1969).
169 404 P.2d at 953.
170 *Id*.
171 *Leavenworth Plaza Assocs., L.P. v. L.A.G. Enterprises*, 16 P.3d 314, 319 (Kan. 2000).
172 *Lawson v. Callaway*, 293 P. 503, 504 (Kan. 1930); 404 P.2d at 953.
173 *T.R. Inc. of Ashland, Kansas v. Brandon*, 87 P.3d 331, 334 (Kan. App. 2004).
174 *Bolz v. State Farm Mut. Auto Ins. Co*., 52 P.3d 898, 902 (Kan. 2002).

KENTUCKY

Where the lease provides that the tenant shall acquire the landlord's consent before assignment or subletting the leased premises, the landlord is in control and may refuse consent without giving his reason.[175] Kentucky follows the common law and gives the words of the lease full effect without implying covenants that are not expressly agreed upon by the tenant and landlord.[176] Where a restrictive covenant in a lease requires the tenant to secure consent of the landlord before assigning or subletting the lease and does not say that the landlord shall not unreasonably withhold such consent, the landlord reserves the right to refuse consent for any reason or no reason at all.[177]

Similarly, where the lease provides that consent shall not be unreasonably withheld, the landlord's refusal to consent to assignment or subletting must be based on reasonable grounds.[178] In addition, where the lease has no provision regarding assignment or subletting, a tenant can freely assign or sublease the leased premises without securing the landlord's consent.[179] A restrictive covenant contained in a lease against the assignment is not violated by a subletting of the premises, and a limitation upon the right to sublease is not violated by an outright assignment of the lease.[180] Finally, while Kentucky recognizes a lease to be a contract and thus subject to the implied covenant of good faith and fail dealing, this general rule seems not apply where the landlord expressly reserves the right to refuse consent without imposing any limitation on that right.[181]

LOUISIANA

Under Louisiana law, where the tenant is not permitted to sublet without the prior consent of the landlord, such prohibition is not absolute and the tenant may sublet provided he obtains a subtenant acceptable to the landlord.[182] Louisiana courts have consistently applied the Louisiana Civil Code Article 2725 to commercial leases and have held that a tenant has the right to sublet or assign the leased premised unless he contracts away this right by agreeing to secure the consent of the landlord before subletting the leased premises.[183] In such situation, the landlord can refuse to consent for any reason unless such consent violates the Abuse of Rights doctrine.[184] The landlord's refusal to consent violates the Abuse of Rights doctrine if: (a) the predominant motive for the refusal was to cause harm; (b) there was no serious or legitimate motive for refusing consent; (c) the exercise of the right to refuse consent is against moral rules, good faith, or basic fairness; and (e) the right to refuse consent is exercised for a purpose other than for which it was granted.[185] In other words, a landlord can refuse consent for any serious and legitimate reasons.[186] But when a tenant presents a perfectly suitable and acceptable subtenant, the landlord cannot arbitrarily withhold consent.[187]

175 *Hill v. Rudd*, 35 S.W. 270 (Ky. 1896); *Cities Service Oil Co. v. Taylor*, 45 S.W.2d 1039 (Ky. 1932).
176 45 S.W.2d at 1041.
177 *Id*.
178 *Id*.
179 *Id*. at 1040.
180 *Id*.
181 *Id*. at 1041.
182 *Gamble v. New Orleans Hous, Mart, Inc*., 154 So. 2d 625, 627 (La. App. 1963).
183 *Illinois C. G. R. Co. v. International Harvester Co*., 368 So. 2d 1009, 1013 (La. 1979).
184 *Id*. at 1014.
185 *Truschinger v. Pak*, 513 So. 2d 1151, 1154 (La. 1987).
186 368 So. 2d at 1015.
187 *Associates Commercial Corp. v. Bayou Management, Inc*., 426 So. 2d 672, 674 (La. App. 1982).

When a lease contains the additional proviso that the landlord's consent shall not be unreasonably withheld, the landlord's right to refuse consent will not be protected unless the landlord's refusal is based on reasonable grounds.[188] Unless the tenant's right is expressly restrained by the lease provision, the tenant is free to assign or sublet the leased premises without asking the landlord for consent.[189] Finally, a landlord's refusal to consent to proposed assignment or subletting is arbitrary and unreasonable if it violates good faith and fairness.[190] Thus the obligation of good faith and fairness is implied in all contracts and is imbedded in the fabric of Louisiana Civil Code and the Abuse of Right doctrine.[191]

MAINE

While residential landlords are under statutory duty to mitigate damages by making reasonable efforts to re-let the abandoned premises, no such duty is imposed on commercial landlords.[192] In the absence of an agreement to the contrary, a commercial landlord is under no legal obligation to mitigate damages where the tenant defaults in paying rent or abandons the leased premises.[193] Where a tenant has breached the lease and abandoned the leased premises, the landlord may permit the leased premises to remain vacant, refuse to recognize the attempted surrender by the tenant, and bring suit to collect the rent as it comes due.[194] Therefore, where the lease prohibits assignments or subletting without the landlord's consent, and the tenant is unable to perform his obligations under the lease and requests the landlord's consent to assign or sublet the leased premises to a suitable person, the landlord may arbitrarily refuse consent, permit the leased premised to remain vacant, and hold the tenant liable for the breach of the lease.

On the other hand, where the lease provides that the landlord's consent to an assignment or subletting shall not be unreasonably withheld, the landlord is under contractual duty to base his refusal to consent on reasonable grounds.[195] Covenants against assignment or **subletting** are restraints which courts do not favor and are strictly construed to defeat their effects.[196] Thus a covenant restricting assignment does not prohibit subletting and vise versa. Furthermore, where the lease has no provision regarding assignment or subletting, the tenant is free to assign or sublet the leased premises without the landlord's consent.

MARYLAND

Jacobs v. Klawans[197] was the first case to address the issue of whether a landlord may arbitrarily withhold consent under an unqualified provision in the lease prohibiting assignment or subletting of the leased premises without the landlord's consent. In *Jacobs*, the lease provided that the tenant shall have no right to assign or sublet the leased premised without the prior written consent of the landlord.[198] The

188 513 So. 2d at 1154.
189 368 So. 2d at 1013; La. C.C. Art. 2725 (2004).
190 513 So. 2d at 1154.
191 *Id*.
192 14 M.R.S. § 6010-A(2) (2004).
193 10 A.2d at 610.
194 *Id*.
195 *Dahl v. Comber*, 444 A.2d 392, 395 (Me. 1982).
196 *Waterville v. Kelleher*, 141 A. 70, 71 (Me. 1928).
197 169 A.2d 677 (Md. 1961).
198 *Id*. at 678.

tenant presented several ready, willing, and able subtenants which the landlord arbitrarily refused.[199] The court held that where a subletting or assignment of the leased premises without the consent of the landlord is prohibited, he may withhold his consent arbitrarily, unless the lease provides that consent shall not be arbitrarily or unreasonably withheld.[200] The court rationalized its holding by stating that the right of the landlord to choose a tenant of his own preference to occupy and use his property offsets any evils flowing from the enforcement of the restriction on alienation, and that such restriction is in many cases of minor importance.[201]

The *Jacobs v. Klawans* holding was overruled by the Court of Appeals of Maryland in *Julian v. Christopher*.[202] The *Julian* Court agreed with the Restatement (Second) of Property § 15.2 rule and held that it is in the public interest that when a lease provision gives the landlord the right to withhold consent to a sublease or assignment, the landlord should act reasonably, and the courts ought not to imply a right to act arbitrarily or capriciously.[203] Arbitrary refusal to consent to an assignment or sublease for any reason or no reason would virtually nullify any right to assign or sublease.[204]

Where the lease provides that consent shall not be unreasonably withheld, the landlord's refusal to consent to assignment or subletting must be based on reasonable grounds.[205] What constitutes a reasonable refusal to consent to an assignment or sublease may include factors such as the financial irresponsibility or instability of the subtenant, or the unsuitability or incompatibility of the intended use of the leased premises by the subtenant.[206] On the other hand, what constitutes an unreasonable refusal to consent to an assignment or sublease may include facts that the reasons for withholding consent have nothing to do with the proposed subtenant or the subtenant's use of the leased premised, or the refusal to consent was solely for the purpose of securing a rent increase.[207]

Where the lease has no provision regarding assignment or subletting, a tenant can freely assign or sublease the leased premises without securing the landlord's consent.[208] Restraints on alienation are viewed as against public policy, are looked upon with disfavor, and are strictly construed in favor of the tenant.[209] Finally, a lease is a contract and has an implied covenant of good faith and fair dealing.[210] When the landlord retains the right to exercise discretion, he should act in good faith and in accordance with fair dealing.[211] When the lease document does not specify a standard for withholding consent, the implied covenant of good faith and fair dealing should imply a reasonableness standard.[212]

MASSACHUSETTS

The two major cases addressing the issue of whether the landlord may arbitrarily withhold consent under an unqualified provision in the lease prohibiting assignment or subletting of the leased premises

199 *Id*.
200 *Id*. at 679.
201 *Id*.
202 575 A.2d 735 (Md. 1990).
203 *Id*. at 738.
204 *Id*.
205 *Id*. 739.
206 *Id*.
207 *Id*.
208 *Id*.
209 *Id*.
210 *Id*.
211 *Id*.
212 *Id*.

without the landlord's consent are *Slavin v. Rent Control Board*[213] and *21 Merchants Row Corp. v. Merchants Row, Inc*.[214] While the issue in *Slavin* concerned a residential lease, the court implied that it would not impose a reasonableness standard had it been addressing a commercial lease.[215] Two years later, the Supreme Judicial Court of Massachusetts in *21 Merchants Row* held that a commercial landlord may arbitrarily refuse consent under a lease provision requiring the landlord's prior consent to an assignment or subletting.[216] Where a commercial lease requires the tenant to obtain the landlord's consent before assigning or subletting the leased premises, the Massachusetts law does not impose an obligation on the landlord to act reasonably in withholding consent.[217]

Where the lease provides that consent shall not be unreasonably withheld, the landlord's refusal to consent to assignment or subletting must be based on reasonable grounds.[218] The parties to a lease are parties to a contract and are free to negotiate their rights and obligations under the lease.[219] Where the lease provides that consent shall not be unreasonably withheld, a landlord who violates such unambiguous provision regarding consent breaks his promise and is in breach of contract.[220]

Where the lease has no provision regarding assignment or subletting, a tenant can freely assign or sublease the leased premises without securing the landlord's consent.[221] A provision in the lease that prohibits a tenant from assigning a lease without the landlord's consent is intended to protect the landlord's right choose suitable subtenants.[222] Where the landlord fails to impose such restraint on alienation in the lease, he forfeits that right and the tenant is free to assign or sublet.[223] Finally, the bargaining power of commercial tenants at the lease drafting stage is ordinarily greater than that of residential tenants.[224] Since a reasonableness requirement is not implied in the assignment clause of a residential lease, it is logical that such standard will not be implied in commercial leases.[225]

MICHIGAN

A major case addressing the issue of whether the landlord may arbitrarily withhold consent under an unqualified provision in the lease prohibiting assignment or subletting of the leased premises without the landlord's consent was *White v. Huber Drug Co*.[226] In *White*, the lease at issue provided that the tenant shall not assign or sublet the leased premised without the prior written consent of the landlord.[227] The Supreme Court of Michigan held that the purpose of such a provision in the lease reserves to the landlord the right to choose who shall occupy his property.[228] Where the right is clearly reserved to the landlord, he may accept or reject a proposed subtenant as he desires.[229] The court will

213 548 N.E.2d 1226 (Mass. 1990).
214 587 N.E.2d 788 (Mass. 1992).
215 548 N.E.2d at 1228.
216 587 N.E.2d at 789.
217 *Id*.
218 *Healthco, Inc. v. E & S Realty Associates*, 511 N.E.2d 579 (Mass. 1987).
219 *Id*. at 582.
220 *Id*.
221 *Id*. at 581.
222 *Id*.
223 *Id*.
224 587 N.E.2d at 789.
225 *Id*.
226 157 N.W. 60 (Mich. 1916).
227 *Id*. at 61.
228 *Id*.
229 *Id*.

not determine whether the landlord's refusal was reasonable or whether the proposed subtenant would or would not make a good and acceptable subtenant.[230]

Where the lease provides that consent shall not be unreasonably withheld, the landlord's refusal to consent to assignment or subletting should be based on reasonable grounds.[231] Where the landlord agrees not to withhold his consent unreasonably, he breaches an express covenant if he refuses consent based on unreasonable grounds.[232] In the absence of a provision in the lease regarding assignment or subletting, a tenant is free to assign or sublet his interest in the leased premises without first obtaining the landlord's consent.[233] This is true because covenants against assignment or subletting are not favorably regarded by the courts and are liberally construed in favor of the tenant.[234]

MINNESOTA

In *Gruman v. Investors Diversified Services*,[235] the lease at issue contained a provision restricting the right of the tenant to assign or sublet without the prior written consent of the landlord.[236] The landlord refused consent to a proposed subtenant who was the postmaster general of the United States and was considered to be highly satisfactory, desirable, and suitable subtenant.[237] The Minnesota Supreme Court held that the landlord is under no duty to mitigate damages and may arbitrarily refuse to accept a subtenant suitable and responsible.[238] Accepting the majority rule, the court held that "many leases now in effect covering a substantial amount of real property and creating valuable property rights were carefully prepared by competent counsel in reliance upon the majority viewpoint."[239] The landlords are justified and entitled to rely upon the language of the lease and the majority rule holding the tenants to fulfill their duty under the lease.[240] If a tenant wants the right to assign or sublet the leased premises, a clause might readily be inserted in the lease stating that the landlord's consent to assignment or subletting of the leased premises should not be unreasonably withheld.[241]

Where the lease provides that consent shall not be unreasonably withheld, the landlord's refusal to consent to assignment or subletting should be based on reasonable grounds. Since parties to a lease are free to negotiate their rights and obligations under the lease, a landlord who agrees to limit his right to refuse consent only upon reasonable grounds is under obligation to exercise reasonable care and diligence in refusing a subtenant who is ready, willing, and otherwise suitable.[242]

230 *Id*.
231 *Id*.
232 *Id*.
233 *Id*.
234 *Id*.
235 78 N.W.2d 377 (Minn. 1956).
236 *Id*. at 378.
237 *Id*. at 379.
238 *Id*.
239 *Id*. at 381.
240 *Id*.
241 *Id*. at 382.
242 *Id*.

MISSISSIPPI

The common law regards leases as conveyances of property rather than contracts.[243] Under this view, the estate belongs to the tenant for the period of time reserved in the lease.[244] In addition, where the tenant abandons the leased premises and breaches the lease, the landlord is under no duty to re-let the premises and mitigate damages.[245] While the minority rule imposes a duty on the landlord to make reasonable efforts to re-let the premises and mitigate damages, Mississippi has never overruled the common law rule and allows the landlord to sit back, allow the leased premises to remain vacant, and hold the defaulting tenant liable for the entire rent under the lease.[246]

Where a lease provision provides that the landlord shall not unreasonably withhold his consent to a proposed assignment or subletting, the landlord is under a duty not to refuse consent contrary to fairness and commercial reasonableness.[247] This does not mean that the landlord cannot attach conditions to his approval of an assignment.[248] Otherwise, the right to withhold consent would be meaningless.[249] What it means is that the conditions attached to approval of a transfer must be reasonable.[250] Therefore, it is commercially reasonable for a landlord to condition his approval of an assignment requiring the proposed subtenant not to make substantial alterations to the leased premises.

MISSOURI

Under Missouri law, a landlord is under no duty to mitigate his damages by seeking to re-let the leased premises when the tenant breaches a commercial lease by abandoning the leased premises, but may let the premises lie idle and collect the rents as they come due.[251] Where a tenant breaches a commercial lease and abandons the leased premises, the landlord has three options: (1) leave the leased premises vacant, treat the lease as operating and collect rent as it comes due; (2) give notice to tenant, take possession of the leased premises and attempt to re-let in order to mitigate any damages; or (3) take possession in its own right and terminate the lease.[252] Thus, in the absence of a provision in the lease to the contrary, a landlord is under no duty to accept a suitable subtenant produced by the tenant or to seek a new tenant when the original tenant breaches the lease and abandons the leased premises.[253]

In the absence of a provision in the lease prohibiting assignment or subletting, the tenant is free to assign or sublet without the landlord's consent.[254] Courts will not imply restrictive covenants in the lease if the parties have either dealt expressly with the matter or have intentionally left the contract silent on the point.[255] Where the landlord is under contractual duty not to unreasonably withhold

243 61 Miss. L.J. 527, 562 (1991).
244 *Id*.
245 *Id*.
246 135 So. at 199.
247 *Wright v. Rub a Dub Car Wash, Inc*., 740 So. 2d 891, 899 (Miss. 1999).
248 *Id*.
249 *Id*.
250 *Id*.
251 *MRI Northwest Rentals Inv. I, Inc. v. Schnucks-Twenty-Five, Inc*., 807 S.W.2d 531 (Mo. App. 1991); *Hurwitz v. Kohm*, 516 S.W.2d 33 (Mo. App. 1974); *Whitehorn v. Dickerson*, 419 S.W.2d 713 (Mo. App. 1967); *Jennings v. First Nat'l Bank*, 30 S.W.2d 1049 (Mo. App. 1930).
252 807 S.W.2d at 534.
253 516 N.W.2d at 37.
254 *Crestwood Plaza, Inc. v. Kroger Co*., 520 S.W.2d 93, 98 (Mo. App. 1974).
255 *Medicare Glaser Corp. v. Kimco of Missouri, Inc*., 760 S.W.2d 180, 182 (Mo. App. 1988).

consent, the landlord breaches the contract if he unreasonably refuses to consent to a proposed assignment or subletting.

MONTANA

While Montana has not expressly adopted the minority rule, it has held that a landlord is measured by conduct of a reasonably prudent person in the **landlord's** position exercising reasonable commercial responsibility.[256] Thus the landlord will not be exercising reasonable commercial responsibility if he arbitrarily refuses consent under an unqualified provision in the lease prohibiting assignment or subletting of the leased premises without the landlord's consent. While the *Brigham Young* case involved a lease clause stating that the landlord shall not unreasonably withhold consent, the Supreme Court of Montana hinted that a landlord might be under a general duty to exercise reasonable care when refusing consent to a proposed assignment or subletting.[257]

A landlord has an absolute right to decide who may occupy his premises and for what purpose should the premises be used.[258] However, where a landlord agrees to a lease provision providing that the landlord shall not unreasonably withhold his consent to assignment or subletting, the landlord promises that he will be governed by principles of fair dealing and commercial reasonableness when refusing consent to an assignment or subletting.[259] Under this standard, arbitrary considerations of personal taste, sensibility or convenience are not proper criteria for refusing consent.[260] On the other hand, the financial responsibility of the proposed subtenant, the character of his business, its suitability for the building, the legality of the proposed use, and the nature of the occupancy are among the proper criteria.[261] Finally, the free alienation of property is encouraged unless expressly agreed otherwise.[262] Where the lease is silent on the issue of assignment or subletting, the tenant has the right to assign or sublet the leased premises without the landlord’s consent.

NEBRASKA

Nebraska follows the Restatement (Second) of Property § 15.2 and allows the landlord to impose restrictions in the lease requiring the tenant to obtain the landlord’s consent before assigning or subletting the leased premises.[263] Where the landlord fails to reserve for himself an absolute right to withhold consent, the landlord may not unreasonably withhold consent to the tenant’s request for assignment or subletting.[264] The Supreme Court of Nebraska in *Newman* held that where a commercial lease does not give the landlord an absolute right to refuse consent but only contains a provision stating that there can be no assignment or subletting without the landlord’s prior consent, the landlord may not withhold consent unless he has a good faith and reasonable objection to the proposed assignment or subletting.[265] A lease is a contract and where it gives one party a discretionary power affecting the

256 *Brigham Young Univ. v. Seman*, 672 P.2d 15, 18 (Mont. 1983).
257 *Id*.
258 *Id*.
259 *Id*.
260 *Id*.
261 *Id*.
262 *Baker v. Berger*, 873 P.2d 940, 942 (Mont. 1994).
263 *Newman v. Hinky Dinky Omaha-Lincoln*, 427 N.W.2d 50, 54 (Neb. 1988).
264 *Id*.
265 *Id*. at 55.

rights of the other, a duty is imposed to exercise that discretion in good faith and in accordance with fair dealing.[266]

Where the lease provides that consent shall not be unreasonably withheld, the landlord's refusal to consent to assignment or subletting should be based on reasonable grounds.[267] Factors that may be considered in determining whether a landlord has acted with good faith and reasonably in withholding consent to an assignment of a commercial lease or subletting include but are not limited to the financial responsibility of the proposed subtenant, suitability of the proposed subtenant for the leased premises, legality of the proposed use, the proposed subtenant's need for alteration of the leased premises, and the nature of the proposed subtenant's occupancy.[268]

Where the lease has no provision regarding assignment or subletting, a tenant may freely assign or sublease the leased premises without securing the landlord's consent.[269] In Nebraska, restrictive covenants in a lease against assignment or subletting are not favorably regarded by the courts and are liberally construed in favor of the tenant.[270] Where a tenant is entitled to assign or sublet under common law and has not agreed to limit that right by first acquiring the consent of the landlord, the tenant is free to assign or sublet and need not ask for the landlord's consent.[271]

NEVADA

Under Nevada law, the covenant of good faith and fair dealing is implied into every contract including commercial contracts.[272] Thus an injured party may recover contract damages for breach of the **implied** covenant of good faith and **fair dealing** in a commercial contract.[273] It can be argued that where a lease provision provides that no assignment or subletting shall be made without the prior consent of the landlord, the implied duty of good faith requires the landlord not to arbitrarily withhold consent to a proposed assignment or subletting of the leased premises.

Where a lease provision requires the landlord not to arbitrarily withhold consent to a proposed assignment or subletting, the implied duty of good faith and fair dealing demands that the landlord demonstrate a reasonable rationale for withholding consent. Finally, provisions restricting the right of free alienation of property are strictly construed and cannot be extended or enlarged beyond the terms in which the restriction is expressed.[274] Thus where the lease is silent on the issue of assignment or subletting, the tenant is free to assign or sublet the leased premises without the landlord's consent.

NEW HAMPSHIRE

A major New Hampshire case that addressed the issue of whether a landlord may arbitrarily withhold consent under an unqualified provision in the lease prohibiting assignment or subletting of the leased premises without the landlord's consent was *Segre v. Ring*.[275] In *Segre*, the New Hampshire Supreme

266 *Id*. at 54.
267 *Id*.
268 *Id*.
269 *American Community Stores Corp. v. Newman*, 441 N.W.2d 154, 158 (Neb. 1989).
270 *Id*.
271 427 N.W.2d at 54.
272 *A.C. Shaw Constr. v. Washoe County*, 784 P.2d 9, 10 (Nev. 1989).
273 *Id*.
274 *Aikins v. Nevada Placer*, 13 P.2d 1103, 1105 (Nev. 1932).
275 170 A.2d 265 (N.H. 1961).

Court followed the precedent set forth by the Massachusetts cases and held that where the lease instrument contains an unqualified provision stating that the tenant shall not assign or sublet without the written consent of the landlord, the landlord has the right to refuse consent to a proposed assignment or subletting and his reasons for so doing are immaterial and need not be disclosed.[276]

Every contract imposes upon each party a duty of good faith and fair dealing in its performance and its enforcement.[277] Good faith performance or enforcement of a contract emphasizes faithfulness to an agreed common purpose and consistency with the justified expectations of the other party.[278] This implies that where a tenant agrees to ask the landlord's consent before assigning or subletting the leased premises and does not include a provision in the lease requiring the landlord to not unreasonably withhold such consent, the tenant should not expect the landlord to act reasonably in refusing a request for a proposed assignment or subletting.

NEW JERSEY

One of the first New Jersey cases that discussed the issue of the landlord's right to refuse consent to an assignment or subletting was *Muller v. Beck*.[279] In *Muller*, the Supreme Court of New Jersey held that a landlord who negotiates a provision in the lease prohibiting assignment or subletting without the consent of the landlord reserves for himself the right to choose who will occupy his property.[280] Where a landlord is acting within his right expressly reserved by the lease, he may, for any reason or no reason, refuse to consent to a proposed subtenant.[281]

Over the years, the *Muller* holding has been eroded by subsequent court decision. First, the Supreme Court of New Jersey in *Sommer v. Kridel* held that a landlord is under an obligation to maker reasonable efforts to mitigate damages.[282] Second, the Superior Court of New Jersey in *Jonas v. Prutaub Joint Venture* implied that a commercial landlord may be required to act reasonably in withholding consent under an unqualified provision in the lease prohibiting assignment or subletting of the leased premises without the landlord's consent.[283]

Modern authorities agree that New Jersey law prohibits a landlord from arbitrarily withholding consent under an unqualified provision in the lease prohibiting assignment or subletting of the leased premises without the landlord's consent.[284] Furthermore, New Jersey courts have defined a lease as constituting a contract and thus subject to the implied covenant of good faith and fair dealing.[285] Thus a landlord's unreasonable and arbitrary refusal to consent would violate the implied covenant of good faith and fair dealing and would constitute a breach of the lease.

276 *Id*. at 266.
277 *Harper v. Healthsource N.H*., 674 A.2d 962, 965 (N.H. 1996).
278 *Id*.
279 110 A. 831 (N.J. Super. 1920).
280 *Id*. at 832.
281 *Id*.
282 378 A.2d 767, 769 (N.J. 1977).
283 567 A.2d 230 (N.J. Super. 1989).
284 397 So. 2d at 1173.
285 378 A.2d at 771.

NEW MEXICO

The first New Mexico case that addressed the issue of whether a landlord may unreasonably and arbitrarily withhold consent to an assignment or subletting when the commercial lease agreement provides that the tenant must obtain the written consent of the landlord before assigning or subletting the leased premises was *Boss Barbara, Inc. v. Newbill*.[286] In *Boss Barbara*, the New Mexico Supreme Court held that a landlord may not unreasonably withhold consent to an assignment or subletting of commercial property to a commercially reasonable tenant where the lease requires the landlord's prior written consent.[287]

A lease is a contract and should be governed by the general contract principles of good faith and commercial reasonableness.[288] Therefore, consent should not be refused unless the proposed subtenant is unacceptable, applying the same standard that was used in judging the original tenant.[289] Since New Mexico law requires fairness, justice, and right dealing in all commercial practices and transactions, there is no reason not to apply the same standard to the rental of commercial premises.[290]

Where the lease provides that consent shall not be unreasonably withheld, the landlord's refusal to consent to assignment or subletting should be based on reasonable commercial objectives.[291] Furthermore, restraints upon the alienation of property are not favored and are strictly construed against the landlord.[292] In the absence of such restraints, the tenant is free to assign or sublet the leased premises without the landlord's consent.[293]

NEW YORK

Under New York Law, a landlord may arbitrarily withhold consent under an unqualified provision in the lease prohibiting assignment or subletting of the leased premises without the landlord's consent.[294] In *Mann Theatres Corp. v. Mid-Island Shopping Plaza Co*.,[295] the Supreme Court of New York held that where the lease permits assignments or subleases only with the consent of the landlord and does not provide that such consent shall not be unreasonably withheld, the landlord may arbitrarily refuse consent for any or for no reason.[296] The enforcement of such provisions in a lease is reasonable because landlords have a substantial interest in controlling the assignability of leases.[297] In *Herlou Card Shop, Inc. v. Prudential Ins. Co*.,[298] the Supreme Court went further and held that where a

286 638 P.2d 1084 (N.M. 1982).
287 *Id*. at 1085.
288 *Cowan v. Chalamidas*, 644 P.2d 528, 530 (N.M. 1982).
289 638 P.2d at 1086.
290 *Id*.
291 644 P.2d at 531.
292 638 P.2d at 1086.
293 *Id*.
294 *Gladliz, Inc. v. Castiron Court Corp*., 677 N.Y.S.2d 662 (1998); *Mann Theatres Corp. v. Mid-Island Shopping Plaza Co*., 464 N.Y.S.2d 793 (1983); *Herlou Card Shop, Inc. v. Prudential Ins. Co*., 422 N.Y.S.2d 708 (1979); *American Book Co. v. Yeshiva University Development Foundation*, 297 N.Y.S.2d 156 (1969); *Dress Shirt Sales, Inc. v. Hotel Martinique Associates*, 190 N.E.2d 10 (1963); *Arlu Associates, Inc. v. Rosner*, 220 N.Y.S.2d 288 (1961); *Singer Sewing Machine Co. v. Eastway Plaza, Inc*., 158 N.Y.S.2d 647 (1957); *Ogden v. Riverview Holding Corp*., 234 N.Y.S. 678 (1929).
295 464 N.Y.S.2d 793 (1983).
296 *Id.* at 798.
297 *Id*.
298 422 N.Y.S.2d 708 (1979).

landlord has the unqualified right to refuse consent, he can modify the lease and place conditions as prerequisite for consent.[299]

Where the lease provides that consent shall not be unreasonably withheld, the landlord's right to refuse consent should be based on reasonable grounds.[300] Reasonable grounds include factors such as: (1) the financial ability and responsibility of the subtenant; (2) the suitability of the subtenant's business for the particular building; (3) the legality of the proposed use; or (4) the nature of the subtenant's occupancy.[301]

The parties to a commercial lease are free to fix their rights and duties within the limits of the law. In the absence of a restriction on the right of assignment or subletting fixed by the parties themselves, a tenant has the right to assign his or her leasehold interest in the demised premises without the consent of the landlord.[302] The reason for this rule is that provisions limiting assignment or subletting are a restraint on the free alienation of land.[303] They are not viewed with favor by the courts and are strictly construed in favor of the tenant.[304] Therefore, where a commercial lease is silent with respect to assignment or subletting, a tenant need not request consent and may freely assign or sublet the demised property.[305]

NORTH CAROLINA

In *Sanders v. Tropicana*,[306] the Court of Appeals of North Carolina held that consent withheld arbitrary or unreasonably is invalid where the lease prohibits assignments or subletting without the prior consent of the owner.[307] However, the *Sanders'* case involved a board of directors of a cooperative apartment refusing consent under a contract which restrained a tenant-shareholder from transferring his lease and stock subscription without the Board's consent.[308] The board of directors' restriction on assignment or subletting applied to corporate stock as well as leasehold.[309] Thus the issue of whether a commercial landlord may arbitrarily withhold consent under a commercial lease provision requiring the prior consent of the landlord before any assignment or subletting was left in doubt.

In *Isbey v. Crews*,[310] the Court of Appeals of North Carolina distinguished *Sanders* and held that a landlord may arbitrarily withhold consent under an unqualified provision in a commercial lease prohibiting assignment or subletting of the leased premises without the landlord's consent.[311] Where the landlord and tenant freely enter into a lease contract and knowingly include a provision allowing the tenant to assign or sublet with the prior consent of the landlord, but knowingly omit a provision that the

299 *Id*.
300 297 N.Y.S.2d at 160; *Singer Sewing Machine Co. v. Eastway Plaza, Inc*., 158 N.Y.S.2d 647, 649 (1957); *Ontel Corp. v. Helasol Realty Corp*., 515 N.Y.S.2d 567, 568 (1987).
301 297 N.Y.S.2d at 160.
302 464 N.Y.S.2d at 797; 297 N.Y.S.2d at 159; *Butterick Pub. Co. v. Fulton & Elm Leasing Co*., 132 Misc. 366, 369 (1928).
303 464 N.Y.S.2d at 797.
304 297 N.Y.S.2d at 159.
305 *Id.*
306 229 S.E.2d 304 (N.C. App. 1976).
307 *Id*. at 307.
308 *Id*. at 308.
309 *Id*.
310 284 S.E.2d 534 (N.C. App. 1981).
311 *Id*. at 537.

landlord's consent shall not be unreasonably withheld, the court will not insert a requirement that the landlord not unreasonably withhold his consent.[312]

On the other hand, where the lease states that the landlord's consent shall not be unreasonably withheld, the landlord should have legitimate commercial reasons for refusing consent.[313] Refusal of consent based on arbitrary considerations of personal taste, sensibility, or convenience is arbitrary and unreasonable.[314] Finally, where the lease does not impose any restrictions on assignment or subletting, the tenant is free to assign or sublet without the landlord's consent.[315] Restraints on the alienation of property are not favored and the court will not imply one unless expressly stated in the lease.[316]

NORTH DAKOTA

Under North Dakota law, a landlord is under a duty to mitigate damages that arise out of his tenant's default.[317] The landlord has a duty to make a good faith effort, expending reasonable effort and diligence, to re-let the leased premises.[318] This implies that when a tenant's default is imminent and he presents a ready, willing, and suitable subtenant, the landlord is under a duty to act in good faith and not arbitrarily refuse the proposed subtenant. The burden is upon the tenant to prove that the landlord has acted unreasonably and in bad faith.[319]

Where the landlord and the tenant have made a contract which the tenant has broken, the landlord must make reasonable efforts to render the landlord's injury as light as possible, and the landlord cannot recover from the tenant breaking the contract damages which would have been avoided had the landlord performed such duty.[320] The rationale for imposing such duty on the landlord is that public policy demands that the property be put to some beneficial use, and a modern lease is more like a continuing contractual obligation than the purchase of an estate and thus subject to the general contract principle of good faith and fair dealing.[321]

Where the landlord and the tenant enter into a lease contract requiring the landlord not to unreasonably withhold consent to a proposed assignment or subletting, the landlord is under contractual obligation not to refuse consent arbitrarily or unreasonably.[322] As a general rule, unreasonable restraint on the alienation of property is against public policy and therefore invalid.[323] Under this rule, where the lease does not contain a provision regarding assignment or subletting, the court will not imply one and the tenant is free to assign or sublet the leased premises without the consent of the landlord.[324]

312 *Id*.
313 *Id*.
314 *Id*.
315 229 S.E.2d at 308.
316 *Id*.
317 *Ruud v. Larson*, 392 N.W.2d 62, 63 (N.D. 1986).
318 *Id*.
319 *Id*.
320 *Mar-Son, Inc. v. Terwaho Enters*., 259 N.W.2d 289, 291 (N.D. 1977).
321 *Id*.
322 *Id*.
323 *Northwestern Fed. Sav. & Loan Ass'n v. Ternes,* 315 N.W.2d 296, 303(N.D. 1982).
324 *Id*.

OHIO

In *F & L Center Co. v. Cunningham Drug Stores*,[325] the Court of Appeals of Ohio adopted the majority rule and held that where the lease requires the consent of the landlord before assignment or subletting occurs, the landlord may withhold consent for any reason absent a provision in the lease stating that consent shall not be unreasonably withheld.[326] In rationalizing its holding, the court held that the landlord and the tenant are free to negotiate and include in the lease a provision stating that the landlords shall not withhold consent arbitrarily.[327] Where the parties decide not to include such provision in the lease, the court will not imply such provision on its own.[328] An implied covenant of good faith is a covenant that neither the landlord nor the tenant will destroy the rights of the other to receive the fruits of the lease.[329] The duty of good faith must arise from the language of the lease or be indispensable to effectuate the intentions of the parties.[330] Exercising a freely negotiated right under a lease does not violate the implied covenant of good faith and fair dealing.[331]

Where the lease provides that consent shall not be unreasonably withheld, the landlord's refusal to consent to assignment or subletting should be based on reasonable grounds.[332] When a landlord negotiates and agrees not to withhold his consent unreasonably, he is under contractual duty to be faithful to his words and use due diligence in refusing consent.[333] Similarly, where the lease has no provision regarding assignment or subletting, the tenant is free to assign or sublet the leased premises without the landlord's consent.[334] Restrictions against the assignment of leases are restraints against the alienation of property interests and are strictly construed to prevent the restraint from going beyond the express stipulation.[335] The court will not imply such restriction unless expressly stated in the lease.[336]

OKLAHOMA

In Oklahoma, where a tenant breaches the lease and abandons the leased premises, the landlord is under no duty to mitigate damages and may let the premises remain vacant and sue the tenant at the end of the lease term for the entire rent.[337] Upon the tenant's breach and wrongful abandonment of the leased premises, Oklahoma gives the landlord three options: (1) the landlord may terminate the lease, enter and take possession recovering accrued rents to the date of entry (2) the landlord may let the premises remain vacant and sue at the appropriate time for the entire term or (3) the landlord may give notice to defaulting tenant of his refusal to accept the surrender and re-let the premises for the benefit of the tenant to mitigate his damages.[338] Oklahoma statute regulating commercial landlord and tenant conduct prohibits the assignment or transfer of a commercial lease without the written consent of the

325 482 N.E.2d 1296 (Ohio. App. 1984).
326 *Id*. at 1300; *Shoney's, Inc. v. Winthan Props*., 2001 Ohio 3965 (Ohio. App. 2001).
327 *Id*. at 1300.
328 *Id*.
329 *Conway v. Nissley*, 1995 Ohio App. LEXIS 5390.
330 *Id*.
331 *Id*.
332 482 N.E.2d at 1300.
333 *Id*.
334 *Fairbanks v. Power Oil Co*., 77 N.E.2d 499, 503 (Ohio. App. 1945).
335 *Id*.
336 *Id*.
337 *Higgins v. Street*, 92 P. 153 (Okla. 1907); *Rucker v. Mason*, 161 P. 195 (Okla. 1916); *Liberty Plan Co. v. Adwan*, 370 P.2d 928 (Okla. 1962); *Carpenter v. Riddle*, 527 P.2d 592 Okla. 1974).
338 527 P.2d at 594.

landlord if the lease is for two years or less, at will, or by sufferance.[339] Leases exceeding two years are obviously subject to the express language of the lease contract.

Under Oklahoma law, a lease in writing constitutes a written contract.[340] Thus under contract principles, where the lease provides that the landlord's consent to assignment or subletting shall not be arbitrarily withheld, the landlord violates an express covenant in the contract if he unreasonably refuses consent to a proposed assignment or subletting. Finally, restrictive provisions in a contract run counter to public policy and are strictly construed to defeat their purpose.[341] Therefore, in the absence of a restrictive provision in the lease contract prohibiting assignment or subletting, the tenant is free to assign or sublet the leased premises without the landlord's consent.

OREGON

Under Oregon law, when a lease provision prohibits subletting or assignment of the leased premises without the consent of the landlord, the landlord may arbitrarily withhold his consent for any or no reason, and in granting his consent may impose such conditions as he desires.[342] The law imposes a duty of good faith and fair dealing in the performance and enforcement of every contract including leases.[343] This duty of good faith will be applied in a manner that will effectuate the reasonable contractual expectations of the landlord and tenant.[344] In doing so, only the objectively reasonable expectations of the landlord and tenant will be examined in determining whether the obligation of good faith has been met.[345] The duty of good faith cannot serve to contradict an express provision in the lease, nor does it provide a remedy for an unpleasantly motivated act that is expressly permitted by lease.[346] Therefore, when the landlord and the tenant expressly agree that there shall be no assignment or subletting without the prior consent of the landlord excluding the phrase that such consent shall not be unreasonably withheld, the parties' reasonable expectations have been met and the duty of good faith is not violated if the landlord unreasonably refuses to consent to proposed assignment or subletting.[347]

Where the lease provides that consent shall not be unreasonably withheld, the landlord's refusal to consent to an assignment or subletting should be based on reasonable grounds.[348] When the lease gives the landlord discretion to refuse consent for reasonable commercial factors, the landlord has performed in bad faith if he has used his discretion to refuse consent unreasonably.[349] Where the lease has no provision regarding assignment or subletting, a tenant can freely assign or sublease the leased premises without securing the landlord's consent.[350] While the right of a tenant to assign or sublet may be restricted by the terms of the lease, in the absence of any covenant in the lease to the contrary, a tenant has the right to sublet or assign the leased premises.[351]

339 41 Okl. St. § 10 (2004).
340 370 P.2d at 930.
341 *Lohmann v. Adams*, 540 P.2d 552, 555 (Okla. 1975).
342 *Abrahamson v. Brett*, 21 P.2d 229, 232 (Ore. 1933).
343 *Pacific First Bank by Wash. Mut. v. New Morgan Park Corp*., 876 P.2d 761, 767 (Ore. 1994).
344 *Uptown Heights Assocs. Ltd. Partnership v. Seafirst Corp*., 891 P.2d 639, 645 (Ore. 1995).
345 *Id*.
346 *Id*.
347 876 P.2d at 767.
348 *Id*. at 766.
349 *Id*.
350 21 P.2d at 232.
351 *Id*.

PENNSYLVANIA

Under Pennsylvania law, where the lease contains a provision prohibiting the tenant to assign or sublet without the written consent of the landlord, the landlord may arbitrarily refuse consent to a proposed assignment or subletting out of mere caprice or whim and irrespective of the acceptability or suitability of the proposed subtenant.[352] Furthermore, the Supreme Court of Pennsylvania in *Stonehedge Square Ltd Pshp. v. Movie Merchants*[353] held that Pennsylvania follows the common law view that where the tenant breaches the lease and abandons the leased premises, the landlord is under no duty to mitigate damages and my allow the leased premises to stand idle and hold the tenant liable for the entire rent.[354] Re-letting the leased premises is not imposed on landlord as a duty but he may lease it and hold the tenant for the difference.[355]

The parties to a lease may impose appropriate restraints on the alienation of the leased premises, and can eliminate the legal problem of determining what sort of restraint they have created if they use language in the lease which plainly states what they intended.[356] A major problem in contract cases is to determine what the parties intended when they failed to clearly express their intentions.[357] Thus, where a lease provision clearly and expressly states that the landlord shall not unreasonably withhold his consent to assignment or subletting, there is no problem of interpretation and the landlord is under contractual duty to base his refusal to consent on reasonable grounds.[358] Furthermore, contractual restraints upon alienation of property are disfavored and strictly construed in favor of permitting transfer.[359] Thus in the absence of a provision in the lease clearly and properly prohibiting assignment or subletting, the tenant has the right to assign or sublet the leased premises without the landlord's consent.[360]

RHODE ISLAND

Under Rhode Island law, a landlord claiming injury that is due to breach of lease contract by a tenant is under a duty to exercise reasonable diligence and ordinary care in attempting to minimize its **damages.**[361] This rule prevents the landlord from sitting silent while the **damages** accumulate.[362] The law requires reasonable efforts and ordinary care in such circumstances.[363] The landlord is not allowed to recover that amount of **damages** he or she could have reasonably avoided.[364] The tenant has the burden to prove that the landlord failed to exercise reasonable diligence and ordinary care in attempting to mitigate damages.[365] Thus it could be argued that where a tenant is unable to continue his obligations under a lease and requests the landlord's consent to a proposed assignment or subletting, the landlord is under a duty to minimize his damages by exercising reasonable diligence not to reject a suitable subtenant.

352 *S. W. Straus & Co. v. B. Lancaster Trust Co*. (Pa. 1926) 40 Lanc L Rev. 125; also reported in 21 A.L.R.4th 188 § 3.
353 715 A.2d 1082 (Pa. 1998).
354 *Id*. at 1084.
355 *Id*.
356 *B. C. & H. Corp. v. Acme Markets, Inc*., 19 Pa. D. & C.3d 419, 428 (Pa. 1980).
357 *Id*.
358 *Id*.
359 *Id*. at 429.
360 *Id*.
361 *Tamaino v. Concord Oil*, 709 A.2d 1016, 1026 (R.I. 1998).
362 *Id*.
363 *Id*.
364 *Bibby's Refrigeration, Heating & Air Conditioning v. Salisbury*, 603 A.2d 726, 729 (R.I. 1992).
365 *Id*.

Implied covenants are not favored by law and courts are reluctant to imply covenants that are not expressed in the written lease.[366] The rationale for this rule is that when the parties have entered into a written lease agreement that contains their obligations, they have expressed all of the covenants by which they intend to be bound.[367] Thus where the lease has no provision regarding assignment or subletting, the tenant may assign or sublet the leased premises without the landlord's consent.

SOUTH CAROLINA

South Carolina follows the majority rule and allows the landlord to arbitrarily withhold consent to an assignment or subletting in the absence of a provision in the lease requiring the landlord not to unreasonably refuse consent.[368] The Supreme Court of South Carolina expressly rejected the Restatement (Second) of Property § 15.2(2) rule and held that the common law view that consent may be arbitrarily refused is preferred because the judicial function of the courts is to enforce leases as made by the parties and not to re-write or distort the terms of an unambiguous lease.[369] Where the lease document is clear and unambiguous, the court will enforce it regardless of the apparent unreasonableness or the parties' failure to protect their rights carefully.[370]

Where the lease unambiguously provides that the landlord's consent to an assignment or subletting shall not be unreasonably withheld, the landlord is under contractual duty to refuse consent only upon reasonable grounds.[371] Restraints on the alienation of property are not looked upon with favor by the courts and are strictly construed to limit its scope.[372] Where the lease is silent on issue of assignment or subletting, the tenant is free to assign or sublet the leased premised without the landlord's consent.[373]

SOUTH DAKOTA

South Dakota recognizes the rule that a landowner is under a duty to make reasonable efforts to mitigate damages.[374] No damages may be awarded for losses which the landowner might have prevented by reasonable efforts.[375] Under this rule, a landlord who allows the leased premises, abandoned by the defaulting tenant, to remain vacant, may not recover damages that he could have avoided by re-letting the abandoned premises. Furthermore, it can be argued that where the landlord reserves the right to grant or refuse consent to a proposed assignment or subletting, the rule directs the landlord to accept a suitable and responsible subtenant and avoid enhancing the damages.

Where a lease provision requires the landlord not to unreasonable withhold his consent to assignment or subletting, the landlord must demonstrate a reasonable rationale for withholding consent.[376] Otherwise, the landlord will be in breach of the contract and liable to the tenant for

366 *Aneluca Assocs. v. Lombardi*, 620 A.2d 88, 92 (R.I. 1993).
367 *Id*.
368 *Dobyns v. South Carolina Dep't of Parks, Recreation & Tourism*, 454 S.E.2d 347 (S.C. App. 1995); *Dobyns v. South Carolina Dep't of Parks, Recreation & Tourism,* 480 S.E.2d 81 (S.C. 1997).
369 *Id*. at 84.
370 454 S.E.2d at 350.
371 480 S.E.2d at 84.
372 *Spann v. Carson*, 116 S.E. 427, 433 (S.C. 1923).
373 *Id*.
374 *State Highway Comm'n v. Pinney*, 171 N.W.2d 68, 69 (S.D. 1969).
375 *Id*. at 70.
376 *Wandler v. Lewis*, 567 N.W.2d 377, 386 (S.D. 1997).

damages. Finally, restraints against assignment or subletting are looked upon with disfavor and are strictly construed against the landlord.[377] They are construed with the utmost jealousy and various methods have been used in defeating them.[378] Thus covenant against assignment does not prevent subletting and a covenant not to sublet is not violated by subletting part of the leased premises.[379] Furthermore, where there are no covenants against assignment or subletting in the lease, the tenant is free to assign or sublet the leased premises without the landlord's consent.

TENNESSEE

While Tennessee has not expressly adopted the minority rule, the standard it usually applies in determining whether withholding of consent was arbitrary is a reasonable commercial standard.[380] This standard includes the elements of good faith and fair dealing.[381] Thus it is safe to assume that where a tenant produces a suitable subtenant and the landlord refuses consent out of mere caprice or whim, the landlord has violated the elements of good faith and commercial reasonableness.

The same standard is applicable to a lease provision stating that the landlord shall not unreasonably withhold his consent to assignment or subletting.[382] In such situation, a landlord may not withhold consent because of personal whim or taste or other arbitrary reasons, but must act in good faith and in a commercially reasonable manner.[383] A major factor in determining whether a landlord acted in good faith and in a commercially reasonable manner is the financial worthiness of the proposed subtenant.[384] On the other hand, it is unreasonable for a landlord to refuse consent based on personal taste, convenience, or sensibility.[385] Finally, covenants against assignment or subletting are strictly construed against the landlord.[386] They are looked upon with the utmost jealousy, and different methods have been applied for defeating them.[387] Thus where the lease contract is silent regarding assignment or subletting, the tenant is free to assign or sublet the leased premises without the landlord's consent.

TEXAS

The Texas Property Code[388] prohibits a tenant from assigning or subletting the leased premises without the prior consent of the landlord. This provision is applicable to commercial leases and is incorporated into all leases by operation of law.[389] This statutory provision against assignments or subletting without the landlord's consent can only be changed by a clearly expressed provision in the lease document.[390] This restraint against assignment or subletting is for the sole benefit of the landlord.[391] By an express

377 *Smith v. Hegg*, 214 N.W.2d 789, 791 (S.D. 1974).
378 *Baron Bros. v. National Bank*, 155 N.W.2d 300, 304 (S.D. 1968).
379 *Id*.
380 *First American Bank, N.A. v. Woods*, 781 S.W.2d 588, 590 (Tenn. App. 1989).
381 *Id*.
382 *Id*.
383 *Id*.
384 *Id*.
385 *Id*. at 591.
386 *Woods v. Forest Hill Cemetery, Inc*., 192 S.W.2d 987, 990 (Tenn. 1946).
387 *Id*.
388 Tex. Prop. Code § 91.005 (2004).
389 *718 Assocs., Ltd. v. Sunwest N.O.P., Inc*., 1 S.W.3d 355, 362 (Tex. App. 1999).
390 *Reynolds v. McCullough*, 739 S.W.2d 424, 429 (Tex. App. 1987).
391 *Id*.

provision in the lease, the landlord may agree not to unreasonably or arbitrarily withhold his consent to a proposed assignment or subletting.[392] Absent such provision in the lease, the landlord is under no duty to act reasonably in withholding his consent.[393] He may withhold his consent arbitrarily and his reason for it is immaterial.[394] Furthermore, Texas courts have rejected the minority view and have held that there is no implied duty of good faith and fair dealing in all contracts.[395] In the absence of a special relationship between the landlord and tenant, there is no duty to act in good faith in an ordinary commercial contract.[396]

Where a lease provision provides that the landlord shall not unreasonably withhold his consent to an assignment or subletting, the landlord is under contractual duty not to unreasonably withhold his consent.[397] Thus it is unreasonable for a landlord to condition consent on a change in the terms of the original lease based on what the landlord finds economically advantageous at the time of the attempted assignment or sublease.[398] Finally, while most jurisdictions oppose and strictly construe restrictive covenants on the alienation of property, Texas statutorily prohibits a tenant from assigning or subletting the leased premises without the landlord's consent.[399] Therefore, in the absence of a provision in the lease prohibiting assignment or subletting, a tenant cannot assign or sublet the leased premises without first obtaining the landlord's consent.[400]

UTAH

In Utah, virtually every contract imposes upon each party a duty of good faith and fair dealing, the violation of which gives rise to a claim for breach of contract.[401] For commercial contracts, a covenant of good faith is statutorily imposed by Utah Code.[402] Under the **covenant** of good faith and fair dealing, the parties to a commercial lease impliedly promise that they will not intentionally or purposely do anything which will destroy or injure the other party's right to receive the fruits of the lease contract.[403] This implied covenant of good faith and cooperation prevents either party to the contract from impeding the other's performance of his obligations under the contract.[404] Thus the implied duty of good faith and fair dealing prevents the landlord from arbitrarily and unreasonably rejecting a suitable subtenant where a lease provision requires the tenant to secure the landlord's consent before assigning or subletting the leased premises.

Where a clause in the lease states that the landlord shall not unreasonable withhold consent to a proposed assignment or subletting, the implied duty of good faith and cooperation is violated if the landlord refuses consent out or mere caprice or whim. The landlord in such situation is required to fulfill his obligations under the lease and demonstrate reasonable rationale for withholding consent. Finally, restrictive covenants are not favored in the law and are strictly construed in favor of the free

392 *Id*.
393 *Trinity Prof'l Plaza Assocs. v. Metrocrest Hosp. Auth*., 987 S.W.2d 621, 625 (Tex. App. 1999).
394 *Id*.
395 *Id*.
396 *Id*.
397 739 S.W.2d at 429.
398 *B.M.B. Corp. v. McMahan's Valley Stores*, 869 F.2d 865, 869 (U.S. App. 1989).
399 Tex. Prop. Code § 91.005 (2004).
400 1 S.W.3d at 362.
401 *Oakwood Vill. L.L.C. v. Albertsons, Inc*., 104 P.3d 1226, 1239 (Utah. 2004).
402 Utah Code Ann. § 70A-1-203 (2005).
403 *St. Benedict's Dev. Co. v. St. Benedict's Hosp*., 811 P.2d 194, 199 (Utah. 1991).
404 *Zion's Properties v. Holt*, 538 P.2d 1319, 1321 (Utah. 1975).

alienation of property.[405] Restrictive covenants must be clearly and expressly stated and will not be implied except under extreme circumstances.[406] Therefore, in the absence of a restrictive covenant against assignment or subletting, the tenant is free to assign or sublet the leased premises without the landlord's consent.

VERMONT

The Vermont Supreme Court in *B & R Oil Co. v. Ray's Mobile Homes*[407] expressly declined to adopt the Restatement (Second) of property § 15.2(2) rule and held that Vermont law gives the landlord the right to arbitrarily withhold his consent to an assignment of a lease where the lease contains a provision prohibiting assignment without the landlord's express consent.[408] In *B & R Oil*, the lease prohibited assignment or subletting without the prior written consent of the landlord.[409] The tenant requested the landlord's consent to assign the lease to a third party who was suitable and wanted to continue to operate the existing retail gasoline station.[410] The landlord had no objection to the third party being a lease holder but refused consent because he wanted to renegotiate the terms of the lease.[411] The court held that the language of the lease is unambiguous and the court will not try to rewrite the lease to include the reasonableness standard therein.[412]

VIRGINIA

Under Virginia law, a landlord's actions under a commercial lease are governed by principles of fair dealing and commercial reasonableness.[413] Thus where a lease prohibits assignment or subletting of the leased premises without the landlord's consent, the landlord is under a duty to act fairly and in commercially reasonable manner.[414] The tenant has the burden to prove that the landlord's refusal to consent was arbitrary and unreasonable.[415]

Where a lease provision provides that the landlord shall not unreasonably withhold his consent to assignment or subletting, the landlord must produce valid business reasons for withholding his consent to a proposed assignment or subletting.[416] A reason for refusing consent, in order for it to be reasonable, must be objectively sensible and of some significance and not based on mere caprice or whim or personal prejudice.[417] It is unreasonable to refuse consent in order to improve economic position, personal taste, convenience, sensitivity or personal satisfaction.[418] On the other hand, refusal to consent is reasonable if it is based on reasons such as the character of the business, suitability of the

405 811 P.2d at 198.
406 *Id*.
407 422 A.2d 1267 (Vt. 1980).
408 *Id*.
409 *Id*.
410 *Id*.
411 *Id*.
412 *Id*. at 1268.
413 *Marriot Corp. v. Fischer*, 1994 Va. Cir. LEXIS 901, 3 (1994).
414 *Id*.
415 *Id*.
416 *Safeway Inc. v. CESC Plaza Ltd. P'ship*., 261 F. Supp. 2d 439, 463 (U.S. Dist. 2003).
417 *Id*. (Quoting Restatement (Second) of Property § 15.2).
418 1994 Va. Cir. LEXIS 901 at 4.

building, legality of the proposed use, the nature of the occupancy and the economic position of the subtenant.[419]

Restrictions on the power of alienation are not favored by the law and are strictly construed against the party imposing the restrictions.[420] A restriction against assignment or subletting is governed by the rule of strict construction, and it does not exist unless clearly and expressly stated in the lease contract.[421] Thus where the lease is silent on the issue of assignment or subletting, the tenant is free to assign or sublet the leased premises without the landlord's consent.[422]

WASHINGTON

In *Coulos v. Desimone*,[423] the Washington Supreme Court held that a landlord and a tenant may lawfully covenant that no assignment or subletting of the leased premises should be valid without the written consent of the landlord, and an assignment or subletting in violation of such covenant will put the tenant in default of the lease.[424] Where the lease does not expressly require the landlord to act reasonably in refusing consent, the landlord may arbitrarily out of mere caprice or whim refuse consent to a proposed assignment or subletting regardless of the fitness and suitability of the proposed assignee or subtenant.[425]

This issue was revisited in *Johnson v. Yousoofian*[426] where the Washington Court of Appeal agreed with *Coulos* holding and stated that Washington follows the common law and rejects the Restatement (Second) of Property rule.[427] The court held that while there is an implied duty to perform all contractual duties in good faith, the duty of good faith exists only in relation to the performance of specific contract terms and does not obligate a party to accept new obligations.[428] Thus if there is no contractual duty, there is nothing that must be performed in good faith.[429] On the other hand, where the lease states that the landlord shall not unreasonably withhold consent, the duty of good faith is violated if the landlord refuses consent out of mere caprice or whim.[430]

Lease covenants requiring the landlord's consent to assignment or subletting are restraints on alienation and are strictly construed against the landlord.[431] Therefore, where the lease is silent with respect to assignment or subletting, the tenant is free to assign or sublet the leased premises or any part thereof without the landlord's consent.[432]

419 *Id*.
420 *Wainwright v. Bankers' Loan & Investment Co*., 72 S.E. 129, 130 (Va. 1911).
421 *Taylor v. King Cole Theaters, Inc*., 31 S.E.2d 260, 261 (Va. 1944).
422 72 S.E. at 130.
423 208 P.2d 105 (Wash. 1949).
424 *Id*. at 110.
425 *Id*. at 111.
426 930 P.2d 921 (Wash. App. 1996).
427 *Id*. at 925.
428 *Id*. at 924.
429 *Id*. at 925.
430 *Id*.
431 *Id*. at 924.
432 *Id*.

WASHINGTON D.C.

Where a lease provision prohibits assignments or subletting without the landlord's consent, a landlord has the right to arbitrarily refuse consent to a proposed assignment or subletting.[433] A covenant in the lease against assignment or subletting is for the benefit of the landlord because it gives him the right to choose who shall use his property.[434] Furthermore, where the tenant breaches the lease and abandons the leased premises, a landlord is under no obligation to mitigate damages and may allow the leased premises to lie idle and hold the tenant liable for the entire rent due.[435] The landlord is neither required to find a new tenant for the leased premises nor must he accept a suitable subtenant produced by the defaulting tenant.[436] Instead, the landlord has three options how to deal with defaulting tenant: (1) the landlord may accept the abandonment and terminate the lease; (2) the landlord may take possession, re-let, and hold the tenant liable for any deficiency in rent; or (3) the landlord may allow the leased premises to lie idle and hold the tenant liable for the entire rent due.[437]

A lease is a contract subject to general contract principles. Whether a contract is ambiguous is question of law to be resolved by the court. Thus where a contract clearly and expressly states that the landlord shall not unreasonably withhold his consent to a proposed assignment or subletting, the landlord is under contractual duty to not to refuse consent arbitrarily. It is unreasonable for a landlord to refuse consent to an assignment or sublease solely to extract an economic concession or to gain economic leverage.[438]

WEST VIRGINIA

Under West Virginia law, lease agreements are governed by the Uniform Commercial Code.[439] There is imposed upon both parties to a business transaction an obligation of **good faith** in its performance or enforcement.[440] The test of **good faith** in a commercial setting is honesty in fact and the observance of reasonable commercial standards of **fair dealing** in the trade.[441] Thus where a commercial lease prohibits assignment or subletting without the prior consent of the landlord, it can be argued that the duty of good faith and fair dealing requires the landlord not to arbitrarily withhold consent to a proposed assignment or subletting.

Where a commercial lease requires the landlord not to unreasonably withhold consent to a proposed assignment or subletting, the duty of good faith and fair dealing demands that the landlord demonstrate a reasonable commercial rationale for withholding consent to a proposed assignment or subletting or the leased premises.[442] Finally, covenants in a lease prohibiting assignment or subletting without the landlord's consent are restraints on the free alienation of property, are not favored, and are strictly construed.[443] Thus where a lease has no provision restricting assignment or subletting, the tenant is free to assign or sublet the leased premises without the landlord's consent.

433 *Friedman v. Thomas J. Fisher & Co*., 88 A.2d 321, 323 (D.C. App. 1952).
434 *Id*.
435 *Id*.
436 *Id*.
437 *Truitt Evangel Temple, Inc*., 486 A.2d 1169, 1172 (D.C. App. 1984).
438 *1010 Potomac Associates v. Grocery Mfrs. Of America, Inc*., 485 A.2d 199, 210 (D.C. App. 1984).
439 *Barn-Chestnut, Inc. v. CFM Dev. Corp*., 457 S.E.2d 502, 508 (W.Va. 1995).
440 *Id*.
441 *Id*.
442 *Id*.
443 *Miller v. Fredeking*, 133 S.E. 375, 377 (W.Va. 1926).

WISCONSIN

Under Wisconsin law, a **landlord**-tenant relationship requires the parties to deal with each other in good faith and in a commercially reasonable manner.[444] Thus where a lease provision provides that the tenant shall not assign or sublet the leased premises without the landlord's consent, the landlord is under a duty to act in good faith and in a commercially reasonable manner when refusing consent to such proposed assignment or subletting.[445] In order for it to be reasonable, refusal to consent must be objectively sensible and of some significance and not be based on mere caprice or whim.[446] The burden is on the tenant to prove that the landlord's reasons for refusing consent were arbitrary or commercially unacceptable.[447]

Where the lease contract provides that the landlord's consent to a proposed assignment or subletting shall not be unreasonably withheld, the landlord is under contractual duty not to refuse consent for personal or arbitrary reasons.[448] Whether a landlord's reasons for refusing consent are commercially reasonable is a question for the jury.[449] It is not commercially reasonable if the only purpose for refusing consent is to charge a higher rent than the original contract allowed. On the other hand, refusing consent based on the financial irresponsibility of the subtenant is reasonable.[450]

Under common law, the tenant was free to assign or sublet the leased premises unless restricted by the express terms of the lease.[451] Restrictions on the alienation of property were disfavored and strictly construed.[452] Thus where the lease is silent in regards to assignment or subletting, the tenant may freely assign or sublet the leased premises without the landlord's consent.

WYOMING

Under Wyoming law, a landlord who is injured by the breach of a tenant must exercise reasonable care and diligence to avoid loss and minimize the resulting damage.[453] Thus where the tenant breaches the lease and abandons the leased premises, the landlord is not allowed to fold his hands and do nothing.[454] The landlord is under a duty to make reasonable efforts to re-let the leased premises and to mitigate his damages. From this rule, it can be argued that where a tenant in default produces a suitable subtenant for the leased premises, the landlord is under a duty to be reasonable in rejecting such subtenant even though the leased provides that no assignment or subletting is allowed without the consent of the landlord.

Every contract imposes upon each party a **duty of good faith and fair dealing** in its performance and its enforcement.[455] This implied duty is applied by courts to insure a notion of fairness.[456] Thus where a lease provision requires the landlord not to unreasonably withhold consent to assignment or

444 *Morgan Prods. V. Park Plaza of Oshkosh, Inc*., 598 N.W.2d 626, 629 (Wisc. App. 1999).
445 *Id*.
446 *Id*. at 630.
447 *Id*.
448 *Rock County Sav. & Trust Co. v. Yost's, Inc*., 153 N.W.2d 594, 596 (Wisc. 1967).
449 598 N.W.2d at 630.
450 *Id*.
451 153 N.W.2d at 596.
452 *Id*.
453 *Sturgeon v. Phifer*, 390 P.2d 727, 730 (Wyo. 1964).
454 *Goodwin v. Upper Crust*, 624 P.2d 1192, 1197 (Wyo. 1981).
455 *Husman, Inc. v. Triton Coal Co*., 809 P.2d 796, 801 (Wyo. 1991).
456 *Id*.

subletting, the covenant of good faith requires the landlord to act fairly and demonstrate a reasonable rationale for withhold consent to a proposed assignment or subletting of the leased premises. Restrictive covenants are not favored, are to be strictly construed, will not be implied, and in case of doubt the restrictions will be construed in favor of the free use of property.[457] Thus where the lease is silent on the issue of assignment or subletting, the tenant has the right to assign or sublet the leased premises without the landlord's consent.

457 *Kindler v. Anderson*, 433 P.2d 268, 271 (Wyo. 1967).

JURISDICTIONAL TABLE

	Jurisdiction	May a landlord arbitrarily withhold consent under an unqualified provision in the lease prohibiting assignment or subletting of the leased premises without the landlord's consent?	Must the landlord's refusal to consent to assignment or subletting be based on reasonable grounds where the lease provides that consent shall not be unreasonably withheld?	Can a tenant freely assign or sublease the leased premises without securing the landlord's consent where the lease has no provision regarding assignment or subletting?
1	**Alabama**	NO	YES	YES
2	**Alaska**	NO	YES	YES
3	**Arizona**	NO	YES	YES
4	**Arkansas**	NO	YES	YES
5	**California**	NO	YES	YES
6	**Colorado**	NO	YES	YES
7	**Connecticut**	NO	YES	YES
8	**Delaware**	YES	YES	YES
9	**Florida**	NO	YES	YES
10	**Georgia**	YES	YES	YES
11	**Hawaii**	NO	YES	YES
12	**Idaho**	NO	YES	YES
13	**Illinois**	NO	YES	YES
14	**Indiana**	YES	YES	YES
15	**Iowa**	NO	YES	YES
16	**Kansas**	NO	YES	YES
17	**Kentucky**	YES	YES	YES
18	**Louisiana**	YES/NO	YES	YES

	Jurisdiction	May a landlord arbitrarily withhold consent under an unqualified provision in the lease prohibiting assignment or subletting of the leased premises without the landlord's consent?	Must the landlord's refusal to consent to assignment or subletting be based on reasonable grounds where the lease provides that consent shall not be unreasonably withheld?	Can a tenant freely assign or sublease the leased premises without securing the landlord's consent where the lease has no provision regarding assignment or subletting?
19	**Maine**	YES	YES	YES
20	**Maryland**	NO	YES	YES
21	**Massachusetts**	YES	YES	YES
22	**Michigan**	YES	YES	YES
23	**Minnesota**	YES	YES	YES
24	**Mississippi**	YES	YES	YES
25	**Missouri**	YES	YES	YES
26	**Montana**	YES/NO	YES	YES
27	**Nebraska**	NO	YES	YES
28	**Nevada**	NO/YES	YES	YES
29	**New Hampshire**	YES	YES	YES
30	**New Jersey**	NO	YES	YES
31	**New Mexico**	NO	YES	YES
32	**New York**	YES	YES	YES
33	**North Carolina**	YES	YES	YES
34	**North Dakota**	NO	YES	YES
35	**Ohio**	YES	YES	YES
36	**Oklahoma**	YES	YES	YES
37	**Oregon**	YES	YES	YES
38	**Pennsylvania**	YES	YES	YES
39	**Rhode Island**	YES/NO	YES	YES
40	**South Carolina**	YES	YES	YES

	Jurisdiction	May a landlord arbitrarily withhold consent under an unqualified provision in the lease prohibiting assignment or subletting of the leased premises without the landlord's consent?	Must the landlord's refusal to consent to assignment or subletting be based on reasonable grounds where the lease provides that consent shall not be unreasonably withheld?	Can a tenant freely assign or sublease the leased premises without securing the landlord's consent where the lease has no provision regarding assignment or subletting?
41	**South Dakota**	NO/YES	YES	YES
42	**Tennessee**	NO/YES	YES	YES
43	**Texas**	YES	YES	NO
44	**Utah**	NO	YES	YES
45	**Vermont**	YES	YES	YES
46	**Virginia**	NO	YES	YES
47	**Washington**	YES	YES	YES
48	**West Virginia**	NO/YES	YES	YES
49	**Wisconsin**	NO	YES	YES
50	**Wyoming**	NO/YES	YES	YES
51	**Washington DC**	**YES**	**YES**	**YES**