



*Guiding You Through the Legal Maze.<sup>SM</sup>*

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## **NEGOTIATING A “FAIR” BUSINESS LEASE**

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## NEGOTIATING A "FAIR" BUSINESS LEASE

### INTRODUCTION

The selection of an ideal location and the negotiation of a fair and equitable lease are, probably, very important to the success of your business, particularly for retail concepts. The entry into a lease or the renewal of a lease is a long-term financial commitment. This should be taken very seriously, as you are committing to pay many thousands of dollars in rent and other expenses over many years.

If you are a franchisee, you also have to make sure that the lease you negotiate is consistent with your obligations under your franchise agreement. You should re-read your franchise agreement carefully regarding your obligations for site selection, construction, leasing, rights of the franchisor under your lease, etc. You also want the term of the lease and the term of the franchise agreement be "co-terminus," meaning that both the lease and the franchise agreement expire at the same time.

A business lease is a right granted by an owner of real property (landlord) to another party (tenant) to occupy and use the real property (premises) for the tenant's business. The rights and obligations of the parties are usually evidenced by a written agreement called a "lease." There are several types of leases, the 3 most common being a gross lease, percentage lease and net lease.

A gross lease requires that you pay a fixed amount, usually monthly, throughout the term of the lease. This amount usually includes the rent and the costs for insurance, taxes and maintenance. However, there is usually a provision allowing the landlord to increase the gross rent if costs increase.

A percentage lease usually means that you pay a lower monthly base rent with an additional amount of rent is payable based on a percentage of your gross sales. Be sure to set a cap (maximum amount of rent to be paid) in the lease as well as a "break point" figure (see **Percentage Rent** below).

A net lease involves paying a monthly base rent plus paying all, or in the case of a multi-tenant building, a proportionate share of real estate taxes, insurance, maintenance and other pass-through expenses. Net leases are also sometimes called "triple net" leases.

Choosing the right type of lease depends on your business, your budget and the custom in the locality. Most leases are net leases.

Included in this paper is a glossary of lease terms, which should help you better understand the business and legal nomenclature used by landlords and attorneys. However, these are general definitions only. Most leases have specific definitions of the words and phrases used in the lease. These specific definitions will control, so read the definitions section of the lease very carefully.

As you probably assumed, the landlord's standard lease was prepared by the landlord's attorneys, who are paid by the landlord to protect the interest of the landlord, **not** your interest. Certain provisions need to be negotiated and finalized by you and the landlord, such as the description of the premises, lease term, rent, security deposit, build-out, etc. to reflect your business terms. Other provisions that the landlord considers standard "boilerplate," need to be "**renegotiated**" by you to make the landlord/tenant relationship more equitable. You may want to consider entering into a non-binding letter of intent with the landlord outlining the material business issues you have agreed to before you and your attorney begin "renegotiating" the boilerplate provisions.

This paper will assist you in your negotiations of a business lease. It is merely a guide, however. All leases are different and real estate and landlord/tenant laws vary from state to state. **I strongly suggest you retain an attorney qualified in real estate and leasing matters to represent your interest and to assist you in your negotiations with the landlord.**

In addition to a copy of the landlord's standard lease and rules and regulations, you or your attorney should ask the landlord or the leasing agent for a copy of the landlord's owner's title insurance policy and copies of existing mortgages, restrictions, easements, etc. (the "Schedule B-II" exceptions). This will help you to verify that you are dealing with the proper owner and also to determine what restrictions and rights exist on the property that may affect your ability to operate your business and what rights the landlord's mortgagee has that may be adverse to your interests. For example, condemnation award (see **Condemnation** below), covenant of quiet enjoyment (see **Covenant of Quiet Enjoyment** below), casualty proceeds (see **Damage by Fire or Other Casualty** below), insurance (see **Insurance by the Tenant** below), prepaid rent (see **Security Deposit and Prepaid Rent** below) and subordination (see **Subordination, Non-Disturbance and Attornment** below).

My procedure is to review the landlord's standard lease (along with my client) and meet with my client to discuss his or her comments and concerns as well as my comments and concerns. I then prepare a letter to the landlord or its leasing agent enclosing an Addendum to Lease Agreement (which modifies the standard lease to the terms my client wants) and requesting the title policy and exceptions as well as any other matter particular to the transaction.

You normally do not have the luxury of starting from scratch and having your attorney prepare the lease for submittal to the landlord since most landlords have their own standard (landlord-oriented) lease. However, if you are in a superior bargaining position or you are dealing with a new or small or unsophisticated landlord, you may be able to submit your form (tenant-oriented) lease.

#### **GLOSSARY OF LEASE TERMS**

Business leases contain many unique words and phrases readily understood by landlords, leasing agents and real estate attorneys. However, these words and phrases may not be part of the typical tenant's vocabulary. The following is a brief explanation of commonly used words and phrases (in alphabetical order) contained in business leases.

**"Abatement"** usually means the situation when the tenant does not have to pay rent for a period of time usually due to a fire or other casualty that renders all or a portion of the premises untenable (see **Damage by Fire or Other Casualty** below).

**"Acceleration"** usually means the right of the landlord to demand that all of the rent to be paid over the entire term of the lease (future rent) becomes immediately due and payable (not just the back rent) upon the tenant's default (see **Default by the Tenant** below).

**"Additional Rent"** usually means payments by the tenant to the landlord other than base rent such as for taxes, insurance, common area maintenance (CAM), repairs and maintenance, etc.

**"Appurtenances"** usually means a right to use something in addition to the premises that comes along with the lease of property like an easement, parking spaces, etc.

**"Anchor Store"** usually means a large department store, supermarket or other retailer which draws consumers to the center (see **Anchor Stores** below).

**"As-Is"** usually means that the landlord makes no promise to you as to the condition of the premises and any furnishings, fixtures and equipment in the premises at the time the tenant takes occupancy.

**"Assignment"** usually means the transfer of the tenant's interest under the lease to another person who becomes the tenant under the lease (see **Assignment and Subletting** below).

**"Attornment"** generally means to agree to become the tenant for a new owner of the property such as a new buyer of the property or the lender of the landlord if the lender forecloses on the landlord's interest in the property (see C.66 below).

**"Base Rent"** usually means the fixed minimum rent a tenant is required to pay.

**"Break Point" or "Break Even"** usually means the point where the percentage rent equals the base rent. For example, if the base rent is \$40,000 per year and the percentage rent is 4% of gross sales, the break point is \$1,000,000 of gross sales (see **Percentage Rent** below).

**"Center"** usually means all the land, buildings, other improvements and common areas including parking lots in which the premises is located and are a part.

**"Commencement Date"** usually means the date when rent begins (see **Commencement Date** below).

**"Common Areas"** means the parking areas, sidewalks, courts, malls, roof, streets, roadways, loading platforms, service areas, stairways, comfort stations, reflecting pools, lounges and shelters, staff offices and other facilities designated by the landlord from time to time for the nonexclusive use of the tenant and the other tenants in the center, their respective employees, agents, customers, licensees and invitees.

**"Common Area Maintenance (CAM)" or "Operating Charges"** usually means all costs and expenses of every kind and nature paid and incurred by the landlord in operating, managing, cleaning, protecting, equipping, lighting, repairing, replacing and maintaining walkways, corridors, public areas, common restrooms and meeting areas, vehicle parking areas, driveways, drainage facilities, traffic signals and other traffic control devices, heating, ventilating, air conditioning and other expenses in maintaining the common areas, including a management fee and/or administrative fee [see Operating (CAM) Costs below].

**"Condemnation"** usually means the taking of all or a portion of the property or property rights by a governmental unit for public purposes (for example, road widening) (see **Condemnation** below).

**"CPI"** usually means the Consumer Price Index published by the U.S. Department of Labor which measures inflation (see **Cost of Living Adjustment** below).

**"Curb Cut"** usually means a road improvement allowing for vehicles to enter and exit a parcel of property.

**"Default"** usually means a breach (violation) of the lease by a party (see **Default by the Landlord** and **Default by the Tenant** below).

**"Easement" or "Cross-Easement"** usually means the right of one property owner to be able to cross over another person's property. This is commonly entered into between 2 adjoining property owners so that they and their tenants and guests can travel over each other's property.

**"Egress"** usually means the ability to exit the property over a road and through a curb cut (see **Ingress and Egress** below).

**"Estoppel Certificate"** usually means a statement by the tenant or the landlord to a third party about the status of the lease (see **Estoppel Certificate** below).

**"Event of Default"** usually means a default which still exists after the giving of any required notice of default and the expiration of all applicable time (grace) periods in which to cure the default and, thereby, entitling the landlord to, possibly among other things, terminate the lease and evict the tenant (see **Default by the Landlord** and **Default by the Tenant** below).

**"Eviction"** usually means the process by which a tenant loses the right to continue to occupy the premises and must vacate (leave) the premises.

**"First Generation Space"** usually means premises in a new building never previously occupied by a tenant or the owner and in which no leasehold improvements have been made.

**"Force Majeure"** is a French term meaning superior or irresistible force. It usually means acts beyond the control of the parties such as earthquakes, floods, riots and other acts of God (see **Force Majeure** below).

**"Free Rent"** means the period in which the tenant does not have to pay rent, usually at the beginning of the lease term, when the tenant is building out the premises and is not yet open for business and earning revenue (see **Free Rent** below).

**"Generally Accepted Accounting Principles"** generally means those principles of accounting which fairly represent the financial position of the particular entity and which are employed by certified public accountants which principles have become, through their use, generally accepted by the accounting industry, including those principles set forth in the opinions and statements of the Accounting Principles Board, Accounting Research Bulletins, Statements of the International Accounting Standards Committee, Statements, Opinions, Interpretations and Technical Bulletins of the Financial Accounting Standards Board of the American Institute of Certified Public Accountants or other principles which have substantial authoritative support and are applicable in the circumstances as of the date of any report required in the lease or as of the date of an application of such principles as required in the lease.

**"Gross Leasable Area"** generally means the gross leasable area of the premises that is measured from the outside of the exterior walls or the center of any common walls, as the case may be,

without deduction for columns or other structural elements within the premises. This is usually the figure from which base rent on a "dollars per square foot per year" basis is calculated.

**"Gross Sales" or "Gross Revenues"** usually means the sales price of all merchandise sold and the charges for all services performed by the tenant or any other person, firm or corporation selling merchandise or performing services in, upon, and from any part of the premises, including rentals, mail or telephone orders received or filled at the premises, all deposits not refunded to purchasers and all merchandise sold or service performed for cash or for credit, regardless of collections or for any other consideration. Installment, credit or layaway sales are usually treated as a sale for the full price in the month in which such sale is made, regardless of when the tenant receives payment from its customer. Barter or "trade-outs" are usually included. No deduction is usually allowed for uncollected or uncollectible credit accounts or bank or credit card charges. Gross sales usually do not include: (a) sales or retail excise taxes imposed by and duly constituted government authority on sales collected by the tenant and paid to such authority; (b) exchanges of merchandise between the tenant's stores unless for the purpose of consummating a sale made in, upon or from the premises; (c) the sales price of goods delivered in exchange for goods returned to the tenant, or returned to the manufacturer, vendor or shipper; and (d) sales of fixtures outside the tenant's ordinary course of business that are not a part of the tenant's stock in trade (see **Percentage Rent** below).

**"Guaranty"** is the promise by a person to be responsible for the obligations of another. In leasing, it usually means the promise by a person other than the tenant (for example, a shareholder) to be responsible for the monetary and other obligations of the tenant (for example, a corporate tenant) to the landlord under the lease (see **Guaranty of the Tenant's Obligations** below).

**"Hazardous Substance"** usually means any substance which is toxic, ignitable, reactive, or corrosive and which is regulated by any local government, a state or the United States government. "Hazardous Substance" includes any and all material or substances, which are defined as "hazardous waste," "extremely hazardous waste," or a "hazardous substance," pursuant to state, federal or local governmental law. "Hazardous Substance" includes asbestos, polychlorobiphenyls ("PCB's") and petroleum (see **Hazardous Waste** below).

**"Holdover"** usually means the situation where the tenant continues to occupy the premises after the expiration of the lease without signing a new lease (see **Holdover Rent** below).

**"HVAC System"** usually means the heating, ventilating and air conditioning system (see **Services and Utilities** below).

**"Indemnification"** usually means a promise by one party to restore another party of a loss by payment of money, replacement or repair (see **Indemnification** below).

**"Ingress"** usually means the act or right of entering to obtain access to property usually over a road and through a curb cut (see **Ingress and Egress** below).

**"Key Money"** usually means a special up-front fee a landlord charges the tenant as a premium to lease the premises. Key money is common in Europe but not in the U.S. (see **Key Money** below).

**"Landlord"** usually means the owner of the real estate being leased. The owner is sometimes called the "lessor."

**"Landlord's Work"** usually means the work to be performed by the landlord to build out the premises (see **Leasehold Improvements** below).

**"Landlord's Lien"** usually means the right of the landlord, by statute or by a provision in the lease, to have a lien on the tenant's property located in the premises as security for the tenant's obligations under the lease, including the payment of rent (see **Landlord's Lien** below).

**"Landlord's Allowance"** or **"Landlord's Credit"** usually means a dollar allowance contribution or credit by the landlord towards the tenant's construction of leasehold improvements with the tenant being responsible for any excess costs.

**"Late Charge"** usually means a charge imposed by the landlord if the tenant pays the rent late (see **Late Charge** below).

**"Lease Term"** usually means the initial term and all renewal terms of the lease.

**"Lease Date"** usually means the date the lease is signed.

**"Leasehold Improvements"** usually means the construction of the interior of the premises, including walls, shelving, flooring, partitions, etc. (see **Leasehold Improvements** below).

**"Lien"** usually means a charge, security interest or other encumbrance on property.

**"Mechanics' Lien"** or **"Contractors' Lien"** usually means a lien on the premises filed by a contractor or supplier of materials who did work at the premises.

**"Merchant's Association"** usually means an association composed of all the tenants at the center who engage in collective advertising activities (see **Merchant's Association and Advertising** below).

**"Non-Recourse"** usually means that a person has no right to assert an otherwise valid claim against another (see **Non-Recourse Against the Landlord** below).

**"Percentage Rent"** usually means the rent paid by the tenant as a percentage of the tenant's gross sales (see **Percentage Rent** below).

**"Permitted Use"** usually means the specific use or purpose for which the tenant may use and occupy the premises (see **Use of the Premises** below).

**"Premises"** usually means the interior space rented by the tenant. It is sometimes also called the "leased premises" or the "demised premises."

**"Restrictive Covenant"** is a promise of the owner of the land to do or not to do something that binds the owner and all later purchasers of the property (for example, to use the land for a restaurant only).

**"Second Generation Space"** usually means premises in a building which were previously constructed with leasehold improvements and occupied by a prior tenant or tenants.

**"Security Deposit"** usually means the amount of money that the tenant must give the landlord in advance as security for the tenant's obligation to pay rent and maintain the premises (see **Security Deposit and Prepaid Rent** below).

**"Sublease"** usually means a transaction where the tenant leases all or a portion of the premises to another person while remaining the tenant under the lease with the landlord. In effect, the tenant becomes the subtenant's landlord.

**"Subordination"** usually means the process by which a persons' rights are ranked below (behind) the rights of others (see **Subordination, Non-Disturbance and Attornment** below).

**"Subrogation"** usually means the right to step into the shoes of another person to enforce a claim against a third party (see **Insurance by the Tenant** below).

**"Substantial Completion"** usually means the period when the center and/or the premises are complete enough for the landlord or tenant to obtain a certificate of occupancy from the local governmental body and allow the tenant to move in. There still may be additional repairs or improvements (for example, landscaping), which are required to totally complete the building or the premises.

**"Subtenant"** usually means the person who subleases from a tenant.

**"Tenant"** usually means the person receiving rights to use and occupy the premises. He, she it is sometimes called the "lessee."

**"Tenant's Work"** usually means the leasehold improvements which are the obligations of the tenant (see **Leasehold Improvements** below).

**"Turn Key"** usually means that the landlord completes the space in accordance with the landlord's build-out proposal and the tenant's plans usually at the expense of the landlord. This most often occurs with first generation space.

**"Untenantable"** usually means the circumstance whereby the tenant can no longer occupy or use the premises for its intended purposes (see **Damage by Fire or Other Casualty** below).

## **TYPICAL LEASE PROVISIONS**

While all leases are not identical, you should be aware of the following commonly included provisions (in alphabetical order) (some of which may not apply to you) and negotiate to protect your interest. Don't just rely on this Paper - get an attorney involved.

### **Abandonment of the Premises**

Most leases provide that if you abandon (vacate) all of a portion of the premises you are in default of the lease, even if the rent is current. Try to eliminate this and have the "right to go dark" provided you continue to pay the rent. This may not be realistic in a percentage rent situation.

### **Acceleration of Rent (Future Rent)**

Most leases contain language allowing the landlord to accelerate the total rent due for the remaining lease period following its premature termination due to the tenant's default, so that all the rent which would be paid over the life of the lease is now due. The best approach to this issue is to state to the landlord unequivocally that you do not sign leases containing acceleration language as any acceleration can prove to be costly to you and should be deleted. This approach may work if you are in a good bargaining position. At a minimum, change the acceleration language to limit the tenant's liability to either a present valuation of the total rent (for example, a present value discount of 8%) or the difference between the total rent due and the value of the rent that the landlord could anticipate receiving from a successor tenant. In addition, the landlord must agree to mitigate (minimize) its damages by using its best, or at minimum, reasonable efforts to relet the premises at comparable rents.

While some states require landlords to mitigate damages without the need for express language, you should insist upon incorporating this protective language. If a lease contains a liquidated damages clause (that is, a fixed dollar amount if you default), insist upon its deletion, unless it's reasonable.

### **"ADA" or "Americans with Disabilities Act"**

Most commercial premises must comply with the handicap construction requirements of the Americans with Disabilities Act (ADA) such as wheelchair ramps, wider hallways and doors, handicap bathrooms, etc. Make sure that the landlord warrants to the tenant that the building complies with the ADA. The landlord should also indemnify and hold the tenant harmless for any ADA violation not relating to the tenant's action.

### **Advertising**

In multi-tenant retail locations, such as malls and shopping centers, especially if percentage rent is charged, the landlord requires that the tenants, usually through a merchant's association collectively advertise their businesses and the mall or shopping center. If you are a franchisee, make sure your expenses for this type of advertising are credited against your local advertising obligation. (See **Merchant's Association and Advertising** below.)

## **Alterations and Improvements**

Most leases require that the landlord's permission is required, which may be withheld at the landlord's sole discretion, before the tenant can make any alterations or improvements to the premises. Try to reserve the right to make non-structural alterations or improvements to the premises subject to the landlord's reasonable requirements and approval, such as builder's risk insurance, no mechanics' liens, a qualified contractor, building permits and not changing the general character of the premises. Also provide that you can take these improvements with you at the end of the lease such as trade fixtures. If they have to stay, they become the landlord's property. Do allow the landlord to have the right to require you to return the premises to the way they were before the alterations or improvements were made.

## **Anchor Stores**

Where the premises are located in a newly constructed regional mall or a strip shopping center, determine the importance of a particular anchor store. In a brand new mall or shopping center, the anchor stores may provide a significant flow of customer traffic. Delayed openings of anchor stores might adversely affect your business initially. If this scenario could occur, negotiate a substantially reduced base rent, and eliminate the payment of percentage rent, if applicable. In the alternative, try to negotiate paying only a straight percentage rent, without a minimum, for the period from your opening until the opening of the anchor store or stores.

If the premises are located in an older center that has experienced a loss of tenants, then a reduced rent should be negotiated if one or more anchors close or if a significant percentage of non-anchor tenants go out of business and their premises remain unleased. If there are fewer operating stores, there will inevitably be fewer customers to patronize your business. Similarly, and somewhat contradictory, is the notion that if a lease contains a provision for increasing the base rent in the event additional anchor stores open during the lease term, attempt to have this provision deleted. Often new anchor stores are built onto outlying sections of a shopping center, and rarely benefit the smaller tenant who is not nearby with increased foot traffic. Therefore, there is no rationale for increasing your base rent.

## **Arbitration**

Due to the tremendous time and cost for all parties involved in going to court, many landlords are implementing arbitration in lieu of litigation. Arbitration is the non-judicial resolution of a dispute made by one or three individuals called arbitrators. The arbitrator's decision is usually final and binding on the parties and not appealable. There are private, independent organizations, like the American Arbitration Association, who provide arbitration services. However, arbitration is not perfect. In my experience, arbitration is not cheaper, faster or better. You are much better off with a jury of your peers, particularly as a tenant.

## **Assignment and Subletting**

Most leases prohibit a tenant from assigning the lease or subletting the premises to another person. A transfer of controlling interest in a corporate tenant (for example, a transfer of 50% or more of the voting stock) may also be considered an assignment. Sometimes this is an absolute prohibition, other times; the landlord's consent is required. Make sure you have the right to assign or sublease

with the landlord's consent, which consent cannot be unreasonably withheld or delayed (no more than 30 days) (see **Landlord's Consent or Approval** below) and specify reasonable conditions to such assignment or subletting which are fair to the landlord and with which you can live. You should try to provide that upon assignment, you are released for many further obligations under the lease. Otherwise, you end up being a guarantor of the assignee's obligations under the lease. In addition, negotiate to provide that the assignee may use the premises for any lawful purpose provided the use does not conflict with any exclusive use previously granted by the landlord to any other existing tenant in the building.

Your franchise agreement may require you to include a provision in your lease allowing an assignment to the franchise or another franchisee. If your franchise agreement requires this, make sure to include it in the lease (see **Triparty Agreement** below). In addition, if you anticipate that you will borrow money using your lease as additional collateral, you need to provide this in your lease so that you can collaterally assign the lease to your lender.

### **Assignment to Another Franchisee**

Notwithstanding the forgoing restrictions on assignment (see **Assignment and Subletting** above), if you are a franchisee, try to provide that the landlord will consent to your assignment of the lease to the franchisor or another franchisee having the financial strength and business experience equal to or greater than the tenant's. Make sure you also are released from future liability under the lease upon an approved assignment.

### **Attorneys' Fees**

Most landlord standard leases provide that you have to pay the landlord's attorneys' fees and costs if the landlord sues you. This one-sided provision is not fair and should be made reciprocal (mutual). Therefore, you should insist upon a prevailing party attorneys' fees provision whereby the successful party (either you or the landlord) in any suit concerning the lease or its interpretation would be entitled to the payment of its attorneys' fees and costs by the losing party. Alternatively, provide that each side pays their own attorneys' fees no matter what.

### **Audit by the Landlord**

Some leases provide, particularly if percentage rent is paid, that the landlord has the right to audit the books and records of the tenant. If no percentage rent is to be paid, have such a provision deleted, as it is unnecessary and intrusive. If the landlord retains the right to audit, make sure the lease provides that the expense is the landlord's (unless the audit reveals a material deficiency) and that the results of the audit remain confidential (see **Confidentiality of the Tenant's Records** below).

### **Audit of CAM**

Common Area Maintenance expenses are expenses incurred for the maintenance of the common areas of a building or center, including janitorial, electricity, insurance, security, management fees, maintenance and repairs. The tenants usually pay the expenses as additional rent to the landlord, in proportion to the amount of space they lease. There have been instances of abuse by landlords of these expenses and funds including payment of unrelated expenses, expenditures of a capital nature, excessive payments to the landlord or an affiliate for services or products, etc. Have the landlord agree

to have its accountants annually audit these expenses and send a copy of the audit to each tenant. In addition, provide that the tenant has the right to cause its agents to conduct an audit of these common area costs and that the landlord will cooperate with such audit.

### **Broker**

If neither you nor the landlord has retained a broker, state so in the lease. If you and/or the landlord used a broker, provide that the landlord pays the brokerage commission.

### **Casualty Repairs**

Most leases provide that upon a casualty to the premises, the landlord is required to repair the premises solely from any insurance proceeds. The tenant continues to remain obligated under the lease no matter how long it takes the landlord to repair the premises. There should be some language requiring the landlord and its lender to use any insurance proceeds to repair or rebuild the premises or the common areas unless a substantial portion (for example, 50% or more) has been damaged or destroyed. The landlord's mortgage should be reviewed to make sure the lender cannot take the insurance proceeds and apply it against the loan rather than give it to the landlord to rebuild the building. To the extent that the premises or a substantial portion of the building or shopping center is damaged by fire or other casualty, the landlord should agree to a proportionate abatement (stopping) of rent and Common Area Maintenance (CAM) charges. The abatement should continue until the premises or common areas have been rebuilt or repaired and you are operational again (see **Proportionate Abatement of Rent** below). Provide that if the casualty causes the tenant to lose all or a portion of the use of the premises, that rent will abate (stop) or be reduced in proportion to the reduction in useable space. Repairing or rebuilding should be completed in a timely fashion. Also provide that the repairs must be completed within 6 months of the occurrence. If the repairs cannot or are not completed within this period, the tenant may terminate the lease.

### **Commencement Date**

If the premises is not ready for occupancy (such as if the building or a shopping center is in the initial stages of construction) or the existing tenant doesn't vacate on time, you will want to provide that, if the landlord fails to deliver the premises to you by a date certain (the "drop dead" date), you can elect to terminate the lease, get any deposit back and go somewhere else. Alternatively, provide for a liquidated damages provision (see **Liquidated Damages** below). Furthermore, you should provide that, notwithstanding your entry into possession of the premises, rent does not begin until a certain anchor tenant opens for business or until tenants occupy a certain percentage of the building or shopping center (see **Anchor Tenants** above). Try to negotiate a delay in paying rent for 60-90 days while any tenant improvements are being made.

### **Condemnation**

Although the taking by the state or other government unit of the premises or a substantial portion of a building or shopping center seems unlikely, new highways or wider roads have a way of eliminating the theory that condemnation is merely an academic exercise. You should assure that you retain your rights to all damages that may be awarded a tenant in the event of a condemnation of the building or shopping center or the premises. You may end up negotiating with the landlord with respect to who retains the award for the value of the leasehold in the event of a short-term lease.

However, you should not negotiate with the landlord regarding you relocation or loss of business damages or costs of a similar nature that directly impact upon your business and that you may have a right to recover from the condemning authority.

### **Condition of the Premises**

Most leases provide for the tenant to accept the premises “as is.” The landlord makes no warranty as to the condition of the premises or of any personal property or fixtures in the premises. Make sure you thoroughly inspect the premises before signing the lease. You may want to hire a building inspector and get a report. You may want to submit to the landlord an inspection report or “punch list” of items that need repair before you take occupancy. If equipment is being included, it should be in good working order at the time you take possession. Have the landlord warrant that the premises comply with all applicable building codes, including the Americans with Disabilities Act (for example, handicapped-accessible bathrooms).

### **Confidentiality of the Tenant’s Records**

A landlord may have your personal and corporate tax returns, sales information, reports and other important and sensitive information you want to keep confidential. Make sure to have the landlord agree to keep all your records and information confidential.

### **Consent or Approval of Landlord**

There will be several provisions in the lease where you agree that the consent or approval of the landlord is required for you to do or not to do something. Sometimes the lease specifically provides that the landlord may arbitrarily refuse to consent. This may hamstring you in some way. Have the lease provide that whenever the consent or approval of the landlord is specifically required under the lease, such consent or approval will not be unreasonable withheld, delayed (more than 30 days) or conditioned. When the consent or approval of a governmental body is required, provide that the landlord agrees to automatically consent or approve the action upon the governmental body’s consent or approval.

### **Contingencies**

Once you sign the lease you become obligated to the landlord. If there is some contingency such as suitable financing, rezoning or the purchase of a franchise for you to go forward with the lease, these contingencies need to be set forth in the lease or addendum, so that if the contingency does not occur, you can back out of the lease. If you require financing to build out the premises or otherwise to operate the business, you need to negotiate a financing contingency which provides that if you cannot obtain your necessary financing you can terminate the lease and get back any money you previously paid the landlord. If the property is presently not zoned for you intended use (see **Zoning** below), you need to provide that if you are unable to obtain rezoning or a variance, or if you cannot obtain a building permit, you can terminate the lease and get back any money you paid the landlord. If you intend to buy a franchise, you need to provide that if you are unable to obtain the franchise, you can terminate the lease and get any money you paid to the landlord.

### **Cost of Living Adjustment**

Since a lease can be a long-term contract, a fixed rent for the entire term is rarely given. Many leases provide for an increase in base rent based on increases in a Consumer Price Index [for example, Consumer Price Index-Urban (CPI-U) (1982-84 = 100)] to reflect increased costs in operating a building. Try to negotiate a period of time (3 to 5 years) before the first increase. Try to negotiate a ceiling (cap) on an increase but be prepared to give the landlord a floor on a decrease.

### **Covenant of Quiet Enjoyment**

Please make sure that the lease contains a covenant of quiet enjoyment whereby the landlord promises you that your rights under the lease will not be disturbed (that is, your lease canceled or you're joined in the landlord's foreclosure action) by anyone claiming by or through the landlord such as from mortgagors, mechanics' lienors, etc. Don't just rely on this covenant; you may also need a nondisturbance agreement. (See **Subordination, Nondisturbance and Attornment** below).

### **Cure Period**

If you become in default under the lease, provide that the landlord must give you written notice explaining the nature of the default and what steps you must take to cure the default. You should be given a reasonable time to cure the default preferably 30 days or if the nature of the default is such that it can not be reasonably cured within such 30-day period, such longer period of time as is necessary to cure the default provided reasonable efforts are undertaken to cure the default within such 30-day period.

### **Default by the Landlord**

Most landlords are so arrogant that their leases don't address the possibility of default under the lease by the landlord. That's because the landlord's attorney drafted the lease! The lease should be amended to add that if the landlord is in default of its obligations to the tenant under the lease, the tenant will give the landlord 30 days' written notice of the default describing the nature of the default. If the landlord fails to cure the default with the 30-day period, the tenant may terminate the lease and/or remedy the default itself and offset the cost against the rent due the landlord and/or sue for specific performance and/or sue for damages.

### **Default by the Tenant**

A lease will usually contain a laundry list of ways you can default under the lease. I call them the "50 ways to leave your lover" provisions. A minimum of 10 days should be granted before the late payment of rent and other charges is deemed a default. All other obligations should have a minimum 30-day period (preferably longer if the default is such that it cannot be reasonably cured within 30 days provided you start and diligently work to cure within the 30-day period) after written notice detailing the nature of the default and what steps should be taken to cure the default, before a failure to perform is considered to be an event of default under the lease. (see **Cure Period** above). With respect to bankruptcy or insolvency proceedings, the timeframe for dismissing, discontinuing or vacating the proceeding should involve a minimum of 90 days.

## **Description and Size of the Premises**

Make certain that the lease contains a clear and unambiguous description of the demised premises. The size of the premises should be at least the net leasable square feet exclusive of common areas required by, and compatible with, the franchisor's basic floor plan. Verify the figures such as square footage and percentage of building contained in the lease. Landlords and their staffs often make errors.

## **Entire Agreement**

Most leases have a provision near the end of the lease, usually in the "Miscellaneous" or "General" article, which provides that the lease represents the entire agreement between the landlord and the tenant. This is legally referred to as an "integration" or "merger" provision. Any oral representations, promises, understandings by the landlord or its leasing representatives which are not specifically included, in writing, in the lease may not be enforceable or binding on the landlord. This is why it is critical that any promises by the landlord or its agents, which are important to you and are reasons why you have decided to enter in the lease, must be included in the lease or the addendum. Make sure everything is in "black and white."

## **Estoppel Certificate**

An estoppel certificate is a letter from a tenant or a landlord to a third party confirming certain details about the lease such as the term of the lease, amount of rent including prepaid rent, amount of security deposit, whether any default exists, etc. Once you send out an estoppel letter, you are estopped (prevented) from saying the information you put in the letter was wrong. Lenders and prospective purchasers of the property may require estoppel letters from the landlord's tenants before they lend money or buy the property. A person assuming a tenant's interest in a lease as part of buying the business may require an estoppel letter from the landlord. Make the obligation to give an estoppel letter mutual, that is, you agree to give one to the landlord and the landlord agrees to give one to you, upon reasonable request. You should not agree to appoint the landlord as your attorney-in-fact for purposes of executing estoppel certificates or other confirmatory documentation.

## **Exclusivity**

In certain instances, you can and should negotiate exclusivity for the sale of your products and/or services. You don't want a competitor next door or in the same center. In street locations and in strip center malls, a landlord will generally agree to an exclusivity if the same landlord owns other buildings or strip centers in close proximity to the building or shopping center in which the premises will be located. Although it is more difficult to convince a major mall developer to grant exclusivity, it may be possible to limit the number and location of competitors within the mall protect the franchisor's and your integrity and viability.

## **Expansion Rights**

You may want to consider negotiating an option for adjacent space or a right of first refusal for adjacent space to give you flexibility in expanding next door. While you may not be able to get an option, a right of first refusal is not uncommon. In this event, when the landlord finds a prospective tenant for the space, you will have a short period of time (for example, 10 to 30 days) to elect to take

over the space. If you fail to do elect at that time, the landlord is free to lease the space to the third party.

### **Free Rent**

Try to negotiate a period of free rent, particularly if there is a period where you are under construction and not open for business.

### **Force Majeure**

If a force provision does not appear in the lease, suggest that this language be added to protect the interests of both parties. If the provision is solely in favor of the landlord, insist that it be made mutual so you also get the benefit of it. Who knows when a fire, flood, earthquake, hurricane, riot, bombing, etc. may occur?

### **Grace Period**

Make sure you are given written notice of any default and have a period of time in which to cure, preferable 30 days. In addition, add "or if the nature of the default is such that it can not be reasonably cured within such 30-day period, such longer period of time as is necessary to cure the default provided reasonable efforts are undertaken to cure the default within such 30-day period.

### **Guaranty of the Tenant's Obligations**

Try to have the tenant be your corporation and not you personally. Try to negotiate out your personal guarantee. The landlord is usually a corporation with no personal guarantees (see **Non-Recourse Against the Landlord** below). Your ability to do this may depend on the financial strength of the corporation. If a personal guarantee is required, try to limit it to the first year or two of the lease. Don't have your spouse also sign the guarantee. This will expose most of your joint personal assets.

### **Hazardous Substances**

Under federal and state environmental laws you may have liability for hazardous wastes including hazardous wastes that existed on the property before you take occupancy. You may want to consider having an environmental audit conducted by an environmental inspection firm to know what you're getting into. You should insist upon the indemnification by the landlord for any existing hazardous condition at the time of delivery of the premises or for any hazardous substances that might be brought into or onto the premises, during the term of the lease, by the landlord, its agents, employees or contractors. You may be required to make similar representation.

### **Holdover Rent**

If the lease contains a provision stating that the rent during any hold over period, the holdover rent should be limited to 100%-150% of the base rent only, as opposed to 200% or even 300% that some leases provide.

### **Hours of Operation**

Make sure that the building or shopping center, particularly the common areas, stairways and elevators important for your traffic, are opened at all hours you're open. Get a representation by the landlord as to hours of operation under the lease are consistent with your franchise agreement. Make sure the parking areas remain lighted at least until you close.

### **Indemnification**

Generally, this language is drafted in a completely one-sided fashion. The tenant fully indemnifies the landlord for all liability of any form or fashion. At a minimum, the landlord must indemnify you and your agents, employees and contractors from any action or inaction on the part of the landlord, its agents, employees, or contractors based on negligence or a willful act that results in a claim, suit, demand or judgment for liability including hazardous waste.

### **Independent Contractor**

There will be a provision in the lease providing that the tenant is not the agent, employee, partner or joint venturer of the landlord but is an independent contractor. This is beneficial for both parties. However, make sure it also provides that the landlord is not an agent of the tenant, as well.

### **Independent Covenants**

In contract law, covenants, promises or agreements made by one party are usually dependent upon the other party honoring its covenants, promises or agreements. If one party fails to honor its covenants, promises or agreements, the other party is excused from its obligations to perform under the agreement. The covenants are considered "dependent." However, if the contract specifically provides that a covenant, promise or agreement is independent of the other party's performance, and can be enforced even if the other party is in default under the contract, the promise is considered to be an "independent" covenant.

The typical lease provides that the tenant must continue to pay rent even if the landlord is in default. The tenant's promise to pay rent is an independent covenant. Try to have this changed but it is difficult. Therefore, if you have a dispute with the landlord, you must keep paying rent and you must file a separate lawsuit.

### **Ingress and Egress**

Look at the site plan of the building or shopping center. Can your customers get to you easily? Where are the curb cuts? Do you have or need an easement over another portion of the property or someone else's property to get to the main highway? Get the landlord's assurances, in writing, and backed up by appropriate documentation, such as a reciprocal easement agreement.

### **Insurance by the Landlord**

If the tenant is multi-tenant or you have a gross lease, make sure the lease provides that the landlord maintains adequate property and casualty insurance. Have the landlord provide you with copies of its insurance policies.

### **Insurance by the Tenant**

The lease will contain a provision regarding insurance requiring you to maintain certain insurance throughout the term of the lease for your and the landlord's benefit. This insurance is separate and apart from, and may be different in types of coverage, amount of coverage, deductibles, etc. Fax this provision to your insurance agent. An agent needs to review this provision to determine what types of insurance are required, amount of coverages, deductibles, etc. Have your agent determine if the requested insurance is reasonable and necessary for your business and how much it's going to cost you annually. For example, some leases require business interruption insurance, which is expensive and may not be obtainable for a start-up. Your agent must also deliver a certificate of insurance to the landlord naming the landlord as an additional insured and/or loss payee (depending on the type of insurance) and provide 10 - 30 days' prior written notice of a change or cancellation of the insurance.

### **Injunctive Relief**

To prevent harm, which cannot be undone and for which monetary damages are inadequate ("irreparable harm"), a person may want a court to issue an injunction enjoining a person from doing something ("injunctive relief"). Even if arbitration is required (see **Arbitration** above), the lease will typically provide that the landlord can go to court to obtain injunctive relief against the tenant. There may be circumstances where the tenant may want to enjoin the landlord, such as enjoining it from terminating the lease and dispossessing the tenant when the grounds for termination are in dispute. Therefore, this provision usually has to be revised to be made mutual, so that the tenant has these remedies as well.

### **Insolvency of the Tenant**

During the course of operating many small business there may come a time due to poor cash flow that you become technically "insolvent," that is, your business liabilities exceed your business assets and you are unable to pay all of your bills as they become due. It is entirely different than when you file an insolvency proceeding. You just have to work your way out of the problem.

The typical lease provides that if the tenant becomes insolvent, this constitutes an automatic, non-curable event of default and your lease is terminated. If the lease is terminated before you are able to seek some sort of bankruptcy protection, the lease is not considered to be part of your bankruptcy estate and you may lose flexibility in being able to accept or reject the lease as an executory contract.

Therefore, ask that the language "shall become insolvent" be changed to "shall be judicially declared insolvent." There may come the situation where you desire to reorganize under Paper 11 and reject (terminate) your lease.

### **Key Money**

If the lease calls for key money, request that payments be made over a 2- or 3-year period, either in lump sums on the anniversary dates of the lease or in equal monthly installments. Never agree to pay interest on this contribution. If key money is paid, be certain that such key money can be recouped upon the assignment of the lease to another tenant. Be aware that some developers are demanding and receiving capital contributions of \$50,000 and as much as \$100,000. These payments amount to blackmail to secure the most strategic locations in a shopping center. The payment of these large sums may jeopardize the viability of your business.

### **Landlord's Contractor**

If the lease requires you to use the landlord's contractor, provide that the contractor will charge reasonable fees customary for the locality. It would be better to have several approved contractors so you can get competitive bids. Make sure your franchisor approves the contractor.

### **Landlord's Lien**

The landlord should not be granted any security interest in, or lien on, the leasehold improvements and equipment owned by you, if this can be negotiated into the lease. Many state laws grant the landlord a statutory lien on the tenant's personal property located in the premises as security for the tenant's obligations. At a minimum, the landlord must agree to subordinate its security interest or lien in such improvements and equipment to the entity or entities that have provided or will provide you financing. Certain landlords try to insist that such subordination be limited to the initial financing of the business, but this sharply limits your ability to obtain subsequent financing to refurbish or expand the business operations.

### **Landlord's Maintenance Obligations**

You should obtain a general obligation of the landlord to keep the common areas of the building or shopping center, including the painting of the building or shopping center, maintenance of the landscaping, parking areas and walkways up to a specified standard, such as "first class," or "in a good condition consistent with commercial retail developments of like nature." As you will be paying for the upkeep of these areas, you should have a voice to the extent of which your money is used for this purpose.

### **Landlord's Right of Access**

Most leases provide that the landlord has the right to enter your premises at any time without prior notice to you to make repairs, inspections and to show the space to prospective tenants or buyers. This can become disruptive to you and your business. Limit the landlord's right of access during normal business hours and upon reasonable notice (except for emergencies) so as not to disrupt your operations. You should limit, however, the landlord's right to display any "For Rent" signs at the premises during the final 3 to 6 months of the lease term. This practice - particularly in strip center and on-street locations - can affect adversely your business during the final months of occupancy. If the landlord maintains an easement for pipes, cables, wires and the like, you must ensure that you retain sufficient ceiling heights to meet the needs of your equipment and leasehold improvements.

### **Late Charges**

Most leases provide that if you are late (usually after a period of time) in paying the rent, a late charge will be imposed on top of the rent. The late charge can be very small or very large. The time period can begin immediately or up to a grace period of 10 days. Try to include a 5 - 10 day grace period before a late charge is imposed. Try to negotiate out a percentage charge (for example, 5%) or a fixed fee (for example, \$100.00), which can be excessive, in favor of an interest charge.

### **Leasehold Improvements**

You should closely scrutinize the provisions relating to your obligations and the landlord's obligations with respect to the construction of leasehold improvements. Be very specific as to the scope of landlord's work and the scope of your work. A detailed work letter should be signed. In an overbuilt real estate market, you should require the landlord to contribute towards your costs or for the landlord to obtain a loan on your behalf for the improvements. With respect to improvements by the landlord, you should demand an outside date when such improvements will be completed (a "drop-dead" date) and, if not completed by that time, you should have the right to either terminate the lease or impose certain penalties such as a per diem charge against the landlord.

Any provision within the lease whereby you are deemed to accept the condition of the premises upon your occupancy thereof should be subject to the completion and correction of punch list items and latent defects. As mentioned in **Commencement Date** above, negotiate not paying rent until the leasehold improvements are completed. Also, make sure the landlord agrees to review and approve your plans and specifications promptly and not unreasonably withhold or delay in giving its consent. Be certain to incorporate language that delays in the landlord's construction and delivery of possession automatically extends the period of time within which you must complete your leasehold improvements.

### **Leasehold Title Insurance Policy**

In addition to a landlord's warranty of title (see **Other Covenants of the Landlord** below) and covenant of quiet enjoyment (see **Covenant of Quiet Enjoyment** above), if the lease is for a long period of time and for a significant rental, you may want to consider obtaining a leasehold title insurance policy insuring your interest under the lease, and perhaps requiring the landlord to supply this at its expense. If the leasehold is to be mortgaged, the tenant's lender will probably require a leasehold mortgagee title insurance policy.

### **Limitation of the Tenant's Liability**

The lease normally places no limits on the tenant's liability but places limits on the landlord's liability (see **Nonrecourse Against the Landlord** below). Try to negotiate that the maximum liability that the tenant may have against the landlord is limited in some manner such as a letter of credit or prepaid rent and security deposit.

### **Liquidated Damages**

You may want to consider providing that, if the landlord fails to deliver the premises to the tenant by a certain date, the landlord will pay to the tenant liquidated damages (such as \$500 per day) for each day after the promises delivery date.

### **Maintenance and Repair**

You should specify who has what obligations for maintenance and repair. Try to have the landlord responsible for the structural elements and common areas (see **Landlord's Maintenance Obligations** above).

### **Merchant's Association and Advertising**

You should determine the extent to which you have to contribute to any merchant's association and should weigh this against the benefit to be derived from the association. If the association is inactive you may wish to resist joining, unless you are placed on the governing board of the association. Any required contributions for advertising charges should be reviewed as far as the individual benefit you will derive from such advertising. You may consider negotiating a set off against such required sums for your individual advertising that uses the center's name. The larger the mall, the greater the amount that a tenant will be required to contribute for the merchant's fund, seasonal advertising circulars and print advertising. Often there is an initial grand opening advertising charge for new or newly renovated shopping centers. These advertising contributions can be unreasonably expensive, particularly for a tenant operating a smaller store (1,000 square feet of space or less). If you have to make a minimum contribution that exceeds the reasonable square footage basis, tie the contribution to the actual size of the premises. Try to negotiate a cap on annual increases for the merchant's fund and other advertising contributions.

If the franchisor requires you to contribute to the franchisor's regional or national franchise advertising program, have the landlord remove any obligation to expend monies on local advertising or to participate in seasonal advertising circulars. Generally, the landlord will acknowledge that the advertising contributions to the franchisor fulfill the landlord-directed obligations on the part of the tenant to advertise.

### **"Most Favored Tenant" Clause**

A "most favored tenant" clause is a provision where the landlord agrees that you will pay lower rent (usually on a per square foot per year basis) if another tenant in the building is charged a lower rent. This allows you to get the benefit if rents fall after you sign the lease. This is a difficult provision to get. You must be in a superior bargaining position with the landlord.

### **Name of the Tenant**

Most landlords ask that you, and possibly your spouse if married, sign the lease personally. This means that your personal assets are at risk as to the monetary obligations of the tenant to the landlord. The franchisee should be a corporation or other business entity and not you personally. You will note that there are no personal guarantees on the landlord's side. In fact, its liability is limited to any equity in the property. (See **Non-Recourse Against the Landlord** below).

### **New Lease Agreement by the Buyer**

It is better to have your buyer assume your lease rather than sign a new (and usually different and more onerous) lease.

### **Non-Recourse Against Landlord**

Many newer leases include a provision that the tenant's recourse against the landlord (that is, a claim for damages against the landlord) is limited to the landlord's equity in the building or center and the landlord is not personally liable for its obligations. If the building or shopping center is mortgaged, there may be little or no equity and you're out of luck. I suspect a lawyer for a bank thought this up. Try your best to negotiate this out or at least exclude the landlord's willful acts or negligence from the non-recourse provision. You should also cite this provision in trying to negotiate out any guarantee of the tenant's obligation (see **Guaranty of the Tenant's Obligations** above).

### **Notice of Inspection**

It is best to provide that the landlord will give reasonable notice to the tenant before exercising its right of entry and use, except for emergencies.

### **Notice to Renew**

The landlord should give first notice to you of the end of the term and your right to renew to prevent your inadvertent oversight.

### **Notices**

Your franchise agreement may provide that dual and contemporaneous notices from the landlord should be sent to both the franchisor and to you at the premises (see **Triparty Agreement** below). If (receipted) hand delivery constitutes notice to the tenant, then (receipted) hand delivery should constitute notice to the landlord. In addition, the notice provision should also include "receipted overnight delivery" as an acceptable means of delivering notice.

### **Operating (CAM) Costs**

In regional mall locations in particular, tenant contributions towards operating costs or CAM charges are often more costly than the base rent itself. In addition, tenants located in food courts are assessed additional food CAM's. Try to negotiate a cap on these contributions either by basing the figure as a percentage of your gross revenues or by establishing a base figure for year one of the lease and limiting increases to a set percent of the CPI. If the CPI is utilized, then remember the days of double-digit inflation and cap the CPI increase (see **Cost of Living Adjustment** above). Scrutinize the description of items that comprise the CAM's. Require that the landlord delete those items, which are not expenses but rather are capital expenditures, such as replacement (or new construction) of roofs, buildings, parking lots and common areas, major equipment and mechanical systems. These costs should be amortized (deducted) based on their useful life and not totally expended during a single year. Try to negotiate for non-contribution to any significant common area refurbishment or major

capital improvement costs during the final year of the lease term as you will derive little benefit from these capital costs.

Negotiate a reasonable cap on administrative or management fees, particularly if the management company is affiliated with the landlord. Be suspect when the management company is an affiliate of the landlord. Make sure the management fee is reasonable and is not coupled with an administrative fee (disguised rent).

Your proportionate share, which is used to determine the amount of total operating costs that you will pay should be based upon the proportion of the area, you lease to the total leasable areas in the entire building or center rather than only the areas actually leased from time to time within the center. This way, the landlord is responsible for operating costs with respect to unleased premises. You should also determine whether the center is fully built-out, and if not, you should consider some type of provision whereby you will not be adversely affected whether by virtue of increased operating costs, or otherwise, in the event of additional buildout of the center.

An annual accounting should be given to all tenants incorporating the computation of CAM's and the disbursement of tenant contributions. You should also have the right to review the landlord's books and records concerning the shopping center to determine the accuracy of the operating costs.

### **Option to Purchase**

If you want the right to purchase the building at a specified price at or for some specified time, negotiate an option to purchase the property. This should be a separate legal contract and be recorded in the real estate records.

### **Option to Renew**

Renewal provisions of the lease should be consistent with the renewal provisions under the franchise agreement. Make sure your right to renew is on the same terms contained in the lease except perhaps for a change in rent.

### **Other Covenants of Landlord**

You should obtain other covenants from the landlord such as:

(a) a covenant that your permitted use under the lease is permissible under all zoning and other governmental regulations applicable to the premises (see **Zoning** below); and

(b) a covenant of title with regard to the property on which the premises is located (see **Leasehold Title Insurance Policy** above).

### **Parking**

What are the parking arrangements? For your employees? For your customers? The parking rights of other tenants? Do you have exclusive parking spaces? Are there covered or underground parking spaces? Is there a monthly fee associated with any exclusive parking spaces? Is the parking

area adequately lighted? What are the hours that the parking areas are lighted? What about handicapped parking? You need to really button these issues down in writing.

### **Percentage Rent**

Verify the percentage rent (rent or additional rent based on a percentage of your gross sales) and break point figures. Make sure that the language regarding when percentage rent is paid is clear. Some leases contain language that could be construed to require payment of percentage rent from the first dollar earned, rather than above the break point figure. Make sure you agree on the landlord's definition of "gross sales." It may be different than the definition contained in your franchise agreement. If percentage rent is collected, be certain that the definition of gross sales is limited to sales made from the premises and that it does not include sales from other locations. If no percentage rent is collected, then gross sales need not be reported to the landlord.

If the lease contains language requiring an audit or preparation and certification of an annual financial statement by an independent certified public accountant, require instead that you certify the accuracy of the statement so as to save you accounting fees. If reports of gross sales are to be submitted by you to the landlord, then add a provision by which the landlord agrees to maintain you sales figures in confidence, except in connection with financing, the sale of the shopping center, tax proceedings and other legal requirements. Landlords can be quite free about sharing their tenants' confidential sales figures.

### **Plans and Specifications**

Require that the landlord agree to review promptly your plans and specifications and not to withhold or delay its approval unreasonably. It is also advisable to include an acknowledgement by the landlord that you are part of a national franchise system and its design and trade dress including the signage and colors are in accordance with a prescribed design program.

### **Proportionate Abatement of Rent**

The rent should be abated during the period that the premises remain untenable due to damage or destruction (see **Casualty Repairs** above).

### **Punitive Damages**

Punitive (exemplary) damages are special damages awarded by a court of jury as additional punishment beyond actual damages sustained by the other for a serious wrong. Generally, the claim has to be in the nature of a tort claim rather than a breach of contract claim unless a statute provides otherwise. Some leases limit the ability of the parties to sue each other for punitive damages. Most punitive damage awards are against the landlord and in favor of the tenant. You should not waive your right to obtain punitive damages against the franchisor if its actions warrant.

### **Radius Restriction**

Radius restriction language prohibiting a tenant from operating another unit within a defined radius of the shopping center can be unduly limiting if you are an area developer and have a right to open additional franchises in the area. Unfortunately, this issue is among the most difficult to negotiate

with landlords who insist on outlandish limitations of 5 miles or more, particularly if percentage rent is involved. The long-term potential for, and your obligation to open, additional franchise sites must be factored into the distances to which you agree. In some parts of the country experiencing tremendous population growth, a radius restriction of a mile or more can prohibit rapid growth in concentrated areas. A restaurant in a regional mall food court may not be in competition with a freestanding unit in an out parcel. The penalty for a violation of the radius restriction can include injunctive relief and the payment of percentage rent on all sales made at the secondary location.

### **Real Estate Taxes**

A tenant should only pay taxes for that portion which its own premises represents to the total leasable square footage of the shopping center or building. Make sure the total leasable square footage figure includes the landlord's unleased spaces. Unless they are taxed separately, anchor stores or stores with greater bargaining power should not have their square footage deducted from the equation. Be certain that if the taxes are paid on increases assessed after the commencement date that the base year and month for determining tax escalation should coincide with the commencement of the lease.

### **Reports and Records**

If your lease does not provide for percentage rent (see **Percentage Rent** above) then a provision requiring you to give the landlord financial reports and records should be deleted as unnecessary. If the landlord insists on your financial reports and records, make sure the lease provides that the landlord will keep this information confidential (see **Confidentiality of the Tenant's Records** above).

### **Release of the Tenant upon Assignment**

Upon a permitted assignment or other transfer of this Lease by the Tenant, the Tenant will be released from any further obligation under the Lease except those provisions that survive the transfer or termination of the Lease.

### **Release on Sale by Landlord**

Most leases provide that upon the sale of the property by the landlord, the landlord is release from all future obligations to the tenant under the lease. You may want to clarify that the landlord is still liable for all matter occurring before the transfer.

### **Relocation**

In the shopping center context, the landlord often inserts a provision granting the landlord the right to relocate a tenant to other areas within the shopping center. As this may drastically impact upon pedestrian traffic, visibility from the highway and proximity to undesirable tenant uses, you should steadfastly refuse to have such a provision in the lease, even if the landlord promises compensation for unamortized leasehold improvements, moving and design expenses and comparable rent, as the new location may not be as strategically placed or desirable and sales will suffer in the long run.

### **Renewal (No Default)**

Many leases provide as a condition to the landlord's consent to renew that you "shall have substantially complied with all the terms and provisions of the lease during the term." Technically, with this type of language, if you have ever been in default during the term (even if timely and properly cured!), you could lose your right to renew. The unfair of this provision is obvious. You should only have to be not in default at the time of renewal. Therefore, this provision needs to be deleted.

### **Renewal Fee**

The renewal fee should be minimal to reimburse the franchisor for its costs to renew. There are no sales commissions or renovations to incur.

### **Renewal Lease Agreement**

The renewal lease agreement should not be materially different from the lease without the tenant's consent except for the fair market value of the rent.

### **Repeated Cured Defaults**

Sometimes there is a default provision in the lease that provides that the landlord can terminate the lease if the tenant defaults 2, 3 or more times in any 12-month period, even if each default is timely and properly cured. While a landlord may not want to continue to deal with a recalcitrant tenant – a cure is a cure. The landlord's remedy should be reimbursement of any costs it sustains due to the tenant's default; the "nuclear bomb" of termination and eviction should not be available.

### **Right of First Refusal**

If you cannot negotiate an option to purchase (see **Option to Purchase** above), the landlord may agree to a right of first refusal. A right of first refusal is a right to match an offer made by a third party when the offer is made. A problem is that you don't know what the price will be and when the offer will be made. You'll probably have only 10 - 30 days to make up your mind. If you don't exercise then, your right is gone. This can be in the lease or in a separate legal contract. Notice of the existence of the right of first refusal should be recorded in the real estate records.

### **Right of Set Off Against Rent**

Although this provision is extremely difficult to get as most leases specifically provide that the tenant's obligations to pay rent is independent of any obligation of the landlord, you should try to negotiate for an optional ability to perform the obligations of the landlord under the lease especially the landlord's repair and maintenance obligations upon the landlord's failure or refusal to perform and to set off any such sums expended against the rental or other monetary obligations under the lease. In many instances this will be your only sufficient remedy in the event the landlord fails to perform. The landlord should be offered reasonable notice and an opportunity to cure prior to your being able to exercise such right.

## **Rules and Regulations**

You should review closely the rules and regulations of the building or shopping center before you sign the lease, or in the event such rules have yet to be adopted but are referenced within the lease, you should require their preparation and possibly assist in drafting them prior to signing the lease. You should insist that all rules and regulations be reasonable, non-discriminatory and uniformly enforced and applied against all tenants and the landlord, as well.

## **Sales Tax**

Determine if sales tax is due on the rent and who pays (usually the tenant). For instance, Florida charges a 6% sales tax on commercial rents.

## **Security Deposit and Prepaid Rent**

Many landlords want 2 months' base rent paid in advance plus a security deposit usually equal to one months' base rent. Do not pay any more than this (the landlord's lender probably prohibits any more than this in the mortgage documents). Try to negotiate out the security deposit or the extra months' rent. Alternatively, have the security deposit placed in a separate interest-bearing account for your benefit and/or have the security deposit returned in a year after faithful performance on your part.

## **Security Services**

You need to determine what security services, if any, are provided by the landlord.

## **Services and Utilities**

Verify what utilities are available and if they are sufficient for your particular needs. Do hook-ups need to be provided? If yes, who pays for the hook-ups? Are there any utility impact fees? If so, how much? and who pays? Who pays for the cost of utilities? What about janitorial services? What about pest control? If possible, separate electric and water meters should be installed in the premises to track your actual use. This method is preferable to payment for utilities based on square footage, a method utilized by many landlords. You should also be careful that payment for electrical service is not based upon the landlord's perceived estimate of your use. This type of clause often refers back to your plans. In essence, the landlord calculates the tenant's use based upon 24 hours per day, 7 days per week of the tenant's installed HVAC and equipment, figured on 100% capacity. The net result of such a provision is that your electric charges can be significantly higher than is warranted by your actual usage. The HVAC language must also be scrutinized in conjunction with your architect. Regional malls generally provide access to a universal HVAC system, but may limit the amount of service. For food court tenants with heat generating equipment, such as ovens, grills and/or refrigeration equipment, an increase in the level of service that the landlord provides should be negotiated into the lease. In strip centers, you may be required to install your own HVAC equipment or additional HVAC equipment onto the roof. You should negotiate access onto and the ability to make cuts into the roof, without need of the landlord's consent.

With respect to electrical service, become familiar with your needs. Negotiate increased service to the premises at the landlord's expense, and always require the landlord to bring all utilities -

electric, telephone, gas - into the premises. Landlords often provide that the tenant must bring (and pay for the privilege of bringing) the mechanical services to the premises. The costs for bringing services to the premises from the landlord's main mechanical room can be substantial and can add unnecessarily to the cost for leasehold improvements.

### **Signage**

Make sure that the franchisor's or your standard signage and graphics requirements contained in the franchise agreement are permitted under the lease. Have the landlord agree that if the local governmental authority having jurisdiction over signage approves your signage that the landlord will approve such signage. Inquire as to center-wide pylon signage or directory signs and make sure you're included on them.

### **Specific Performance**

Specific performance is the right to obtain a court order ordering a party to specifically do something under a contract. In many franchise agreements this right is reserved solely by the franchisor. This provision should be made mutual. You should have this remedy as well.

### **Statute of Limitations (Limitations of Claims)**

Under the law, to prevent old and stale claims from being litigated, a claim must be asserted within a certain period of time, usually 1 to 5 years, depending on the nature of the claim. Otherwise, the claim is barred from being raised and a lawsuit can be dismissed if filed. These laws are called "statutes of limitations." There may be a provision in the lease shortening the time you can bring a claim against the landlord and vice-versa. This provision hurts a tenant more than the landlord because you may not know you have a claim against the landlord until you have a problem and consult an attorney. The landlord's claim is usually for unpaid rent of which the landlord immediately aware. This provision only favors the landlord in that it knows when you do not pay. On the other hand your claims relate to fraud, breach of contract, etc. that have longer statutes of limitations under state law.

### **Subordination, Non-Disturbance and Attornment**

In all likelihood the landlord borrowed money to construct the building or shopping center and has granted one or more mortgages to lenders as security for the loan. In all likelihood the landlord's standard lease provides that a tenant's interest under the lease is subordinate and inferior to the interest of any mortgagees under any mortgages now existing or hereafter placed on the property. Having a covenant of quiet enjoyment (see **Covenant of Quiet Enjoyment** above) is not enough. You should, as a condition to agreeing to this provision, demand a non-disturbance agreement whereby the landlord's mortgagees will recognize your rights under the lease and not disturb you notwithstanding a foreclosure of the building or center so long as you are not in default under the terms of the lease. Otherwise, in the event the landlord fails to pay its lender and the lender forecloses, the lender can join you in the foreclosure suit and you can be kicked out of the premises or be subject to a higher rent or other more, onerous terms even though you were never in default under the lease! In a down economy, as many landlords are defaulting on loans and/or filing bankruptcy as are tenants.

### **Surrender of the Premises; Removal of Trade Fixtures**

Agree in advance as to what fixtures, furnishings, machinery, equipment and other personal property are yours and what are the landlord's. You should be certain that the provision for surrendering the premises enables you to remove all trade fixtures and other property owned by you without recourse. Don't agree to restore the premises to its original condition. Generally, the landlord will require a provision that a tenant agrees to repair any damage caused by the removal of the trade fixtures. Upon expiration or termination of the lease (other than due to your default), you must be allowed 2 or 3 days within which to remove your equipment, fixtures and inventory following receipt of written notice of expiration or termination from the landlord.

### **Subordination of Landlord's Lien**

You need to borrow money for your business. Your lender requires a first priority security interest in all your business assets as security for the loan. However, you have already signed a lease that provides for a landlord's lien on all assets located in the leased premises. The lender insists that the landlord "waive" or "subordinate" its lien to the lender's security interest. The landlord has no legal obligation under the lease to do so and refuses. I have witnessed this common "Catch 22." Therefore, you need to negotiate in the lease a provision stating that, if requested by the tenant or the tenant's working capital lender, the landlord will subordinate its landlord's lien and security interest to the security interest granted by the tenant in favor of the lender. The landlord agrees to sign the lender's standard form of subordination of landlord's lien.

### **Tangible Commercial Personal Property Taxes**

Many states, like Florida, impose an annual ad valorem tax on property used in business (similar to real estate taxes). Check to see if this is true in your state. If yes, find out how much the taxes will be. Does the lease provide for the landlord on the tenant pays these taxes? Usually, this is a tenant obligation. You need to include this expense in your budget.

### **Tenant Indemnification**

Many leases provide that the tenant indemnifies and hold the landlord harmless from any claims brought against the landlord by third parties relating to the tenant's actions. You need to make sure that the provision also states that the landlord remains responsible for its negligent (not just gross negligence) or willful acts of its employees.

### **Term**

If you are a franchisee, the initial term of the lease must afford you at least the same term of years as provided in the franchise agreement. A shorter initial term with liberal renewal provisions will satisfy this requirement. You also want the term of the lease and the term of the franchise agreement be "co-terminus," meaning that both the lease and the franchise agreement expire at the same time. Usually, the franchise agreement is signed before the lease is signed so make sure the lease term expires on the same date the franchise agreement expires.

### **Transferee Guarantee**

If you sell your business and your buyer is assuming your lease, make sure that your buyer can be a business entity without having its principals having to personally guarantee the tenant's obligations. (See **Guaranty of the Tenant's Obligations** above.)

### **Transfer Fee**

This fee should be limited to the landlord's actual costs in approving a transfer and not become a profit-center for the landlord.

### **Tri-Party Agreement Between You, the Landlord and Your Franchisor**

If you are a franchisee, the franchisor has an interest in being able to keep the leased location as part of the franchise system in the event you default under your lease. The franchise agreement may contain a provision to the effect that a default under the lease constitutes a default under your franchise agreement (a "cross-default" provision). Normally, the franchise agreement provides that either the following provisions must be included in your lease or the franchisor requires an agreement containing the following provisions signed by you, the landlord and the franchisor:

- (a) The franchisor's right to receive notices of your default under the lease;
- (b) The franchisor's right (but not the obligation) to cure any default;
- (c) The franchisor's right to assign the lease to another franchisee;
- (d) The franchisor's right to protect its interest under the franchise agreement including entry into the premises and removal of signage;
- (e) The franchisor's right to consent to any material modification to the lease; and
- (f) The obligation of the landlord to make available to the franchisor sales reports or other data that you make available to the landlord.

### **Use and Operation**

Leases will vary markedly in the obligations that they place on a tenant's use and operations. Be certain that the lease does not limit non-selling space unreasonably. The tenant typically will require significant space for office use and storage of inventory, and should not be limited by specific percentages. If your business is a restaurant, you should have deleted any language limiting the release of food odors, particularly if the restaurant is located outside the confines of a food court. Adjacent tenants can make life difficult for a food service tenant, which must necessarily emit food odors in the course of its operation, if a limiting clause is contained in the lease. Additionally, be familiar with your floor load needs. If those needs are unusually high, be certain to require the landlord to represent the load bearing capacity of the floor is sufficient for your needs, or require the landlord to make the necessary improvements, if possible.

### **Use of Common Areas**

The landlord should be restricted in its right to change freely the access to and through the common areas, the addition or removal of structures within the common areas, and the access to and use of the parking areas if any such changes will affect the access or visibility of your premises. These changes can include a relocation of access to the shopping center which could eliminate the flow of traffic which passes the premises, the construction of kiosks, fountains and the like which can eliminate, or substantially block, the visibility of your premises and signage, and the elimination of proximate parking which can serve as a major deterrent for customer traffic, particularly in strip center locations. Most landlords will grant some language limiting their ability to affect access to or visibility of the premises.

### **Use of the Premises**

The use clause should be drafted as broadly as possible and at least to include all uses contemplated by the franchise agreement. Be certain to include open-ended language facilitating the addition of new profit centers such as unforeseen products and services that may be incorporated into the franchise system in the future. In addition, a broad permitted uses provision permits greater marketability in connection with the assignment or subletting if it becomes necessary.

### **Use of Trade Name**

The landlord may try to restrict you to using the trade name authorized in the franchise agreement. What if the franchisor changes the trade name? What if you leave the franchise system and operate independently under a different name? Make sure the lease does not restrict your use of a trade name.

### **Waiver**

A "boilerplate" provision in a lease is the anti-waiver clause. It usually provides that a waiver of a provision by the landlord against the tenant, such as a waiver of default, does not constitute a waiver of the right to demand strict performance in the future. This is not an unfair provision. However, the tenant should make this mutual so that a waiver by the tenant of any rights it has against the landlord under the lease does not prevent later enforcement of the provision.

### **Waiver of Trial by Jury**

Many modern contracts, including leases, contain a waiver of trial by jury provision whereby you waive the right to have a jury decide issues of fact. While some landlord/tenant actions are decided by a judge in a summary eviction proceeding (for example, non-payment of rent with no counterclaim), you should not agree to this. Years ago, an old-time Florida attorney told me that "the only thing I allow my clients to waive is the American Flag." This is good advice.

### **Warranties of the Landlord as to the Premises**

Make sure that the landlord represents and warrants to the tenant that the premises is in compliance with all applicable federal, state, county and municipal building codes, including the Americans with Disabilities Act.

## **Visibility**

Visibility from the street can be crucial to the success of certain businesses. If the lease allows the landlord to alter the common areas, including the parking lot, make sure that the landlord cannot construct improvements that may affect your visibility without your consent.

## **Zoning: Restrictive Covenants**

Don't just rely on the landlord's or its agent's representation that the zoning for the building allows your type of operation. You or your contractor or other advisor should check directly with the applicable city or county zoning department to make sure your use of the premises is within the property's current zoning classification. Also review any restrictive covenants that may affect your usage. If the property is not properly zoned, you will need to obtain rezoning or a variance from the municipality and/or county prior to taking occupancy (see **Contingencies** above).

## **LEASE CLOSING DOCUMENTS**

At the time of the closing, in addition to signing the landlord's standard lease and rules and regulations, the following additional documents may be required by the landlord or requested by the tenant:

### **Addendum to Lease**

While you can "mark up" the standard lease, normally an addendum reflecting the changes you were able to negotiate is attached to the lease and separately signed.

### **Corporate Documentation**

If your corporation signs the lease or a guarantee, the landlord may require the following:

- (a) Certificate of Good Standing;
- (b) Copies of Articles of Incorporation and Bylaws; and
- (c) Corporate Resolution authorizing the execution of the lease or guarantee.

You should request similar corporate documentation from the landlord as well.

### **Inspection Report and/or Punch List**

See **Condition of the Premises** above.

### **Memorandum of Lease**

If you are able to negotiate an option to purchase (see **Option to Purchase** above) or right of first refusal (see **Right of First Refusal** above), you need to have recorded in the public records of the county where the property is located (or other applicable recording office), a memorandum of lease summarizing your occupancy rights and the existence of your right of first refusal or option to put the

public on notice of your rights. Otherwise, if the landlord sells the property without complying with your rights, a buyer with notice of your rights buys the property free and clear of your rights. You lose the right to buy the property. You do not lose your lease. You probably have a claim against the landlord. If you do not have an option or right of first refusal, a memorandum of lease is probably not necessary.

### **Non-Disturbance Agreement from Existing Mortgagee**

See **Subordination, Non-Disturbance and Attornment** above.

### **Option or Right of First Refusal**

See **Option to Purchase** above or **Right of First Refusal** above.

### **Leasehold Title Insurance Commitment**

See Leasehold Title Insurance Policy above.

## **SUBLEASE FROM THE FRANCHISOR**

### **Background**

In some franchise systems, the franchised sites are controlled by the franchisor by the franchisor both owning the land and leasing the premises to you (for example, McDonald's) or by the franchisor being the tenant and subleasing the premises to you (for example, Subway). This way, if you default under either the lease or your franchise agreement, you can be evicted from the premises and the franchise can operate a company-owned outlet or put another franchisee at the location. The downside for the franchisor (and why most franchisors don't structure it this way) is that they are liable for the lease payments if you, as subtenant, do not pay.

In addition to the issues described above, there are special issues that need to be addressed in leasing or subleasing from the franchisor. Obtain a copy of the lease between the landlord and the franchisor as tenant. This way you'll know exactly what are the franchisor's and the landlord's obligations.

### **Shell Corporation as Lessor or Sublessor**

Where a franchisor holds real estate, often the franchisor will set up a subsidiary or affiliate corporation with little assets to be the lessor or sublessor to limit the franchisor's liability. If you as tenant have any claims against the lessor or sublessor, there may be no assets from which to collect on a judgment. Furthermore, the lease or sublease may have the non-recourse against landlord provision (see **Non-Recourse against the Landlord** above).

### **Administration Fee**

If you are subleasing from the franchisor, there may be a surcharge of rent imposed by the franchisor to compensate the franchisor for its liability under the lease and for its administrative expenses. All this does is increase your rent. You should try eliminate this fee.

### **Consent of Landlord**

Make sure you obtain the written consent of the landlord consenting to the subleasing of the premises by the franchisor to you.

### **Notices from Landlord**

Make sure your sublease includes a provision requiring the franchisor to give you copies of all notices the franchisor receives from the landlord. Better yet, have the landlord agree to send to you a copy of all notices sent to the franchisor as tenant.

### **Right to Cure Sublessor's Defaults**

In addition to having the landlord give you notice of the franchisor's default, negotiate the right to cure the default and become the primary tenant under the lease. Otherwise, if the franchisor/tenant defaults under its lease and the landlord terminates it, your sublease may be automatically extinguished. This is a non-disturbance agreement from the landlord.

### **Pass-Through of Landlord Benefits**

Have the franchisor pass-through all landlord credits, free-rent, building allowances, etc. to you particularly if you are the initial operating tenant in the premises.

I trust this paper is not overwhelming but a business lease is a complex legal document. The landlord's "standard lease" must be renegotiated to address these issues in a way that is faire for both the landlord and the tenant.

*Keith J. Kanouse, Esq.*