

David v. Goliath

Negotiating a commercial lease on behalf of the tenant

By W. Leighton Lord III

A war story illustrates an important truth about negotiating commercial leases on behalf of tenants. In the story, the attorney's client is opening an office outside of South Carolina. The client found a good location in Atlanta. The attorney and the client spent time reviewing the lease and drafting proposed revisions to the document to make the lease more favorable to the tenant. When the attorney and the client arrived at the landlord's office in Atlanta, the landlord's attorney informed them that the landlord will agree to only five changes to its form lease, so they had better ask for only the most important changes. The landlord was a large institutional landlord, and the tenant was going to be a small tenant in the building. The market was fairly tight, and the landlord had most of the bargaining chips, leaving the tenant with little leverage.

Although the landlord's approach in the story may be extreme, the story illustrates one of the central truths of commercial leasing—the landlord would rather not change its standard lease at all. In fact, the landlord has a legitimate need to keep some uniformity with its leases, so that the landlord will not have to review every lease every time a specific tenant issue arises. In addition, the landlord's lenders and any prospective purchaser of the building will look more favorably on the landlord if the landlord has maintained some uniformity in its leasing terms and conditions.

That does not mean that the tenant's attorney has no obligation to carefully review the lease, advise the client as to the terms and conditions of the lease, and make a good faith attempt to obtain revisions to the lease more favorable to the tenant. Some landlords and their counsel realize that certain provisions of their form lease are unfair and will revise those provisions with little or no struggle, if asked. On the other hand, there are always standard provisions of the landlord's document that are essentially non-negotiable, and the client merely needs to be informed of this fact and the consequences of that provision. In other words, some landlords are never going to revise certain lease provisions, so the tenant must understand how the provisions work and determine if they can live with that provision.

This article is a brief overview on how to best represent the tenant when negotiating a commercial lease. Before discussing the actual terms of a lease, it is important to mention the three types of commercial leases. The first type is the pro-landlord lease. The pro-landlord lease weighs most lease provisions in favor of the landlord. The second type is the pro-tenant lease. No landlord will have this lease, but some large tenants have their own form lease and insist that it be used. If you represent such a tenant, then you are Goliath and the landlord is David. The third type, which large landlords are using more and more is the so-called fair lease or neutral lease. Landlords who want to keep costs down and get leases signed fast have moved toward these fair leases. Beware, what a landlord feels is fair may not be fair to the tenant.

On any South Carolina commercial leasing question the following chapters of Title 27 of the South Carolina Code should be reviewed: (a) Chapter 33 - Landlord and Tenant Generally (S.C. Code Ann.) 27-33-10 et seq.); (b) Chapter 35 - Creation, Construction and Termination of Leaseholder Estates (S.C. Code Ann.) 27-35-10 et seq.); (c) Chapter 37 - Ejectment of Tenants (S.C. Code Ann.) 27-37-10 et seq.); and (d) Chapter 39 - Rent (S.C. Code Ann.) 27-39-10 et seq.) The South Carolina case law on commercial leasing is very limited and tends to be fact specific and of

little general assistance. The vast majority of South Carolina case law deals with determining if a lease exists or issues relating to the termination of a lease.

Business Points

Commercial leases can be divided into two essential parts. The first are the business points, such as the rent and the term, and the second being the standard lease provisions, such as insurance, condemnation and events of default.

The attorney's review of the business points is primarily to assure that the business points are those for which the client bargained. In many cases there will be a letter of intent or at least a term sheet which lists the business points of the lease. If this is the case, the attorney merely needs to be sure that the business points in the lease match that of the term sheet or letter of intent. Where no term sheet or letter of intent exists, the attorney often has to work through the business points with the client to be sure that they meet the client's needs.

Key business points are as follows:

A. The Parties. Be sure that the appropriate tenant is listed. If an individual's limited liability company is going to be the tenant, be sure that the individual is not listed as the tenant. In addition, be sure that the tenant is accurately identified. For example, if the tenant is a limited liability company, be sure the tenant appears on the lease as such and executes the lease only in his capacity as a member or manager of the company.

B. The Building. The lease should accurately identify the building in which the tenant will rent space. Ideally, some type of metes and bounds or survey will be attached to the lease. At the minimum, an accurate address and description of the premises needs to be contained in the lease. If the tenant is obligated to pay a portion of the common area expenses, be sure the common areas are accurately identified.

C. The Demised Premises. The space to be leased must be accurately described by floor, location and square footage. The floor plan is the best way to identify the demised premises along with the square footage.

D. Commencement Date. The commencement date and expiration date need to be clearly defined. If the commencement date can move, define the expiration date as a certain period after the commencement date.

E. Term. Remember that the lease date, the commencement date and the rent commencement date may all be different. The term and any renewal options need to be set out clearly.

F. Rent. The rent and any rent escalations need to be clearly set out. If escalations are by a formula, be sure to run the formula and share that with the client. If the lease is for retail space, the tenant may also have to pay a percentage of its profits from the subject lease. This is called percentage rent.

G. Expansion and Contraction Options. The landlord will probably not offer these, but may agree when a request is made. The bigger the tenant the more likely the tenant will get expansion rights. Contraction rights always come at a price, if a landlord grants any.

H. Additional Rent. Be sure to determine what additional rent, such as operating expenses or real estate taxes that the tenant will be obligated to pay. The real rental rate is a total of everything the tenant must pay to lease the space.

I. Parking. This is a very important issue to most tenants and assurance of adequate parking as well as assigned or reserved parking is often necessary.

J. Signage. Many tenants depend on some form of signage which needs to be contained in the lease. At a minimum, the landlord should allow or provide identification and directional signage.

K. Upfitting. Tenant's right to upfit or make improvements to the demised premises and who will pay for those improvements, needs to be set forth. If the tenant improvements are extensive or costly, the lease may need to include plans and specifications, designation of a contractor, and a separate work letter.

L. Fixtures. If a tenant plans to install trade fixtures in the demised premises, it should be stated that such installation is allowed and that such fixtures will remain the property of the tenant.

Standard Lease Provisions

A. Use. Some leases will provide that the demised premises may be used for any lawful purpose. Most tenants can live with this use restriction. Many use restrictions, however, go much further. Determine if the use restriction impairs not only the tenant's intended use, but also the tenant's ability to sublet or assign the lease.

B. Full Service or Net. You must determine at the onset whether or not the tenant is getting into a full service or net lease. With a full service lease, services such as janitorial, utilities and maintenance are provided by the landlord and included in the rent and/or in additional rent that is charged to the tenant. In a net type lease, items such as taxes, insurance and utilities are either paid directly by the tenant or the landlord forwards invoices to the tenant for these amounts. A full service

lease is typical in a multi-tenant building, whereas the net lease is more typical with a single tenant building. In either case, it must be determined what costs the tenant will be obligated to pay. With a full service lease, the items that the landlord can "pass-through" through the tenant need to be closely scrutinized, to be sure that the landlord is not passing on costs unrelated to the building. In addition, certain costs, such as structural repairs to the building, are not appropriate pass-through items. The tenant should have the right to review the supporting back-up documentation of any operating expense pass-through that the landlord charges the tenant. In multi-tenant buildings, especially one in the process of initial leasing, the tenant should request a "gross-up" provision which requires the landlord to calculate operating expenses upon an assumed occupancy of 90 percent to 95 percent. This is a fair provision for the landlord and tenant.

C. Relocation. No tenant wants to be relocated, but certain small tenants should expect for this to be in a landlord's lease. No tenant should agree to relocation unless the landlord will pay the costs of relocation. In addition, some landlords will agree to only relocate a tenant once during the lease term. Large tenants can usually negotiate the relocation provision out of the lease.

D. Waiver of Subrogation. This provision often confuses tenants, but in fact it is to most every tenant's advantage. Basically, the concept is that the landlord will insure the building, the tenant will insure its property in the demised premises and both parties will agree through waiver of subrogation that they will look to their insurance if there is any damage to the building or the tenant's property and not sue one another, even if the other party may have been negligent. The tenant needs to make sure that this is in compliance with its insurance coverage. Some leases will except gross negligence or intentional misconduct from the waiver of subrogation.

E. Condemnation. The tenant should have the right to terminate the lease if the building or any part of the building is condemned to the extent that the tenant can no longer enjoy the

demised premises. This provision, and the concept of a partial condemnation, need to be closely reviewed where parking that is adjacent to a busy street is important to the tenant. There is a greater likelihood that a strip of parking will be taken than an actual building or a part of a building.

F. SNDA. Real estate and banking lawyers like to throw this acronym out to confuse other lawyers, particularly litigators. It stands for subordination, non-disturbance and attornment. Such an agreement is especially important in a state like South Carolina, because without one a tenant could be on the street for doing nothing wrong. The first part, subordination, means that the tenant's lease is subordinate to the landlord's lender's lien on the land and building. Attornment means if a new landlord takes over, potentially by foreclosure, the tenant will attorn or look to that new landlord as the landlord. Most importantly for the tenant is the non-disturbance, which means that as long as the tenant is not in default under the lease, the new landlord will agree not to disturb the possession (i.e. evict) of the tenant. In a foreclosure action, if there was not a non-disturbance, a foreclosing party could "cut off" and otherwise terminate all subordinated leases. Be particularly careful that there is not a subordination provision without a non-disturbance provision.

G. Events of Default. With regard to standard events of default like not paying rent or destroying the building, consider these non-negotiable. What can be negotiated are notice and cure rights. Be careful that the landlord does not have events of default that are not appropriate for the building and the demised premises. For example, a commercial office building lease may make an event of default the fact that the tenant has moved out of the demised premises even though the tenant continues to pay rent. This so-called "going dark" provision is often inappropriate in a commercial office building since as long as the tenant is paying rent the landlord should not really be that concerned with whether or not the tenant is in the space unless, perhaps, the space is on the ground floor. In a retail situation, the "going dark" provision is vitally important since the landlord is likely collecting percentage rent and has a great desire to have a productive, profitable tenant in the space. A tenant who moves out of retail space will rob the landlord of rent stream and can potentially hurt surrounding retail space due to the fact that it has "gone dark." Regardless of how the events of default are drafted, the landmark commercial leasing case of *Kiriakides v. United Artists Communications, Inc.*, 440 S.E. 2d 364 (S.C. 1994) holds that a lease may not be forfeited or terminated for a trivial or technical breach even if the parties agreed that "any breach" gives rise to the right of termination.

Conclusion

When representing tenants in a commercial lease negotiation, assess leverage and negotiate accordingly. If representing a small tenant against a very large landlord in a tight market or in a very popular building, leverage is limited and therefore only the most important items should be requested in a lease. Be certain that the business points are accurately reflected in the lease. As leverage increases it will be possible to ask for more, but always remember that the landlord has important reasons to keep consistency in its standard lease.

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