

COMMERCIAL LEASE PITFALLS AND HOW TO AVOID THEM

In this very short time, I hope to share some important insights on commercial lease drafting. I am not a transactional attorney: I am a litigator. I know enough about commercial landlord-tenant disputes as I have been litigating and interpreting leases for more than 30 years.

The most important period of the relationship is the lease drafting: a property owner/ manager must draft a lease to anticipate litigation and prevailing should litigation ensue.

Several lease terms for consideration:

Default Provision:

The typical preprinted commercial lease obligates the landlord to serve a cure notice should the tenant violate a non-monetary provision such as unauthorized alterations or failure to remove violations of record. That same lease clause provides that should the tenant commence a cure but full remediation cannot be done within the cure period, the cure period is extended provided the tenant gives the landlord notice that it commenced a cure.

Recent case law in the First Department (Manhattan & Bronx) interpreted such a clause to bar a landlord from terminating the tenancy even when the landlord believed the cure was insufficient. One can go to the expense of terminating the tenancy and learning that it was premature.

A better practice is to modify the language by giving a specific time frame longer than anticipated, but enough time that the tenant can cure, or delete entirely the reference to the offending language.

Conditional Limitation:

Most leases give the landlord the right to accelerate termination of the lease for a non-monetary default. One should add the failure to pay rent and/ additional rent as a default permitting the landlord to accelerate termination. Commonly called a “conditional limitation”, should tenant monetarily default x amounts of time in a twelve month period, landlord, by giving a notice to cure the monetary default, can terminate should the tenant not cure the monetary default. The clause can be so broad as to include monetary defaults over the lease term.

Legal Fees:

Most commercial leases provide for the landlord's right to recover legal fees should tenant default and landlord is obligated to commence suit. Some tenant lawyers seek to make the clause reciprocal. Don't capitulate.

Draft the clause to include any type of proceeding/action that is commenced or is defended, including third party suits, or suits brought by a governmental agency.

Good Guy Guaranty of Payment:

Many include a "good guy" guaranty of payment obligating an individual to pay for the defaults of the entity tenant. Landlords believe that a straight guaranty is often too difficult to obtain: a "good guy" gives the tenant a sense of comfort. Sometimes it can be a second entity.

Best practice is to draft the good guy guaranty to at least demand that the tenant give sufficient notice for landlord to find a replacement before it vacates, pays all the rent and additional rent up through the date it vacates, returns vacant possession, free of all personal property if practicable, and in substantially the same condition as originally rented, reasonable wear and tear excepted.

Alternatively, insist on a full guaranty that can convert to a good guy guaranty only after several years of lease compliance.

Security vs. Letter Of Credit:

Landlords are quick to insist on the collecting of security without regard to future concerns. Typically, a tenant will cease paying rent towards the end of the lease and will tell the landlord to apply the security. The landlord is concerned about cash flow and the risk of applying the security with the tenant leaving the premises in disrepair. A corporate tenant with no asset but the lease gives no comfort to the landlord of collecting the arrears, especially if no guaranty is in place.

The other consideration is a tenant filing for bankruptcy and the landlord applying the security. A trustee or other creditor may question the application of cash security as a preference.

To avoid such concerns, insist on the tenant obtaining a Letter of Credit ("LOC"). The LOC is a bank draft for the landlord's benefit made payable to the landlord, usually permitting draw down at any time. The LOC belongs to the bank and the landlord, and not the tenant, so the LOC never become part of the bankrupt's estate.



David B. Rosenbaum

Borah, Goldstein, Altschuler, Nahins & Goidel, P.C.

Senior Partner

Tel: (212) 431-1300, Ext. 360

Email: drosenbaum@borahgoldstein.com