LEASE LEGALESE MADE EASY

"The lawyers' trade is a trade built entirely on words."
- Fred Rodell, former Yale Law School Professor

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I doubt Professor Rodell was thinking about commercial leases when he said this. But ask any real-estate professional, and he/she will tell you that leases contain too much legalese. Although lawyers defend legalese as a way to be precise in their drafting, many lease provisions are quite mystifying. Hopefully, this will demystify some of the most commonly misunderstood lease clauses and explain why they matter.

Legal Compliance
A landlord client once asked me, "Why do we care if the lease requires the landlord to comply with the law. Don't we have to obey the law anyway?" While it is true that we should always obey the law, the bigger issue here is, Who pays to keep the premises in compliance with the law? During the lease term, laws such as the Americans with Disabilities Act (ADA), the Texas Architectural Barriers Act, and numerous zoning ordinances, building codes, and the like, may require substantial upgrades to the building and common areas. To understand this issue, a landlord should know the answers to all of these questions:
➔ Who pays for and performs upgrades to the premises and common areas to keep them in legal compliance when the lease starts?
➔ Who pays for and performs upgrades to the premises triggered by a tenant's specific use? For example, a hospital or medical clinic has different ADA requirements than a "spec" warehouse space.
➔ Who pays for and performs upgrades to the premises and common areas triggered by changes in the law after the lease starts? The answers to these questions – and thus the allocation of costs – vary from lease to lease.

Casualty & Condemnation
Casualty (i.e., a fire or other damage) and condemnation (i.e., governmental taking of part or all of the building or common areas) are unique leasing issues because the odds of a casualty or condemnation occurring are (thankfully) very low; however, if a casualty or condemnation occurs, the odds of numerous expensive problems and headaches are commonly (and unfortunately) very high. From a business perspective, the landlord needs to understand how the following concepts are addressed in each lease:
➔ Does the landlord have to restore/repair the premises?
➔ Does the landlord have adequate insurance to cover repairs/restorations for a casualty?
➔ What happens if the landlord's insurance doesn't pay to repair/restore?
➔ Is rent abated during the casualty?
➔ Can the landlord terminate the lease instead of repairing/restoring? Can the tenant terminate?
➔ Does the tenant have insurance to restore its fixtures, furnishings and equipment?

➔ What rights does tenant have to claim any condemnation awards? In addition to insuring the building in the event of a casualty, most landlords will carry rent loss insurance to cover any interruption in rent due to a casualty. This insurance makes it economically feasible for the landlord to abate the tenant's rent during a casualty. Of course, the landlord will want to make sure it can pass the premiums through to the tenant.

Force Majeure

Force majeure are events that cannot reasonably be anticipated or controlled, such as acts of God, labor shortages, materials shortages, fire, legal actions, terrorism, etc. A force majeure clause allows a landlord to escape certain defaults, and is sometimes affectionately referred to as the landlord's "get out of jail free" card. On the flip side, tenants often want that same right to "get out of jail free" card and to avoid obligations due to a force majeure event. But before you agree to make this right mutual, be careful to state that your tenant cannot use force majeure to evade fundamental lease obligations, such as the obligation to pay rent, carry insurance, or surrender the premises at expiration. A careful landlord will also require a tenant to provide notice before invoking the force majeure clause, and will also put a time limit on the number of days the tenant can use force majeure to delay performance.

Quiet Enjoyment

The legal concept of "quiet enjoyment" is a long-standing legal theory. At its core, the concept means that as long as the tenant is not in default, the landlord will not disturb its right to use the premises. That includes the landlord's actions as well as those of other tenants in the building or shopping center. If the landlord or another tenant breaches this covenant, the suffering tenant can file a lawsuit to stop the disturbance and seek damages. In certain (extreme) circumstances, the tenant may even have the right to abandon the premises, stop paying rent, terminate the lease and sue for damages. Some leases expand this concept to protect the tenant from third parties (other than the landlord and other tenants). Landlords should never agree to this concept. Likewise, landlords should examine their lease language and consider adding limits on their liability in case a tenant makes a claim for breach of the covenant of quiet enjoyment. From a property management standpoint, a landlord should not summarily dismiss a tenant's complaints about noises, odors or other disturbances.

Condition of Premises & Warranties

Almost all (landlord friendly) lease forms state that the premises will be accepted in an "AS IS WHERE IS" condition. Tenants often balk at this because they do not want to be responsible for every problem or defect that pops up. For example, some tenants will want the landlord to be responsible for "latent" (hidden) defects. To protect themselves, tenants will often negotiate a "warranty" that requires landlord to fix defects, repairs, cure legal violations, etc. As a landlord, if water down your boilerplate "AS IS WHERE IS" clauses with some type of warranty, consider some restrictions or limitations on the warranty. For example, consider the following limitations on a warranty:

➔Any defects or problems must be reported shortly after the tenant takes possession.

➔The landlord is not responsible if the tenant delays providing notice or makes the condition worse.

➔ Limit the landlord's liability to fixing the item in question and expressly state that the landlord is not liable for the tenant's monetary damages. For example, if the roof leaks the week after the tenant moves in, landlord might agree to fix it for free, but the landlord should not be responsible for damage to tenant's equipment or inventory.

Indemnification

The purpose of a lease isn't just to get the 'deal points' in writing. A lease also allows the parties to allocate risk between them. A common tool to shift risk is through indemnification. An indemnity clause requires one party to protect the other party for things that go wrong, such as damage to the premises/building, personal property, or physical harm to a human. Indemnification clauses are not isolated on their own private island– they have to work jointly with the insurance, subrogation (if applicable), default, waiver and limitations of liabilities clauses. For example, the indemnity clause should protect the landlord for personal injuries and damages to property that occur in the premises, and these risks should be covered by the tenant's insurance. Damage to the premises, improvements and the tenant's FF&E (fixtures, furnishings and equipment) should be covered by insurance and a waiver of subrogation (see below) should prevent either party from making property damage claims against the other. The default clause in the lease protects the landlord by allowing it to pursue damages against the tenant if it defaults. On the flip side, if the lease requires landlord to indemnify the tenant, the landlord can reduce its risk through insurance and adding proper waivers and limits of liability in the lease.

Subrogation & Waiver of Subrogation

Subrogation and subordination are not the same thing. Subrogation means that one party 'steps into the shoes' of another party for the purposes of suing someone to recover damages. Property damage claims are the most commonly subrogated claims. In some states, worker's compensation claims can also be subrogated. Not all claims may be subrogated. Subrogation works like this: suppose your tenant or your vendor damages part of the building. Unless your tenant/vendor or their insurance company pays for the damage, you may have to submit a claim to your insurance company. If your insurance company pays the claim, they may want to recover their out-of-pocket costs against the responsible party. In most states (including Texas), your insurance company becomes subrogated to your rights to sue the tenant or vendor. In essence, your insurance carrier 'steps into your shoes' and files the lawsuit. A waiver of subrogation clause minimizes lawsuits and claims between the parties because the risk is shifted to the insurance company, and the insurance premiums are typically passed through. As a practical matter, if the lease requires the parties to waive subrogation, you must ensure both parties' insurance policies allow for such waiver. Sometimes parties argue that a waiver of subrogation is not fair. But real-estate professionals like certainty, and waivers of subrogation help provide a level of certainty because the landlord and tenant each purchases insurance to cover certain losses. The insurance company has been compensated for this via premiums, and should be responsible for the loss without seeking reimbursement. This is another reason to ensure that the tenants pay their share of insurance through passing along operating expenses (i.e., CAM charges).

Subordination,
Non-Disturbance and Attornment

These three concepts took center stage during the economic downtown because, generally speaking, if a landlord defaults on its mortgage, and its lender forecloses, the tenant risks getting kicked out and losing its investment in the premises, even though the tenant is not in default. The tenant's risk is the result of being "junior" (subordinate) to the landlord's lender. The tenant is almost always junior either because the lender's deed of trust (mortgage) was recorded before the lease was signed or because the lease states that tenant's rights are subordinate (junior) to any

existing or future mortgages. Tenants can protect themselves with a subordination, non-disturbance and attornment agreement, (a/k/a SNDA). The subordination portion permits the landlord's lenders' lien to be superior to the tenant's lease. The attornment clause in a SNDA ensures that a tenant can't get out of the lease after a foreclosure. The attornment provision states the tenant will recognize the lender as the landlord in the event of a foreclosure. So, where does the tenant's protection come from? Well, the non-disturbance clause in the SNDA permits the lease to stay in force so long as the tenant is not in default. Tenants looking toward a long-term lease with expensive improvements will most certainly want a good SNDA.

Conclusion

While all this lease language may just be a play on words, it is a game that all real-estate professionals need to understand to protect their interests and reduce their risks