

IN THE SPOTLIGHT: UNENFORCEABLE LEASE PROVISIONS

By: Jack Garson, Esq.

Leases keep getting longer and tougher. Unfortunately, sometimes the people drafting them outsmart themselves and include unenforceable provisions.

When I started out in the law business in the early 1980s, leases were 20 pages long, and the tenants only significant obligation was to pay the rent. Yes, there were a few other provisions, but mostly the tenant had to pay the rent.

Nowadays, the tenant is required to do thousands of things like give the landlord the license plate number of every car that parks at his or her store. Moreover, when the tenant has enough bargaining power to be in charge of drafting the lease, the tenant doesn't even have to pay the rent!

Just kidding. But you get the point.

Some leases make peace in the Middle East look simple in comparison, and every now and then the drafter of a complicated lease pays a price.

JUDGES TOUGH ON TERMINATIONS

Take, for example, the landlord's remedies when a tenant defaults. Many landlords go overboard, causing unforeseen problems that don't surface until the landlord tries to enforce its lease. Notably, a landlord can't terminate a lease just because the lease says so. Indeed, the maxim referred to most often is that the court abhors a forfeiture.

In plain English, this means that a court will not allow a landlord to terminate a lease unless the tenant has done something really bad seriously, really bad! In countless court cases, the judge has rejected landlords attempts to terminate leases. Tenants may put up unauthorized signs, pay the rent late, provide an insurance certificate late, and even fail to keep a premises well-maintained. Still, such conduct often will not entitle a landlord to terminate a tenants lease.

Whats a landlord to do? One effective remedy is to include a liquidated damages provision that can be applied to the more

minor infractions. Specifically, the law endorses remedies that are a measured response to the infraction. Rather than terminating a lease because the tenant's employees park in customer parking, a landlord is much more likely to be able to enforce a fee for each infraction. Be careful, though: The fee must also represent some reasonable estimate of the damages that the landlord will sustain as a result of the tenant's violation of the lease.



Other landlord remedies are also frustrated by rules regarding unenforceability. Another potentially punishing landlord remedy, acceleration of rent, is often unenforceable. In the typical acceleration provision, the landlord terminates the tenant's lease and then requires the tenant to pay all the rent otherwise payable for the remainder of the then current term of

the lease immediately. When challenged, such an acceleration provision frequently fails in court.

THREE WAYS TO ACCELERATE

If a landlord adheres to certain limits, however, the landlord may be able to enforce an acceleration of rent provision. Typically, a court will first require that the amount of accelerated rent payable by the tenant must be reduced to take into account the present value of money. That is, normally the tenant would have paid the rent over many months or years. To require payment in full now gives the landlord a windfall in the time-value of money; money paid now is worth more than money paid later. Reducing the rent to present value provides a more appropriate remedy for the landlord. Second, courts often require the landlord to credit the tenant with the proceeds of any subsequent reletting of the premises during the time period for which the landlord has received the accelerated rent. This limit also prevents a possible additional windfall from the landlord obtaining double rent for the same time period. Third, some courts even prohibit the acceleration of rent altogether unless the tenant is allowed to remain on the premises (provided, of course, that the tenant does

not commit some additional termination-worthy default). Courts applying this third rule explain that acceleration of rent does not unduly punish the tenant if the tenant has committed a serious default, such as repeated failure to pay the rent, so long as the tenant can remain in the premises. The acceleration of rent merely provides the landlord with additional security while the tenant continues to enjoy the bargained-for use of the premises.

SIDEWALK VISIBILITY MORE VALUABLE

In other situations, the landlord may be unable to enforce a lease provision not merely because the provision was unenforceable, but also because of how the landlord applied the provision. For example, in one notable case the tenant abandoned its premises. Under applicable lease provisions, this tenant was liable to the landlord for any deficiency in rent if the premises were re-rented for a lower rent. In this case, the landlord re-rented the premises together with an adjacent store. Arguably the adjacent premises were far more valuable because it abutted the street in a popular downtown area and was much more accessible and visible to potential customers. Moreover, the premises abandoned by the tenant in question was arguably far less valuable because it had only a tiny storefront abutting this popular street, and most of the premises was far removed from the area easily visible to potential customers. Rented alone, the abandoned premises would yield a far lower rent than the other more visible and accessible premises. Yet, the landlord re-rented both premises to one tenant for a combined rent that, on a per square foot basis, exceeded the rent payable for the premises abandoned by the tenant in question. The court ruled that because the landlord had failed to identify different rents payable for the two premises, the landlord could not recover any ongoing deficiency in rent from the tenant that abandoned its premises. Here, the lease provision was enforceable, but the landlord failed to apply the provision in an enforceable manner.

STATE-BY-STATE RULE CHANGES

Operating in different states without a well-developed understanding of local requirements frequently leads to improper lease drafting and unenforceable provisions. In one state, a 1991 court case changed the rules regarding a landlord's consent to assignment of leases. Previously, where the lease required the tenant to obtain the landlord's consent to assignment of the lease, but the lease was silent as to whether the landlord was required to be reasonable in providing or withholding that consent, the law entitled the landlord to withhold its consent unreasonably.

The 1991 court case, however, held that where the lease included such a silent consent clause, the landlord must be reasonable, and the only way that the landlord could withhold

consent in its discretion would be to provide expressly that such consent could be withheld in the sole and absolute, subjective discretion of the landlord. Since that 1991 case, countless landlords who were unfamiliar with this unique local requirement have been disappointed to find that they must accept assignees that they would have preferred to reject (so much for not reading local court cases).

Similarly, state statutes render certain lease provisions unenforceable. While more common with respect to residential leases, even commercial leases are affected in some situations. For example, one notable state statute prohibits all landlords from exculpating themselves from liability for their own acts or omissions, even if there has been no negligence or willful misconduct on the part of the landlord. By virtue of this statute, numerous customary lease provisions, such as the insurance and indemnification provisions, are dramatically affected.

FEDERAL INTERVENTION

In other situations, however, the parties erroneously believe that some provisions are unenforceable when they are, in fact, enforceable. Take, for example, provisions entitling tenants to sell certain products or services exclusively from the premises. Frequently, landlords will claim that such a provision is an unlawful restraint on trade that violates antitrust law. This misconception might flow from old cases where particularly egregious exclusivity rights were found unlawful. In one of these cases, an anchor tenant was given the right to approve every new tenant of a large shopping mall. The U.S. government stepped in and required the landlord and tenant to enter into a consent order invalidating this provision and prohibiting the anchor tenants control over other tenants. Presently, the general rule is that if there are other sources of the tenant's goods and services in the relevant consumer market, the grant of exclusive use rights to a tenant at one particular property ordinarily will not violate antitrust law and is fully enforceable.

AGE-OLD RULES CAN AFFECT NEW CONSTRUCTION

The enforceability of other provisions and entire leases can vary greatly from one jurisdiction to another. Decades ago, leases with uncertain commencement dates were almost uniformly unenforceable due to the clear violation of the rule against perpetuities. This rule imposed the centuries-old requirement that an interest in real estate, even a lease, must come into being, if at all, within a certain, fixed time period set forth in the instrument granting the applicable interest. Leases for newly constructed buildings often fell victim to this rule when the landlord's uncertainty regarding the completion of construction was reflected in the failure to include an outside date for delivery of the premises.

However, numerous state courts began to relax the dire consequences of the rule against perpetuities. Instead, in cases affecting both leases and other interests in real estate, courts began finding an implied, reasonable deadline for delivery of the premises and saved many leases from termination. Certain jurisdictions still faithfully impose this rule, however, and all parties are cautioned to familiarize themselves with local legal requirements.

The final terms of most leases are usually the product of the parties bargaining power. Of course, negotiating skills can enhance the outcome, and in certain instances, the final, enforceable terms of a lease can be the result of a thorough understanding of applicable legal requirements. For the best results, understand the cases and statutes affecting leases.

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Jack Garson's practice focuses on Real Estate, Construction and Business law. He serves as a legal advisor for numerous local, regional and national companies. In his role as legal counsel, Jack also serves as a strategic advisor and lead negotiator. Further, Jack provides guidance on the structure of complex transactions, the resolution of business disputes, the growth and sale of companies, and the management of issues such as liability and risk reduction, employment practices, and enhancing profitability.

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