

Outline of Issues Concerning Rent, Security, Defaults and Remedies

Program Material for "Critical Issues in Drafting & Negotiating Office, Retail, Industrial & Ground Leases"

Jack Fersko

NJICLE

December 2013

RENT:

1. Authority

(a) Confirm the authority of the lease signatory.

(b) *See St. James Apartments, LLC v. Coinmach Corporation*, 2013 U.S. Dist. LEXIS 106116 (D.N.J. 2013).

2. Gross Lease v. Net Let v. Modified Gross Lease

(a) Gross lease – the tenant pays a fixed dollar amount that includes base rent and additional rent and the landlord pays all operating expenses.

(b) Net Lease – the tenant pays a fixed dollar amount for base rent amount and, as additional rent, all expenses including maintenance, taxes and insurance.

(c) Modified Gross Lease - unless a single tenant occupancy, most leases are a hybrid or modified gross lease under which the tenant pays a fixed dollar amount for base rent and, as additional rent, operating expense increases over a base year. The base rent will be a sum sufficient to cover the landlord's costs and provide a profit.

3. Base Year

(a) In the event designated costs increase following the base year, then the tenant will pay the increase, or in a multi-tenant situation the tenant will pay its proportionate share.

(b) The base year usually will be the calendar year in which the lease term commences. The tenant, however, will prefer the first twelve months of the lease term, particularly when the lease commences in the last

Attorneys

Jack Fersko

quarter of the calendar year.

(c) The landlord should scrutinize the base year costs to ensure that there are no anomalies, such as extraordinary snow plowing costs, and reserve a right to make appropriate adjustments to the base year in the event of such anomalies.

4. Base Rent and Additional Rent - Generally.

(a) The lease agreement should provide for the base rent (sometimes referred to as minimum rent) to be paid on the first day of the month, in advance, and without any offset, deduction or abatement.

(b) Provide for adjustments, if any, to the base rent

(i) Adjustments may be determined in any number of ways, including an increase in the consumer price index, a fixed percentage increase in base rent, a fixed dollar increase in base rent, and an increase to the fair market rental value.

(ii) Care should be given in the drafting of these clauses in order to ensure clarity in the manner in which the adjustment will be determined. *See generally, Enniss Family Realty I, LLC v. Schneider Nat'l Carriers, Inc., 2013 WL 2468864 (S.D. Miss. 2013); Cablevision of Oakland, L.L.C. v. CK Bergen Holdings, LLC, 2012 N.J. Super. Unpub. LEXIS 2436 (Ch. Div. Bergen Co. 2012).*

(c) Additional Rent:

(i) N.J.S.A. 2A:18-53 allows for a summary dispossession proceeding with respect to a tenant that holds over after defaulting in the payment of rent. As such, it is important to characterize all sums, in addition to base rent, due under the lease, as additional rent.

(ii) Additional rent may include, by way of example taxes, insurance premiums, utility charges, expenses attributable to reciprocal easements and business park expenses, building and common area operating expenses, costs incurred by the landlord to cure the tenant's breach of the lease agreement, legal fees to enforce the lease agreement, brokerage fees due to a tenant default, percentage rent and a late fee for failure to pay rent and additional rent when due or within a stated grace period.

(d) See **Appendix A** for an example of a general rent and additional rent clause.

5. Additional Rent based on Taxes.

(a) The landlord will broadly define taxes to include, by way of example:

(i) Real estate taxes;

(ii) Assessments for municipal improvements;

Published Articles (Cont.)

(iii) Payments in lieu of taxes (PILOT);

(iv) Business Improvement District/Special Improvement District Assessments;

(v) Water and sewer charges and other charges of governmental authorities that may be a lien on the property;

(vi) Taxes arising out of tenant equipment so affixed to the building as to become a fixture and included in the valuation of the property for real estate tax purposes; and

(vii) Taxes that may be imposed in the future such as sales tax on rent.

(b) The tenant will seek to narrow the definition of taxes.

(i) The tenant will seek to exclude certain taxes, such as, by way of example, gross receipts tax (as opposed to a tax on rents received), excise taxes, franchise taxes, income taxes, inheritance taxes, gift taxes, transfer taxes, taxes on profits and capital levies.

(ii) To the extent that a tax is payable in installments, the tenant will want the landlord to pay the tax in the greatest number of installments possible (e.g., assessments for municipal improvements may be paid over a ten (10) year period) and only obligate the tenant for those installments that fall due during the lease term.

(c) Tax Escrow.

(i) The landlord will want taxes to be paid in monthly installments so that the landlord has the funds available when taxes fall due. Depending upon the size of the leasehold space and the strength of the tenant, the tenant may negotiate for taxes to be paid as they become due (e.g., real estate taxes are due on the first day of the second month of each quarter).

(d) Tax Appeal.

(i) Adjust based on net costs after expenses. Provide for such adjustment regardless of who may prosecute the tax appeal. *See Crosspointe Developers, L.L.C. v. Wegmans Food Markets, Inc.*, 2013 N. J. Super. Unpub. LEXIS 2721 (App. Div. 2013).

(ii) If the landlord permits the tenant to prosecute a tax appeal, the landlord should provide that the tenant will be responsible for any increase in taxes for as long as such increase may apply regardless of the lease term.

6. Additional Rent based on Insurance.

(a) The landlord will want the right to obtain liability and casualty insurance in as broad a form as it may determine and require the tenant to pay its share of the expense.

Published Articles (Cont.)

(b) The landlord will want the tenant's share of insurance costs to be paid in monthly installments so that the funds are available when the insurance premiums fall due.

7. Additional Rent based on Utilities.

(a) The landlord will broadly define utilities to include, by way of example water, sewer, standby water for sprinkler system, gas, electric, heat, phone, cable and all other utilities or services made available to the leased premises.

(i) In a single tenant occupancy setting, the landlord will want the tenant to pay all utilities, deposits and related fees, and may obligate the tenant to put the utilities in the tenant's name..

(ii) When the tenant pays utilities directly to the provider, even when the account is in the name of the tenant, it is important for the landlord to ensure that all utilities are paid or the landlord may be responsible to bring the account current before the utility company will permit a new account to be opened in the name of a subsequent tenant.

(iii) The landlord should account for potential future sustainable development by including in operating expenses a charge for such utilities and/or by obligating the tenant to purchase from any on-site or off-site source.

(b) For the tenant, it is important to determine how utilities are measured. If there is one meter for the property, determine whether there are sub-meters for each tenant's space.

(i) When there are sub-meters, the tenant should determine the basis for the landlord's charge to the tenant (i.e., whether the landlord bills at cost, or assesses an administrative fee or any other form of surcharge).

(ii) In a setting in which there is only one meter and the tenants pay utilities based on a pro rata percentage, the tenant should evaluate whether one tenant's use of certain utilities may be significantly disproportionate to the tenant's and negotiate an appropriate adjustment to the payment obligation.

8. Additional Rent based on Expenses Attributable to Reciprocal Easement Agreement/Business Park Expenses.

(a) The landlord will include in operating expenses, or may separately provide for the payment of expenses attributable to reciprocal easement agreements and/or the business park generally.

(b) The tenant will want to limit its obligation to those expenses that are attributable to the term, will want to exclude or limit capital expenditures (see discussion of capital expenditures in #9 below) and will need to evaluate the correct proportionate share based upon total business park building square footage.

9. Additional Rent based on Operating Expenses.

(a) See **Appendix B - Special Issues Related to Operating Expense Provisions in Leases** - for an excellent general discussion of the topic of operating expenses.

(b) The landlord will include a very broad clause, requiring the payment of all expenses of any nature related to the ownership, operation, maintenance, repair and management of the building and common areas as determined to be necessary and desirable by the landlord, followed by a representative, but not all inclusive list of operating expenses.

(i) The list of operating expenses will include, by way of example:

(A) Cost to keep the building and property in compliance with law;

(B) Cleaning expenses;

(C) Landscaping expenses;

(D) Snow removal costs;

(E) Heating, ventilation and air-conditioning as well as all other utility expenses for the building and common areas not otherwise provided for in a separate lease provision;

(F) Insurance costs not otherwise provided for in a separate lease provision;

(G) Management fees;

(H) Supplies used for the maintenance, repair, replacement, management or operation of the building and/or common areas;

(I) Taxes not otherwise provided for in a separate lease provision;

(J) Wages of employees performing any services with respect to the maintenance, repair, replacement, management or operation of the building and/or common areas, including fringe benefits;

(K) Independent contractor charges pertaining to the maintenance, repair, replacement, management or operation of the building and/or common areas;

(L) Inspection and permit fees, accounting fees, attorney and professional fees incurred in connection with the maintenance, repair, replacement, management or operation of the building and/or common areas;

(M) Maintenance, repairs and replacements to paving, curbing, fencing, walkways, electric power lines, light poles, bulbs and drainage systems;

Published Articles (Cont.)

(N) Line painting and signage;

(O) Security services;

(P) Maintenance, repair and replacement of water, storm, sewer and sanitary sewer lines;

(Q) Amortization and depreciation of equipment purchased and used to maintain, repair, replace, manage or operate the building and/or common areas;

(R) Cost of ground leases;

(S) Garbage collection and removal costs; and

(T) Costs imposed pursuant to municipal approvals, such as maintenance costs for park land or traffic controls.

(c) The tenant will seek to limit operating expenses and provide for certain exclusions from operating expenses, including, by way of example:

(i) Limitations:

(A) Management fees – Tenant will seek to limit to a fixed percentage of base rent and/or limit to fees of independent third party management companies, not to exceed a fixed percentage of base rent.

(ii) Exclusions:

(A) Interest on and amortization of debt;

(B) Refinancing costs;

(C) Expenses that must be treated as capital expenditures under GAAP and therefore must be capitalized and depreciated;

(D) Maintenance, repair or replacement charges pertaining to the roof, foundation, floor, walls, or structure;

(E) Leasehold improvements for new tenants;

(F) Brokerage commissions;

(G) Costs arising from defaults by other tenants and costs attributable exclusively to one or more tenants but not attributable to the tenant;

(H) Amounts paid by landlord as ground rent;

(I) Advertising and promotional costs;

Published Articles (Cont.)

(J) Salaries for employees above the level of building supervisor;

(K) Income taxes;

(L) Cost of art work and sculptures;

(M) Fines and penalties;

(N) Expenses for which landlord is reimbursed by other tenants or insurance carriers; and

(O) Charitable and political donations.

(d) Capital Costs.

(i) The landlord will seek to include but limit the amount of capital expenses rather than exclude capital expenses completely, for example by providing for the amortization of capital expenses over an agreed upon period of time, such as eight or ten years. If agreed upon in concept, the tenant will likely argue for useful life based on GAAP. The landlord will also seek to collect interest on the unamortized portion of the expense. To the extent the landlord agrees that capital expenses should be excluded from operating expenses, rather than included on a limited basis, the landlord should seek to carve out of the exclusion certain capital expenses, including, by way of example:

(A) Capital expenses to address newly enacted laws and regulations;

(B) Capital expenses that result in a cost savings with respect to building operation. In this latter event, the tenant will try to limit the expense to the actual annual savings achieved.

(e) Operating Expense Increase - Limitation.

(i) The tenant will seek to limit any increase in operating expenses to the lesser of actual operating expenses or a fixed percentage increase per year.

(ii) Landlord may then seek to counter such position by either:

(A) Carving out of any limitation provision uncontrollable expenses such as taxes, insurance, snow plowing and utilities; or

(B) Providing that in the event less than the full agreed upon percentage increase is achieved in any one year, the difference may be carried over to another year. By way of example, if the annual cap is four percent and in one year operating expenses increase by only two (2%) percent, then in a subsequent year, the landlord may increase the operating expenses by up to six (6%) percent. The increase is always limited by the actual increase. Without such a provision, the landlord has no incentive to reduce or save on operating expenses.

(f) Audits.

(i) Process: The lease should provide for the landlord to provide the tenant with a reconciliation of operating expenses by a date certain. Thereafter, the tenant should have a set period of time within which to audit the reconciliation. If the tenant fails to timely audit the reconciliation, the tenant should thereafter be barred from an audit. If the tenant does audit the reconciliation, then the tenant should have a set period of time to complete the audit and file any objection. The lease should provide a set period for the parties to amicably resolve the matter before any claim may be filed. The landlord should consider requiring confidential arbitration for any claim pertaining to the audit. In addition, the landlord will want to impose a confidentiality obligation with respect to the entire audit process by requiring that both the tenant and the party undertaking the audit on its behalf execute a non-disclosure agreement satisfactory to the landlord as a condition precedent to the exercise of the audit right. Finally, the landlord should provide that in the event of a breach of the non-disclosure agreement, the tenant will lose its audit rights.

(ii) The tenant should be obligated to provide a copy of the audit and a detailed list of its challenges.

(iii) The lease should address:

(A) Where the audit will be conducted;

(B) Who pays for the audit; and

(C) Who can perform the audit? The landlord will want to preclude a firm that charges a percentage of the savings rather than an hourly fee and a prior employee of the landlord or any of its management companies.

(g) Gross-up of operating expenses.

(i) If the building is less than 95% leased during the base year, the tenant will want the operating expenses to be grossed up to reflect 95% occupancy so that the base year operating expenses are not artificially low.

(ii) If the building is less than 95% occupied during any lease year, the landlord will want the operating expenses grossed up to insure that the landlord collects the complete increase in operating expenses. A landlord wants to recoup all increases in operating costs even if the building is not fully occupied. The tenant may argue that only costs that vary with occupancy should be grossed up as opposed to fixed costs that do not vary with occupancy.

10. Additional Rent based on the Landlord's Costs Incurred in Performing the Tenant's Obligations.

(a) The landlord will want to be reimbursed if the tenant fails to perform any of its obligations under the lease and the landlord proceeds to perform such obligations. The tenant will want an initial notice and an opportunity to cure before the landlord has a right to incur any expenses and will want any reimbursement obligation limited to those expenses incurred that were both reasonable and necessary. The landlord should be careful to reserve a right to cure a tenant breach without having the obligation to

do so in order to avoid the odd result of a landlord breach arising from a tenant default.

11. Additional Rent based on a Late Payment.

(a) If rent or additional rent is not timely paid or paid within an agreed upon grace period (e.g., five days), then the landlord will want the tenant to pay a late fee.

(b) Late fees must be a reasonable estimate of the amount required to compensate the landlord for the loss/harm that the landlord will suffer as a result of the untimely payment or it may be challenged as a penalty. Penalties are not a permitted remedy for a contract breach.

12. Additional Rent based on Legal Fees Incurred to Enforce the Tenant's Obligations under the Lease.

(a) The landlord will want to be reimbursed for legal fees that it incurs as a result of the tenant's default. The lease should clearly specify whether legal fees are limited to litigation expenses or non-litigation expenses incurred in any enforcement effort. *See generally, Village Super Market, Inc. v. Estate of Saul Cantor*, 2011 N.J. Super. Unpub. LEXIS 2919 (App. Div. 2011); *2000 Clements Bridge, LLC v. OfficeMax North America, Inc.*, 2013 U.S. Dist. LEXIS 102444 (D.N.J. 2013).

(b) When the parties agree that the prevailing party will be entitled to legal fees they must be careful to define what constitutes "prevailing party." *See generally, Intercontinental Group v. KB Home Lone Star*, 295 S. W.3d 650 (2009). The parties may wish to provide that the party that obtains a determination of wrongful conduct by the other is the prevailing party regardless of whether actual damages are awarded.

(c) The landlord will also want to provide for reimbursement of legal expenses incurred to review any requests for consent from the tenant (assignment/subletting/alterations) and for review of any documents the tenant may request the landlord provide, including, by way of example:

- (i) A Subordination, Non-Disturbance and Attornment Agreement (SNDA);
- (ii) A Landlord Waiver/Subordination; and
- (iii) An Estoppel Certificate.

13. Percentage Rent.

(a) Percentage rent is frequently calculated on the basis of gross sales. The landlord will want to broadly define gross sales to include, by way of example, the sales price for all goods sold and services performed by the tenant or any other entity in, at or from the premises regardless of whether for cash, credit or other consideration. The landlord will want to include in gross sales all orders that originate at the premises regardless of (i) where delivery may take place, (ii) whether the order is made in person or by any technology based system now or hereafter existing, including, by way of example, telephone, catalogue, facsimile, or internet, and (iii) customer deposits that are not refunded to the customer.

Published Articles (Cont.)

(b) Break Point. The obligation to pay percentage rent will typically attach upon the tenant reaching the annual break point, which is frequently determined by dividing the annual rent by the percentage rent figure. By way of example, if the annual rent is \$100,000 and the percentage rent is eight (8%) percent, the natural break point will equal \$1,250,000. As such, the obligation to pay percentage rent will be triggered by the first dollar of gross sales in excess of \$1,250,000.

(c) The tenant will seek to exclude certain sales from the gross sales calculation, including, by way of example:

(i) Exchanges of merchandise made between tenant stores (although the landlord will want to limit the exclusion to exchanges made for the convenience of the customer and not exchanges made for the purpose of ultimately effecting a sale from another store to avoid percentage rent);

(ii) Returns to suppliers or manufacturers;

(iii) Refunds to customers on transactions otherwise included in gross sales;

(iv) Sales to employees (although the landlord will want to include the sale net of any employee discount);

(v) Interest charges, service charges and installment sales charges;

(vi) Going out of business sales and lost leader sales (on the theory that such sales do not produce profits);

(vii) Amounts from delivery service and installation charges;

(viii) Mail order catalogue sales and internet sales;

(ix) Vending machine sales (although the landlord will want to include the net collection amount); and

(x) Sales, excise and similar type taxes (although the landlord will only exclude to the extent such amount was included within gross sales in the first place).

(d) The landlord and the tenant will have to address reporting and inspection/audit rights just as they must do in connection with operating expenses. The landlord will want point of sales data and sales tax returns.

(e) Provide for closure due to casualty. In this respect, the parties may need to adjust the break point, particularly if the casualty occurs during peak months such as November and December.

(f) The parties may want to negotiate a kick out right entitling one party to terminate the lease if a certain threshold of gross sales is not achieved. If the tenant seeks such a right, the landlord will want to require a continuous operation covenant and reimbursement for tenant improvements, free rent and brokerage expenses.

14. Free Rent.

(a) It is important to be clear whether a period of free rent includes base rent and additional rent or just base rent.

(b) The landlord will seek a provision that requires payment of the free rent in the event the tenant defaults under the lease and the lease or possession is terminated.

(c) Determine whether free rent applies at the commencement of the lease, at the end of the lease, or at milestones during the lease term. Evaluate the impact of each to the intended holding period of the property and its future sale as well the timing of future refinancing.

15. Measurement.

(a) Applies to determination of base rent and pass through percentage. It is important to account for possible building expansion. Also, it is important to express clearly the method by which the rentable and usable square footage of a building and the premises are measured in order to avoid post-lease commencement disputes. In the event that a tenant is granted measurement rights, provide for an express and limited timeframe for an exercise of the right. Also, the lease should express clearly any add on factor included in the method of measurement if not included by definition in an expressed method of measurement. *See generally, ACBB-Bits, LLC v. 550 Broad St., L.P.*, 2011 N.J. Super. Unpub. LEXIS 2875 (App. Div. 2011); *cert. den.* 210 N.J. 217 (2012).

(b) Measurement methods. The Building Owners and Managers Association (BOMA) provides for several measurement standards for leased space, including:

(i) Industrial Buildings: Standard Methods of Measurement (ANSI/BOMA Z65.2-2009) which applies to warehouses, factories, flex space and distribution centers and has two methods of measurement, Method A (Exterior Wall Method) and Method B (Drip Line Method).

(ii) Gross Area of a Building: Standard Methods of Measurement (ANSI/BOMA Z65.3-2009) which usually is applied in a build to suit or sale-lease back transaction and includes two methods of calculation, the Construction Gross Area method and the Exterior Gross Area method.

(iii) Retail Buildings: Standard Methods of Measurement (ANSI/BOMA Z65.5-2010) which usually is used for shopping centers, strip malls and power centers.

(iv) Office Buildings: Standards Methods of Measurement (ANSI/BOMA Z65.1-2010) which supersedes the 1996 standard and has two methods, Method A and Method B.

SECURITY:

Published Articles (Cont.)

1. The landlord seeks security due to a number of factors, including, by way of example:

- (a) A concern for the creditworthiness of the tenant;
- (b) A concern for the fact that the landlord will be investing a certain sum to perform the tenant fit-up pursuant to the landlord's work letter; and
- (c) A concern for the fact that the landlord will have to pay a brokerage commission on the transaction before any meaningful lease term expires and any meaningful rent is collected.

2. Amount of security.

- (a) The amount of security will depend upon the creditworthiness of the tenant, the amount of tenant improvement work to be performed by the landlord and the brokerage commission to be paid by the landlord.
- (b) Although the amount may vary lease to lease, a security deposit will usually be in an amount equal to two months base rent; however, the amount of the security deposit is freely negotiable by the parties. The landlord will usually seek to increase the amount of the security deposit as base rent increases over the term of the lease.
- (c) The commercial landlord is not required to pay interest on the security deposit and is not required to deposit the security into a segregated account. *See generally, Mort's Family Group, L.L.C. v. Yan Huang*, 2011 N.J. Super. Unpub. LEXIS 2427 (App. Div. 2011); *Presberg v. Chelton Realty, Inc.*, 136 N.J. Super. 78 (Dist. Ct. 1975).

3. Forms of Security.

- (a) Guaranty. A guaranty of payment and performance from a creditworthy individual or entity.
- (b) Cash. Cash will provide the landlord with use of the money during the term, including use of the money to perform the tenant improvement work. A cash security deposit will, however, be deemed a part of the tenant's bankruptcy estate in the event the tenant files bankruptcy and seizure will be subject to the bankruptcy automatic stay.
- (c) Letter of Credit. A letter of credit will not be deemed a part of the tenant's bankruptcy estate. *See In Re Zenith Laboratories, Inc.*, 104 B.R. 667 (Bkr. D.N.J. 1989).
- (d) UCC Lien on Tenant's Personalty. The problem with this form of security is that the lien of the landlord will interfere with the tenant's ability to obtain financing for its day to day business operations.

4. Letter of Credit.

- (a) See **Appendix C** for a sample letter of credit lease clause.

Published Articles (Cont.)

(b) Letters of credit are governed by Article 5 of the Uniform Commercial Code (N.J.S.A. 12A:5-101 *et. seq.*) and either the Uniform Customs and Practice for Documentary Credits or the International Standby Practices 1998.

(c) The tenant will be obligated to pay for the letter of credit and any transfers and the landlord will want the letter of credit to comport with the following requirements:

(i) The landlord will want the letter of credit to be in form and content acceptable to the landlord, and will want the letter of credit to be an irrevocable, evergreen letter of credit that automatically renews unless the landlord is notified in writing within a certain number of days prior to the expiry date that the letter of credit will not be renewed. The letter of credit should not expire until at least thirty to forty-five days after the end of the lease term in order to provide the landlord with an opportunity to assess the condition of the property following the end of the lease term.

(ii) The letter of credit should be issued by a national U.S. bank reasonably acceptable to landlord, with an operational branch in the landlord's locale for purposes of drawing on the letter of credit. The letter of credit should be payable upon presentation of a sight draft and name the landlord as its beneficiary.

(A) If the bank fails, the landlord loses its security.

(B) Letters of credit are not covered by the Federal Deposit Insurance Corporation in the event of a bank takeover.

(iii) The letter of credit should be transferrable at no cost to the landlord so that the letter of credit can be transferred to a purchaser or to a mortgagee.

(iv) The letter of credit should permit full or partial draws, upon presentation of a sight draft signed by an officer or member of the landlord.

(v) The letter of credit should not express any conditions to a draw. If the tenant is concerned, then the lease agreement can provide for the conditions for draw, which should include, by way of example, a breach of the lease, a bankruptcy filing by the tenant or any guarantor, a failure to replace or reissue the letter of credit and a notice of non-renewal of the letter of credit.

(vi) The letter of credit should not condition a draw on any notice to the tenant.

(vii) The lease should provide that a draw on the letter of credit will not limit any of the rights and remedies of the landlord under the lease, or at law or in equity.

5. Guaranty.

(a) The guaranty should be absolute guaranty of payment and performance and not limited to collection. The guaranty must be in writing. See N.J.S.A. 25:1-15. See **Appendix D** for a sample form of Guaranty.

Published Articles (Cont.)

(b) If the guarantor is not located in the State of New Jersey then the guarantor should provide for a registered agent for service of process and agree to submit to the jurisdiction of the courts of the State of New Jersey.

(c) The guaranty should not require the landlord to notify the guarantor of any lease amendment, extension, holdover, sublease or lease assignment and the guaranty should expressly continue in full force and effect in the event of any lease amendment, extension, holdover, sublease or lease assignment, regardless of whether the guarantor acknowledges or consents to any of the foregoing. *See generally, Kanouse v. Wise*, 76 N.J.L. 423 (1908); *EAM Investments, LLC v. McDonagh Dodge*, 2012 N.J. Super. Unpub. LEXIS 839 (App. Div. 2012); *Center 48 Limited P'ship v. May Dept. Store*, 2002 W.L. 31741469 (App. Div. 2002).

(i) The landlord will expressly provide in the guaranty that the guarantor consents to any lease assignment, sublease, renewal, extension, space change (whether by addition, relocation or subtraction), and holdover.

(ii) The landlord also will expressly provide that the guaranty will run in favor of any assignee of the guaranty.

(d) The guaranty should provide for the payment of legal fees incurred in the enforcement of the guaranty.

(e) Good Guy Guaranty. Under a good guy guaranty, the guarantor will (i) not have any liability, or (ii) will have limited liability (either for the period from the default until surrender or for a stated period of time, such as one year's worth of rent and additional rent) if the tenant surrenders the premises without any delay provided that the premises is returned without any damage, without any construction liens and in accordance with the lease terms. If the premises is not promptly surrendered then the guaranty will "spring" into a full recourse guaranty. Depending on the nature of the tenancy, the landlord should consider either an added condition to the good guy guaranty, that the premises is returned free of any discharge of environmental violation, or a full recourse guaranty for environmental violations.

DEFAULTS:

1. Types of Tenant Default.

(a) Monetary Default.

(i) Failure to pay rent or additional rent.

(b) Non-Monetary Default – Failure to perform a non-monetary lease obligation, including, by way of example:

Published Articles (Cont.)

- (i) Lease noncompliance;
 - (ii) Bankruptcy filing or other creditor's rights proceeding pertaining to the tenant or a guarantor;
 - (iii) Assignment or sublease in violation of lease;
 - (iv) Failure of the tenant to deliver the letter of credit or a replacement letter of credit;
 - (v) Failure of the issuing bank to honor a draw on a letter of credit or renew a letter of credit.
 - (vi) Abandonment or vacation of the premises.
- (c) Habitual default.
- (i) Failure to pay rent or additional rent timely a stated number of times during a stated period of time, for example, two (2) times in any twelve (12) month period.
 - (ii) Failure to perform the same non-monetary covenant more than a stated number of times, for example, failure to timely deliver evidence of insurance more than two (2) times during the term of the lease.

2. Notice and Cure Rights.

(a) There are a number of issues for the landlord and the tenant to resolve with respect to notice and cure rights, including, by way of example:

- (i) Should a written notice be given before a monetary default or non-monetary default? A notice of default must be clear and unambiguous in informing a tenant of the default. *See generally, Village Super Market, Inc. v. Estate of Saul Cantor*, 2011 N.J. Super. Unpub. LEXIS 2919 (App. Div. 2011).
- (ii) If a written notice is required and an opportunity to cure is provided, how much notice and what length of time to cure should be given? In this respect, the landlord must remain mindful of its obligations to its lender and the timing for performance.
- (iii) If the non-monetary default is not readily susceptible of a cure, should the tenant be afforded additional time to cure? Here too, the landlord must remain mindful of its obligations to its lender and the timing for performance. The landlord will condition any extension on the tenant's having been diligent in its efforts to cure and continuing to diligently complete a cure. Depending on the nature of the default, the landlord may impose an outside date for completion, such as by way of example, where the continuation of the default will place the landlord in default of its mortgage, or subject the premises to a lien or forfeiture, or subject the landlord to liability to a third party.

(b) There are a number of non-monetary defaults with respect to which the landlord will not afford the tenant a right to notice or a right to cure, including, by way of example:

Published Articles (Cont.)

- (i) The tenant's failure to deliver an estoppel certificate in connection with a sale or financing of the premises after the landlord has provided a notice requesting delivery;
 - (ii) The tenant's failure to execute and deliver an SNDA after the landlord has provided a notice requesting delivery;
 - (iii) Environmental non-compliance;
 - (iv) The tenant's holding over after the expiration of the lease term;
 - (v) A bankruptcy filing or other insolvency proceeding filing with respect to the tenant or a guarantor;
 - (vi) An assignment, sublease or other transfer of the lease in violation of the terms of the lease agreement;
 - (vii) A failure concerning the letter of credit (delivery, replacement, honoring a draw); and
 - (viii) During the pendency of a separate and distinct default.
- (c) The landlord will provide in the lease that the landlord is permitted to accept rent during any outstanding notice and cure period as well as during a period of default, without waiving the outstanding default. The landlord will seek to make it clear in the lease that rent tendered during the pendency of an outstanding notice and cure period or following a termination notice, only represents a payment on account of money due and does not constitute a waiver of any outstanding notice of breach, default or notice of termination.

3. Requests for Consent.

- (a) The landlord will provide (i) that the landlord is not obligated to consider any request by a tenant for a consent (e.g., a request to consent to a lease assignment) and (ii) that the tenant is not entitled to exercise any rights (e.g., a right to renew or a right of first refusal), during an outstanding notice of default and related cure period.

REMEDIES:

1. Landlord Remedies for a Tenant Default.

- (a) The landlord will reserve a right of re-entry in the event of a default by the tenant under the lease, thereby permitting the landlord to re-enter by summary dispossession or other legal proceeding. The landlord will provide that even in the event of a re-entry, the tenant nevertheless will continue to be responsible under the lease through the expiration date based upon a survival clause that permits the landlord to sue for damages accruing after the re-entry, based upon the rent and additional rent remaining due under the lease.

Published Articles (Cont.)

(b) The landlord will reserve a right to terminate the lease in the event of any monetary or non-monetary default under the lease. As with the exercise of the right of re-entry, the landlord will provide that the tenant remains responsible under the lease pursuant to the survival clause and following the termination, for damages suffered by the landlord determined based upon the rent and additional rent remaining due under the lease.

(c) The landlord will also provide for the tenant to be responsible for base rent and additional rent arrearages to the date of re-entry or termination as well as certain expenses incurred by the landlord including, by way of example:

(i) The cost of repairing, renovating and placing premises in good order;

(ii) Unamortized brokerage expenses;

(iii) Unamortized tenant improvements;

(iv) Attorneys' fees and other costs of re-entering and re-letting the premises;

(v) Any abated or free rent; and

(vi) Any other obligations under the lease of the tenant that survive expiration or any earlier termination of the lease.

(d) Pursuant to N.J.S.A. 2A:18-53, a landlord has a limited right to sue for possession by way of a summary dispossession proceeding, including:

(i) Non-payment of rent (subject to the right of tenant to pay past due rent prior to the entry of a judgment for possession – N.J.S.A. 2A:18-55).

(ii) A failure to vacate at the end of the lease.

(iii) A violation of a non-monetary provision of the lease following which landlord terminates the lease and serves a notice to quit pursuant to N.J.S.A. 2A:18-56 and has reserved a right of re-entry. *See 350 Main Street LLC v. Guan*, 2011 N.J. LEXIS 1029 (App. Div. 2011), *cert. den.* 208 N.J. 338 (2011), (permitting the service of a notice to quit after the commencement of an action to dispossess but before entry of a judgment for possession).

(iv) In the event landlord obtains a judgment for possession, a warrant for removal will issue pursuant to N.J.S.A. 2A:18-57.

(e) Accelerated Rent.

(i) *See generally, Gannary v. Linker Realty Corp.* 131 N.J.L. 317 (E&A 1943). *See also, 2000 Clements Bridge, LLC v. OfficeMax North America, Inc.*, 2013 U.S. Dist. LEXIS 102444 (D.N.J. 2013) wherein tenant held responsible for rent and additional rent due to end of lease term in excess of rent payable by new tenant, discounted by 6%.

Published Articles (Cont.)

(ii) Accelerated rent is a contract remedy based upon the anticipatory breach by the tenant and its failure to pay rent due in the future. See **Appendix E** for a general form of landlord remedies and **Appendix F** for an alternative acceleration of rent clause.

(f) Waste. N.J.S.A. 2A:65-2 prohibits a tenant from committing waste and N.J.S.A. 2A:65-3 creates a cause of action for waste with a remedy of possession and treble damages. See *Birch v. Hanley*, 324 N.J. Super. 286 (Law Div. Special Part 1999).

(g) Right of Tenant to Excess Rents Collected by Landlord. The lease should provide expressly that the tenant is not entitled to the benefit of any excess rents collected by the landlord upon the re-letting of the premises. See *N.J. Indus. Prop. v. Y.C. & V.L., Inc.*, 100 N.J. 432 (1985).

(h) No Setoff. The landlord should expressly provide that the obligation of the tenant to pay rent is a covenant independent of all other rights of the tenant and obligations of the landlord and that the tenant must pay rent without any set-off, abatement or deduction. By structuring the obligation to pay rent as an independent covenant, the landlord will be in a position to argue that the tenant must pay rent regardless of any claim by the tenant of a default by the landlord.

(i) Self Help. The landlord should be careful about exercising self-help remedies and creating a basis for an alleged breach of the covenant of quiet enjoyment. See N.J.S.A. 2A:39-1 *et. seq.*

(j) Arbitration. If the lease includes an arbitration clause, the landlord should carve out from the obligation to arbitrate the pursuit of injunctive relief and the prosecution of a summary dispossession action. In such an event, the tenant should likewise carve out a right to remove the tenancy action to the Law Division. See N.J.S.A. 2A:18-60; *Morocco v. Felton*, 112 N.J. Super. 226 (Law Div. 1970). The landlord will seek to include a waiver of the right to transfer regardless of whether there is an arbitration provision.

(k) Mitigation. The landlord has an obligation to mitigate damages even in a commercial lease transaction. See *McGuire v. City of Jersey City*, 125 N.J. 310 (1991); *Fanarjian v. Moscovitz* 237 N.J. Super. 395 (App. Div. 1989). A landlord's failure to mitigate damages, however, will not necessarily act as a complete bar to recovery. See *Harrison Riverside Limited Partnership v. Eagle Affil., Inc.*, 309 N.J. Super. 470 (App. Div. 1998).

(i) The landlord should maintain a record of mitigation efforts, including advertising, listing the space with a broker, placement of signs, maintaining records of property showings to prospective tenants, and consultations with brokers to determine the current fair market rental value of the property.

(ii) The landlord should expressly provide that it is not obligated to rent the tenant's space ahead of other available space the landlord may have in its portfolio. The landlord also should provide that it does not have an obligation to correct any damage caused to the premises by the tenant in order to make the premises more presentable for leasing.

Published Articles (Cont.)

(iii) The landlord should provide that the tenant has the burden to prove the landlord failed to mitigate its damages.

(iv) Open question – the right of the parties to contract away the obligation of the landlord to mitigate its damages in a commercial lease.

(l) Issues with Re-Entry. Exercising the right of re-entry has certain issues that a landlord must assess, including the obligation to deal in a commercially reasonable manner with the goods of third parties that are warehoused by the tenant and the furniture, fixtures, equipment and material of the tenant that is subject to a lender lien.

1. Landlord Defaults – Landlord Perspective.

(a) A critical issue for the landlord remains the ability to finance and sell the premises. Each of these economic interests will turn on the lease agreement. As such, the landlord will want to make it clear that there are no implied warranties including warranties of habitability or warranties against latent defects, and will include a limited covenant of quiet enjoyment.

(i) The landlord will also include an exculpatory clause to further limit the obligations of the landlord. Exculpatory clauses are enforceable. *See Designer License Holding Company, L.L.C. v. The Resource Club, Ltd.*, 2009 N.J. Super. Unpub. LEXIS 2904 (App. Div. 2009).

(ii) The landlord will want to limit any recovery by the tenant to the landlord's equity in the property. Since the tenant has no control over the equity the landlord may have in the property, the tenant should seek both a right of set-off and a right to recover against the landlord's interest in the real estate rather than its equity in the property. This will entitle the tenant to pursue both the rent stream from the tenant as well as other tenants on the property, and any equity.

(iii) The landlord will want to limit its liability following a sale of the property and an assignment of the lease in order to avoid continuing liability for post-sale events. *See generally, Renee Cleaners, Inc. v. Good Deal Supermarkets of N.J., Inc.*, 89 N.J. Super. 186 (App. Div. 1965).

(iv) The landlord will exclude any personal liability of its members, partners, shareholder, etc. no matter how arising out of the landlord/tenant relationship, whether the claim is sounded in contract, tort or otherwise.

3. Landlord Defaults – Tenant Position.

(a) In the event of a default by the landlord, the tenant will seek to have all rights and remedies available at law and in equity including a right of off-set and a right to recover legal fees incurred in any action against the landlord.

Sources

Published Articles (Cont.)

Mark A. Senn, *Commercial Real Estate Leases: Preparation, Negotiation, and Forms* (5th ed. 2013).

1 *Commercial Real Estate Transactions in New Jersey* (Jack Fersko ed., 3rd ed. 2010).

Milton R. Friedman and Patrick A. Randolph, Jr., *Friedman on Leases* (5th ed. 2005).

S. H. Spencer Compton and Joshua Stein, *Landlord's Checklist of Silent Lease Issues (Third Edition)*, *Prac. Real Est. Law*, May 2013.