Consider Practical Realities when Drafting Landlord Remedies in Commercial Leases

by David S. Gordon and Todd E. Lehder

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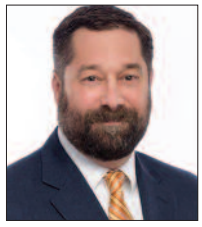

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While there may be an abundance of realty shows on television, no one has yet produced one dealing with the reality facing a commercial landlord when a tenant goes into default. Although not ready for prime time, the scripts for when a tenant defaults will vary depending on several factors, including the nature of the default; the nature and scope of the damages the landlord is facing; the remedies that have been provided in the lease; and, perhaps most important, whether any of these matter if the tenant does not have the financial ability to respond to a claim for damages.

When the tenant's business has simply failed and the tenant closes its doors or files for bankruptcy, the practical reality is that the landlord is between a rock and a hard place. The bankruptcy code creates a special purgatory for commercial landlords where the automatic stay prevents the landlord from taking any action against the tenant or reletting the premises. The bankruptcy trustee's power to reject or assume the lease further inhibits any meaningful planning for the future of the premises. How the commercial landlord operates within the structure created by the bankruptcy code, and the myriad of other situations a landlord may face outside of a tenant bankruptcy, are beyond the scope of this article. Rather, the authors will focus on some practical ideas for dealing with monetary and non-monetary defaults, and some alternative remedies intended to inspire more practical thinking within the commercial leasing marketplace.

Lawyers Love Their Forms

Non-monetary or covenant defaults come in all shapes and sizes. Neither this article nor this entire issue of *New Jersey Lawyer* can deal with all of them. The nature of the defaults, however, may dictate the approach necessary to craft a realistic remedy. One of the authors has actually lived through the surrender of possession of an industrial building used as a commercial bakery where the tenant asserted the accumulation of grease on the underside of the roof deck was the normal wear and tear of its long-term operations.[1] Months of arbitration and thousands of dollars later, the landlord's damage claim was settled. In hindsight, for the breach of a covenant dealing with condition on surrender, it would have been useful for counsel to have provided a detailed framework that could have been used to document the intention of the parties as to what constituted acceptable surrender condition and what constituted normal wear and tear. A sample provision containing such a framework can be found in Appendix A to this article, and can potentially be adapted to multiple types of uses. For other covenant breaches, however, innovative or imaginative drafting may not be the right approach. In those instances, the traditional form lease may provide for remedies such as self-help, specific performance or lease termination. However, except in instances where the market has changed substantially for the better, termination of a lease is often an ineffective, counterintuitive and counterproductive remedy for the landlord.

Take, for example, the failure (or refusal) of a tenant to timely deliver an estoppel certificate required by the landlord in connection with the refinancing of its property. Traditional remedies for this type of default include landlord signature of the estoppel as attorney in fact for the tenant, an action to compel specific performance and termination of the lease. But in many instances, none of these are practical remedies for the landlord. Commercial leasing lawyers might be well advised to consult with their colleagues representing lenders to inquire how many would accept a tenant estoppel signed by the landlord as attorney in fact. The mere fact that the landlord is unable to deliver a tenant estoppel raises a red flag, and the authors will wager that not only would such an estoppel be totally unacceptable to a lender, but a landlord estoppel in lieu of the tenant's would in all probability be equally unacceptable. Similarly,

an action for specific performance is impractical and termination of the lease is contrary to the interests of the landlord, both cutting the rental stream, which the landlord relies on to induce the lender to make the loan, and introducing an element of delay that is likely to be the death knell of the transaction.

What can help a landlord in this instance is an alternative remedy that effectively induces the tenant's cooperation and facilitates obtaining the tenant estoppel in a timely manner. The failure of the tenant to deliver the estoppel despite written and/or telephone notice from the landlord is generally the result of inattention on the part of the tenant or of an effort on the part of the tenant to gain leverage to resolve some conflict or obtain some collateral benefit.

Over the years, the authors have attempted in numerous instances to find alternative innovative remedies to avoid the unappetizing prospect of ligation or lease termination that is not in the landlord's interest. In the case of failure to timely deliver an estoppel certificate, a tenant's actions result in the landlord incurring both additional administrative and financial expense in attempting to close the loan transaction and further exposes the landlord to the potential loss of its loan commitment. The resulting damages, especially those that would arise by virtue of loss of the commitment and the necessity to obtain a new loan, would be difficult to calculate and prove, and may only be recovered by a landlord after a lengthy and expensive litigation process. For several years, some of the lease forms drafted by the authors' firm on behalf of landlords have incorporated a provision applicable in this circumstance, whereby a tenant's failure to timely deliver an estoppel certificate would result in the imposition of liquidated damages intended both to incentivize the tenant's attention to a situation of critical importance to the landlord and to compensate the landlord for the expenses and other potential damages that would be incurred as a result of the delay. Such a provision can be found in Appendix B to this article.

In this situation, the tenant is entitled to a second and detailed notice of the request for the estoppel to protect it from mere inadvertence. While not yet tested in litigation, acceptance of this alternative remedy by numerous experienced and knowledgeable tenants' counsel has convinced the authors that imaginative, outside-of-the-box thinking in formulating practical and realistic remedies can achieve acceptance in the commercial marketplace.[2]

Show Me the Money

Monetary default and intentional vacation of the leased premises by the tenants present entirely different problems to be confronted by landlords and their counsel. In many instances, these tenants either have or will soon go out of business, and absent a guarantee of the lease by a guarantor with continuing financial ability, the landlord's access to any security for the tenant's performance may be the only realistic remedy available. However, in many instances the tenant may be a continuing financially viable enterprise and the traditional remedy of a suit for money damages may be the most productive course.

The obstacle facing landlords in this situation is the obligation imposed by law to mitigate damages.[3] While the authors generally believe a tenant's default should result in the forfeiture of the right of the tenant to challenge the reasonableness of the landlord's costs or efforts to remedy or mitigate the effects of default, the case law places the burden of proving reasonable efforts to mitigate on the landlord and, thus, the reasonableness of those efforts becomes a question for the trier of fact.[4] As any experienced draftsperson knows, words such as material, substantial and reasonable frequently do little to interpose clarity, and more likely create issues that must be resolved by a trier of fact or the process of alternate dispute resolution.

In selecting a replacement tenant, the landlord may have legitimate business concerns impacting its decisions on acceptance or acceptability of a replacement entity, business or use.[5] Absent statutory validation of those concerns, such as is found in the bankruptcy code with regard to tenant mix as a valid concern to the owner of a retail shopping center, current case law leaves the landlord at risk in relying on its perceived legitimate business concerns in rejecting a replacement tenant. What is the landlord to do?

In New Jersey, the cases have not yet confronted a properly framed issue of whether or not sophisticated commercial tenants can waive a landlord's duty to mitigate. The experience of the authors, however, is that attempts by landlord's counsel to include an express waiver of the obligation to mitigate damages will be viewed by tenant's counsel (and perhaps by the tenant and landlord themselves) as an unnecessary waste of time and money. Accordingly, this is another instance in which the efforts of counsel are better directed to detailed drafting of the factors the landlord may take into consideration in connection with its efforts to mitigate damages.

It is curious to the authors that the concept of mitigation of damages or avoidance of economic loss is one that has been cast upon the victim of the breach of a contract or lease, apparently because the landlord knows what it has and has not done. This may be due to the way in which the case law in the area developed from the initial mitigation requirements imposed on landlords in the residential context.[6] In the commercial lease context, whether the tenant finds itself in financial straits or in need of a new home because of changes to its business environment, it is the

tenant who is generally first aware of these issues, usually well in advance of them coming to the attention of the landlord. Accordingly, it is the tenant who would have the first opportunity to take some action to mitigate the damages it is inflicting on the landlord and for which the landlord will eventually seek compensation. Talking to the landlord in advance so as to allow for additional time to plan and implement a search for a replacement tenant, and even the engagement by a tenant of a broker to locate a replacement, are two simple actions that could be taken on the tenant's initiative. For a tenant, or a trier of fact, to hold a landlord to a more stringent standard of reasonable efforts than those taken by the tenant itself, appears to the authors to be unfair in the context of a commercial lease.

The authors have attempted to incorporate in the mitigation of damages provision attached as Appendix C the concept that the trier of fact should take into consideration the efforts made by the tenant in weighing the reasonableness of the landlord's efforts. While this language has also not been tested in the crucible of litigation, it seems reasonable that the parties should be able to impart guidance to the trier of fact in the context of a commercial transaction.

Drawing One's Own Conclusions

Counsel for landlords and tenants, especially in transactions of any substance, should think beyond the forms that are the basis of their initial drafting efforts. While traditional remedies have continued efficacy in many circumstances, thinking about how they will play out in the practical reality of day-to-day commercial transactions will shed light on the situations where more alternative transactions can benefit all parties. And perhaps somewhere in the process counsel will find the inspiration for that new reality TV script that has eluded prime time for so long.

Appendix A

(a) Upon the expiration or earlier termination of the Lease Term of this Lease, Tenant shall quit and surrender to Landlord the Leased Premises in compliance with all governmental regulations as mentioned herein, broom clean and in good order, in the same condition as of the Commencement Date excepting ordinary wear and tear to painted surfaces and floor coverings, and damage by insured casualty. For purposes of clarification, and not limitation, Tenant's deferral of routine maintenance or failure to make repairs and any condition of the Leased Premises which was affected by Tenant's ordinary business operations, such as, but not limited to, accumulations of grease or dust on walls, ceilings, floors or in HVAC equipment, discoloration, staining, pitting or spalling of concrete floor surfaces, damage to walls, columns, bollards or doors or door frames/rails from materials moving equipment such as fork lifts, failure to remove cabling or controls such as, but not limited to, alarm panels, and damage to asphalt parking areas from excessive weight of vehicle or improper use of trailer dollies, shall not constitute ordinary wear and tear. In addition, notwithstanding an exception for reasonable wear and tear, Tenant agrees upon termination of the Lease, the air-conditioning, cooling systems, heating equipment and plumbing and electrical systems shall be in good, operable condition, all light fixtures and bulbs shall be operable, cleaned and in good working order, and the condition of the Leased Premises shall be as though the Tenant made all repairs and replacements as were necessary during the Term and was intending to continue the operation of its business at the Leased Premises. If requested by Tenant, Landlord shall advise Tenant as to the repairs and restoration to be undertaken by Tenant prior to the expiration of the Lease Term and shall remove all personal property of Tenant, and repair any damage done by the installation or removal of same, as directed by Landlord. Further, Tenant shall remove (i) all its signage from the walls and doors of the Building and/or Leased Premises and shall restore such walls or doors to the condition they were in prior to the installation of Tenant's signage (ii) all cable and/or wiring abandoned or to be abandoned by Tenant within the Leased Premises as necessary to comply with current code, rule or regulation, (iii) all debris from the Leased Premises including the cleaning up of the dumpster area(s) and loading dock areas, and (iv) all dumpsters or garbage containers. If the Leased Premises is not surrendered in the condition required under this Section, Tenant shall be deemed to be a holdover, without regard to whether or not Tenant is in physical possession or occupancy of all or part of the Leased Premises, and Tenant shall indemnify and defend Landlord against loss or liability resulting from the delay by Tenant in so surrendering the Leased Premises, including, without limitation, any claims made by any succeeding tenant or proposed succeeding tenant founded on such delay.

(b) Unless sooner terminated, during the last six (6) months of the Term Landlord will inspect the Leased Premises and advise Tenant of the work required to place the Leased Premises in condition for surrender pursuant to the terms of this Section. Landlord's advice shall be subject to circumstances or events occurring

between the date of the inspection and the date of surrender, as to which Landlord reserves all rights.

(c) If Tenant fails to surrender the Leased Premises as required by this Section, Landlord may, at its option, make any repairs or take other actions so as to perform the obligations of Tenant and the costs and expenses shall be reimbursed to Landlord by Tenant upon demand. Additionally, if as a result of the fact that Tenant does not surrender the Leased Premises in the condition required by this Section, work is required to be performed, whether by Tenant or Landlord, following the expiration or earlier termination of the Term, Tenant shall be deemed to be a holdover tenant and shall be liable to Landlord for payment of holdover rent as provided in this Lease.

(d) All remedies of Landlord, including, without limitation, the remedies provided for in this Lease, shall be cumulative, and in addition, Landlord may pursue any other remedies that may be permitted by law or in equity. Forbearance or an election by Landlord to enforce one or more of the remedies herein provided upon an event of default shall not be deemed or construed to constitute an election of remedies, a waiver of any other remedy which may be available or a waiver of such default. Tenant's obligations under this Section shall survive the expiration or earlier termination of this Lease.

Appendix B

(a) Landlord and Tenant each agree that at any time after the Commencement Date and from time to time upon not less than ten (l0) days' prior written request from the other, to promptly execute, acknowledge and deliver a written statement in the form reasonably requested by any actual or proposed mortgagee or actual or prospective purchaser of the Leased Premises, or a permitted sublessee or assignee, lender, lessor or prospective purchaser of Tenant's business, and, if requested, under oath, certifying facts related to this Lease, including, without limitation, that the Lease is unmodified and in full force and effect (or if there have been modifications or exceptions, that the same is in full force and effect as modified or excepted, and stating the modifications and exceptions, if any), the date to which the rental and other charges have been paid in advance, if any, and any other factual matters regarding Tenant and, to the best of Tenant's knowledge, regarding Landlord, which may be reasonably required. Any such statement delivered pursuant to this paragraph may be relied upon by a third party. Tenant shall not be entitled to more than two (2) such statements from Landlord in any period of twelve (12) consecutive months. Tenant shall reimburse Landlord, within thirty (30) days of request for reimbursement, for Landlord's reasonable out of pocket costs and expenses in connection with the review, negotiation and execution of any such statement requested by Tenant, including, without limitation, reasonable counsel fees and disbursements.

(b) Tenant acknowledges that if Tenant fails to provide a statement pursuant to subsection (a) of this Section within the time provided, the cost to and damages that may be incurred by Landlord will be difficult to ascertain and prove. Accordingly, the parties agree that if Tenant's failure continues beyond five (5) business days after Tenant's receipt of a second request for such statement or amendment, which second request expressly states "THIS SECOND REQUEST IS GIVEN PURSUANT TO SECTION ___ OF THE LEASE AND FAILURE TO RESPOND WITHIN FIVE (5) BUSINESS DAYS WILL SUBJECT TENANT TO LIQUIDATED DAMAGES," the Landlord's non-exclusive remedies for such failure shall be (i) to seek an order for specific performance or affirmative injunction against Tenant, (ii) to recover from Tenant liquidated damages in the amount of $500.00 per day for each day or portion thereof of the first five (5) calendar days of such failure, which amount shall double every five (5) calendar days (or portion thereof), *e.g.,* $1,000.00 per day for the 6th to 10th calendar days; $2,000.00 per day for the 11th to 14th calendar days, etc. and (ii) to seek an order for specific performance or affirmative injunction against Tenant, and (iii) to declare an event of default as to which the right to cure provisions of this Lease shall not be applicable.

Appendix C

In the event of a default by Tenant, Landlord shall make commercially reasonable efforts to mitigate damages. Notwithstanding the foregoing, Landlord (i) shall not be required to prefer the Leased Premises over any other vacant space which Landlord or Landlord's affiliates may have, (ii) shall be deemed to be commercially reasonable in considering the relative economic benefit of preferring other space over the Leased Premises, (iii) shall not be required to advertise the Leased Premises to any greater extent than it advertises any other available space, (iv) shall be entitled to consider credit history, negative references from prior landlords, concern over the environmental impact of the business, any change or intensification of use of the Premises

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and restrictions on permitted occupancy as a result of contractual lease obligations to other tenants, and (v) shall have no greater obligation with regard to its efforts to mitigate damages than the efforts made by Tenant itself to mitigate damages prior to or after default by Tenant. ⚖

Endnotes

1. The grease was so thick one could not walk under the former location of the oven in the summer weather when the roof was heated by the sun without the grease dripped like April showers.
2. This remedy is not applicable to all covenants governing tenant deliverables, such as subordination, non-disturbance and attornment agreements (SNDAs), where lenders may have used the SNDA to make changes to the lease and where it would be unfair and prejudicial to the tenant to trigger liquidated damages when tenant's counsel may be negotiating the SNDA form in good faith.
3. The New Jersey Supreme Court has held that a landlord has an obligation to mitigate damages arising from the breach of a commercial lease. *McGuire v. City of Jersey City*, 125 N.J. 310, 320, 593 A.2d 309, 314 (1991). *See also*, *Fanarjian v. Moskowitz*, 237 N.J. Super. 395, 407, 568 A.2d 94, 100 (App. Div. 1989); *Harrison Riverside Limited Partnership v. Eagle Affiliates, Inc.*, 309 N.J. Super. 470, 707 A.2d 490 (App. Div. 1998); *Ringwood Associates, LTD v. Jack's of Route 23, Inc.*, 166 N.J. Super. 36, 398 A.2d 1315 (App. Div. 1979); *Carisi v. Wax*, 192 N.J. Super. 536, 471 A.2d 439 (Bergen County Dist. Ct. 1983); and 2 Andrew R. Berman, F*riedman on Leases* §§16.03, 16:3.1[B], 16:3.1[C] (6th Ed. 2017).
4. *See*, *Borough of Fort Lee v. Banque National de Paris*, 311 N.J. Super. 280, 710 A.2d 1 (App. Div. 1998); *Jaasma v. Shell Oil Company*, 412 F.3d. 501 (3rd Cir. 2005).
5. Relevant criteria in selecting a replacement tenant may include, but are not limited to, credit history, negative references from prior landlords, concern over the environmental impact of the business, any change or intensification of use of the premises and restrictions on permitted occupancy as a result of contractual lease obligations to other tenants.
6. *See*, *Sommer v. Kridel*, 74 N.J. 446 (1977).

Construction Liens Arising From Tenant Work

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extent of the face amount claimed in the lien claim" and is liable for all reasonable legal expenses incurred by any party obtaining the lien's discharge.

While it is unclear that a lien claimant that performed tenant work and then erroneously, but innocently, filed a construction lien against the owner's fee interest would be found to have violated any of the grounds for forfeiture, at the very least if shown to have been wrongfully filed against the fee interest, the court should still summarily order the discharge of the lien. The claimant, thereafter, may be precluded from re-filing its lien even if just by the expiration of the strict 90-day limitations period to file a lien from the claimant's last date of work or provision of materials.[10]

Conclusion

A construction lien resulting from tenant work may be filed against a landlord's fee interest in only limited statutory circumstances. A construction lien wrongly filed against the landlord's fee interest will subject the lien to discharge. Even if properly filed only against the leasehold interest, a construction lien may still cause a variety of problems for a landlord, particularly if it seeks to sell, develop or refinance the property. The landlord generally will have recourse in its lease against its tenant requiring the tenant to discharge the lien, though delays may result. The safest course is for tenants, and their landlords, to maintain as many strict controls over the construction process on their property as possible to attempt to ensure that no construction liens are filed in the first place. ⚖

Endnotes

1. N.J.S.A. 2A:44A-1, *et seq*.
2. *Cherry Hill Self Storage, LLC v. Racanelli Construction Co., Inc.*, Docket No. A-5727-05T5 (N.J. App. Div. June 18, 2007).
3. *The Benmore Construction Group, Inc. v. Herod Rutherford Developers, L.L.C.*, Docket No. A-2460-08T2 (N.J. App. Div. Nov. 18, 2009).
4. *Sagi v. Sagi*, 386 N.J. Super. 517, 524-25 (App. Div. 2006).
5. N.J.S.A. 2A:44-10; N.J.S.A. 2A:44-22.
6. N.J.S.A. 2A:44A-10.
7. N.J.S.A. 2A:44A-38.
8. N.J.S.A. 2A:44A-14, -24.1; N.J.S.A. 2A:44A-31.
9. N.J.S.A. 2A:44A-15d.
10. N.J.S.A. 2A:44A-6a(2).