



Five Deadly Sins: Lease Clauses a Landlord Should Refuse to Negotiate Under Any Circumstances

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When a landlord or its attorney prepares an initial draft of a lease on the landlord's form, it is expected that the tenant will simply sign the lease (but only if the tenant believes it has no leverage whatsoever), return the lease with handwritten comments, or, if the tenant's comments are extensive and it has taken control of the drafting process, return a black-lined copy of the lease that it has revised. What then begins is the long exercise of lease negotiation, where each side asserts its best positions with the hope of ending up with a lease with which each side can live. There are, however, five provisions the landlord and its attorney should not agree to modify. Such modification is tantamount to the commission of a deadly leasing sin. Here are the subject matters and sample lease provisions that should not be touched:

1. Hazardous Materials:

Neither tenant, nor any of tenant's agents, contractors, employees, licensees or invitees shall at any time handle, use, manufacture, store or dispose of in or about the Premises or the Shopping Center any flammables, explosives, radioactive materials, hazardous wastes or materials, toxic wastes or materials, or other similar substances, petroleum products or derivatives or any substance (collectively "Hazardous Materials") subject to regulation by or under any federal, state and local laws and ordinances relating to the protection of the environment or the keeping, use or disposition of environmentally hazardous materials, substances, or wastes, presently in effect or hereafter adopted, all amendments to any of them, and all rules and regulations issued pursuant to any of such laws or ordinances (collectively "Environmental Laws"). Tenant shall protect, defend, indemnify and hold landlord harmless from and against any and all loss, claims, liability or costs (including court costs and attorney's fees) incurred by reason of any actual or asserted failure of tenant to fully comply with all applicable Environmental Laws, or the presence, handling, use or disposition in or from the Premises of any Hazardous Materials, or by reason of any actual or asserted failure of tenant to keep, observe, or perform any provision of this paragraph.

The length and depth of the hazardous materials clause arises because of the complex and constantly growing body of law that now places ultimate responsibility for hazardous materials on the property owner where the material was created, used, disposed, spilled, etc. This liability has forced numerous otherwise solvent landlords into bankruptcy through no fault of their own. It is not only imperative that this clause not be altered, but also that the person responsible for the lease determine what kind of business the tenant is engaged in and what its past record has been with regard to hazardous materials. This clause will receive significant interest from any prospective purchaser or lender and should not be altered without consulting professionals.

If a tenant insists that it be permitted to handle small quantities of Hazardous Materials, the following language could be added:

Notwithstanding the foregoing, and subject to landlord's prior consent, tenant may handle, store, use or dispose of products containing small quantities of Hazardous Materials (such as aerosol cans containing insecticides, toner for copiers, paints, paint remover and the like) to the extent customary and necessary for the use of the Premises for general office purposes; provided that tenant shall always handle, store, use, and dispose of any such Hazardous Materials in a safe and lawful manner and never allow such Hazardous Materials to contaminate the Premises, Building and appurtenant land or the environment.

Even though a lease may be a retail or industrial lease, the use of "general office purpose" is appropriate so that the type of permitted Hazardous Materials is as limited as possible. Allowing materials customary for general industrial purposes, for example, could open the door for virtually any type or amount of hazardous materials.

2. Indemnification:

Landlord shall not be liable and tenant hereby waives all claims against landlord for any damage to any property or any injury to any person in or about the Premises or the Shopping Center by or from any cause whatsoever, except to the extent caused by or arising from the gross negligence or willful misconduct of landlord or its agents, employees or contractors. Tenant shall protect, indemnify and hold the landlord entities harmless from and against any and all loss, claims, liability or costs (including court costs and attorney's fees) incurred by reason of (a) any damage to any property or any injury to any person occurring in, on or about the

Premises or the Shopping Center to the extent that such injury or damage shall be caused by or arise from any actual or alleged act, neglect, fault, or omission by or of tenant, its agents, servants, employees, invitees, or visitors to meet any standards imposed by any duty with respect to the injury or damage; (b) the conduct or management of any work or thing whatsoever done by the tenant in or about the Premises or from transactions of the tenant concerning the Premises; (c) tenant's failure to comply with any and all governmental laws, ordinances and regulations applicable to the condition or use of the Premises or its occupancy; or (d) any breach or default on the part of tenant in the performance of any covenant or agreement on the part of the tenant to be performed pursuant to this Lease. The provisions of this Article shall survive the termination of this Lease with respect to any claims or liability accruing prior to such termination.

There are two key protections for the landlord in this clause: *exculpation* and *indemnification*. First, in the exculpation, the tenant waives, or agrees not to pursue, any claims against the landlord that arise from things that are not due to the landlord's negligence or willful acts. The logic behind this is that the tenant's insurance should cover these kinds of losses and, as long as the landlord is not directly responsible for the loss, the landlord should not be held responsible. This is especially true for the landlord's repair obligations. Unless the landlord is grossly negligent in getting the repairs made, the tenant does not have any recourse (other than to sue for breach of the lease) against the landlord and the tenant's insurance should cover his losses. The second half of this clause, the indemnification, places responsibility on the tenant for losses that arise out of the tenant's fault, work, breach of the lease, or failure to abide by applicable governmental regulations. Again, this clause in many ways is a means of determining whose insurance should cover various incidents and should be read in conjunction with the article regarding insurance requirements. Some tenants may object to their responsibility for "invitees or visitors," but tenants are in the best position to control the actions of such persons and therefore the tenant's insurance should be at risk for the actions of these persons. If this is the only issue, "invitees or visitors" may be deleted.

Often, a tenant will request mutual indemnification from the landlord. This should not be given except on a very limited basis for breach of the landlord's obligations to perform specific covenants under the lease, and the tenant's sole recourse shall be to correct the situation and offset rent. The tenant shall not be allowed to sue the landlord for damages.

3. Insurance:

Tenant shall keep in force throughout the Term: (a) a Commercial General Liability insurance policy or policies to protect landlord against any liability to the public or to any invitee of tenant incidental to the use of or resulting from any accident occurring in or upon the Premises with a limit of not less than \$1,000,000.00 per occurrence and not less than \$2,000,000.00 in the annual aggregate, or such larger amount as landlord may prudently require from time to time, covering bodily injury and property damage liability and \$1,000,000.00 products/completed operations aggregate; (b) Business Auto Liability covering owned, non-owned and hired vehicles with a limit of not less than \$1,000,000.00 per accident; (c) insurance protecting against liability under Worker's Compensation Laws with limits at least as required by statute; (d) Employers Liability with limits of \$500,000.00 each accident, \$500,000.00 disease policy limit, \$500,000.00 disease - each employee; (e) All Risk or Special Form coverage protecting tenant against loss of or damage to tenant's alterations, additions, improvements, carpeting, floor coverings, panelings, decorations, fixtures, inventory and other business personal property situated in or about the Premises to the full replacement value of the property so insured; and, (f) Business Interruption Insurance with limit of liability representing loss of at least approximately six months of income.

Each of the aforesaid policies shall (a) be provided at tenant's expense; (b) name the landlord and landlord's mortgagee as additional insureds; (c) be issued by an insurance company with a minimum Best's rating of "A:VII" during the Term; and (d) provide that said insurance shall not be cancelled unless thirty (30) days prior written notice (ten days for non-payment of premium) shall have been given to landlord; and said policy or policies or certificates thereof shall be delivered to landlord by tenant upon the Commencement Date and at least thirty (30) days prior to each renewal of said insurance.

Tenant is required to maintain certain minimal levels of insurance to make sure that the various liabilities that tenant undertakes under the lease will have some insurance backing them up. These levels should be considered as minimums and may be increased in appropriate circumstances. For instance, where an anchor tenant is taking a particularly large space or its business involves an extraordinary number of visitors or delivery persons or the term runs for a longer than normal time, it might be advisable for higher limits to be set. Most tenants will have the amounts set forth in their standard policies, with the exception of the business interruption insurance. This insurance pays the tenant for lost business if there is an incident that prevents the tenant from operating. This is important from the landlord's viewpoint because it gives some assurance that the tenant will not go out of business if such an incident occurs, and the tenant will have the ability, through insurance, to continue paying rent and other charges as they become due. It is different from rental abatement insurance because it pays the tenant's business losses, not the landlord's rent losses.

Often, a tenant will argue for the deletion of business auto liability and workers' compensation insurance when no work is being performed by the tenant. While this should be resisted, it should not become a "deal point" if the tenant threatens to make it so. Also, many larger tenants will seek to avoid obtaining third-party insurance in favor of self-insurance. If the landlord is unable to change the tenant's position on this issue, a minimum net worth (usually \$100 million) is required, together with the requirement that the tenant's net worth not decrease by more than 10% in any one year. The tenant should have the burden of providing satisfaction to the landlord of the tenant's net worth.

4. Waiver of Subrogation:

So long as their respective insurers so permit, tenant and landlord hereby mutually waive their respective rights of recovery against each other for any loss insured by fire, extended coverage, All Risks or other insurance now or hereafter existing for the benefit of the respective party but only to the extent of the net insurance proceeds payable under such policies. Each party shall obtain any special endorsements required by their insurer to evidence compliance with the aforementioned waiver.

Waiver of subrogation is an area that only insurance agents and very picky and troublesome tenants care about. As both the landlord and tenant carry insurance that covers various losses, both benefit from a waiver of subrogation (eg, if the landlord causes the fire which destroys the tenant's equipment, the tenant will look to its casualty insurance and that insurer will not have the right to sue the landlord). In plain English, this provision means that if either the tenant or the landlord has insurance covering a loss, both parties will look first to the insurance rather than suing the party at fault. If the insurance is inadequate, however, then the lease determines who is liable to whom. Also, if both parties are carrying insurance for the same loss, the lease would govern whose policy would pay.

5. Liability of Landlord (if premises is a shopping center):

If landlord shall fail to perform any covenant, term or condition of this Lease, and if tenant shall recover a money judgment against landlord, the judgment shall be satisfied only out of the proceeds of sale received upon execution of the judgment and levy against the right, title and interest of landlord in the Shopping Center as the same may then be encumbered, and neither landlord nor any of its partners shall be liable for any deficiency. It is understood that in no event shall tenant have the right to levy execution against any property of landlord other than its interest in the Shopping Center. The right of execution shall be subordinate and subject to any mortgage or other encumbrance upon the Shopping Center. No trustee, shareholder, officer, member, director, employee, parent or subsidiary company, landlord affiliate or partner of landlord shall in any event or at any time be personally liable for the payment or performance of any obligation required or permitted of landlord under this Lease or under any document executed in connection herewith. No attachment, execution, writ or other process shall be sought or obtained, and no judicial proceeding shall be initiated by or on behalf of tenant, against landlord personally or landlord's assets (other than landlord's interest in the Shopping Center) as a result of any such failure, breach or default and neither they nor landlord nor any landlord affiliate shall be liable for any deficiency.

This provision may, in fact, be the most dangerous of all the deadly sins if the landlord allows it to be negotiated. The limitation of liability against all individuals affiliated with the landlord should be of primary concern. Often, a tenant will want evidence that a landlord has an equity investment in the project before agreeing to the concept. In other situations, a tenant may insist on having recourse against future rents or other proceeds that a landlord may collect. The landlord should make certain these amounts have not already been pledged to a lender before agreeing to commit them to a tenant.

It should be noted that several key lease provisions (use, alterations, repair, assignment and subletting, default and remedies, etc.) are not discussed in this article. This is not meant to suggest that such provisions are less important than those analyzed above. It simply means that such provisions generally are the subject of much negotiation, and the landlord often concedes more than it originally wanted to do and also has several varying "hot buttons" or positions depending on the particular situation. The five deadly sins either do not elicit the same adverse response from the tenants, or are so narrow in scope that they do not leave much "wiggle" room to negotiate.

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