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Your broker should guide you in finding a property suitable for your business needs by bringing the best deals available in the market to you for consideration. Your broker can also help you save time and avoid unnecessary legal fees by doing the leg-work and conveying information between prospective tenant and landlord. Once you have a proposal from a landlord reflecting the best price terms, a penny spent on a good lawyer to review proposals and work with your broker in negotiations can save many a pound later.

Negotiating a Commercial Lease

by Richard S. Sternberg, Esquire © 1989

Your future landlord has negotiated hundreds of leases this past year. If you haven't been involved in the same number of leases this year, you are at a disadvantage in negotiating one of the largest overhead items in your business. Fortunately, if you are seeking commercial rental space in the Washington Metropolitan Area, this is a good time for shopping; though price negotiations seem to be limited to temporary concessions, it is a buyer's market and landlords are anxious to fill their vacant space. Once your broker has done his or her work by bringing you a few of the best deals, it is time to put your lawyer to work evaluating lease terms, preparing a strategy, and guiding the negotiations. Most businessmen already know how to negotiate price, but the concessions you may be able to negotiate in terms may far outweigh the value of available price concessions.

Personal Guaranties: So long as you are doing business in corporate form, rather than as a sole proprietorship or partnership, a prime consideration ought to be whether the landlord will require a personal guaranty. Signing a personal guaranty makes you liable for breaches of the lease and, generally, gives you no more procedural protection than the tenant.

It is unlikely, however, that the requirement for a personal guaranty will be considered negotiable by the landlord unless your business has sufficient experience and capital backing or the landlord is sufficiently desperate. In the present buyer's market, however, more and more confirmed stories are being heard of weak businesses having commercial leases without personal guaranties.

Assuming you cannot escape a personal guaranty, try to weaken the effect of it. Guarantors are required to receive separate notice of defaults unless the guaranty contract waives notice. All the form guaranties waive notice, but many a tough negotiating session has resulted in the notice waiver clause being struck.

Further, there is an argument, albeit weak, that a guarantor who does not sign the lease is not bound by a jury waiver in that lease. Thus, if your corporation signs the lease, but you sign the guaranty, that distinction could be significant. If the guarantor has a jury trial, even if the corporate tenant does not, the case may be slowed enough to effect a fair settlement.

There is a case from 1882 in the District that states that lease guaranty contracts must be separately dated and signed to be enforceable, even if the guaranty is on the same sheet of paper as the lease and was signed at the same time by the same people. While the case is probably out-of-date and no-one seriously believes it will be enforced, several of the form leases in the metropolitan area break this rule by placing the guaranty at the bottom of the lease as a separate clause of the lease. Any port will do in a storm.

Jury Demands: The standard lease used by landlords in the District and surrounding areas

waives the right to a jury trial of disputes arising out of the lease. While such clauses are frequently invalid in residential leases, they have been uniformly upheld in commercial leases. A demand for jury trial is the single most significant weapon for the tenant if a fight ever develops.

Absent a valid jury demand, trial can occur in a matter of weeks. The trial will occur before an over-taxed judge rendering assembly-line justice. In a court where hundreds of cases are slated for trial each day, any argument more complicated than "I paid the rent; here is a photocopy of the cancelled check" is virtually certain to lose. Grievances about the landlord's failure to provide essential, contracted services will be ignored or shunted over for trial in another court years later. In most instances, there will not be time for you to prepare witnesses or documents before trial, it will be almost impossible to obtain any discovery from the landlord about the evidence supporting his case, and there may not even be time for you to interview and select a trial lawyer to handle your defense. At very least, your business will be wholly, and, often fatally, interrupted while you devote full time and attention to this dispute rather than providing service to your customers. Almost inevitably, this assembly-line judicial process ends with a brief trial during which the court's primary concern is getting through its crowded docket, and a routine finding for the landlord. Landlords win virtually every case tried to a judge in Landlord and Tenant Branch.

Most disputes between landlords and commercial tenants either involve complex issues under the lease or a non-payment of rent by the tenant due to failing business. In both cases, tenants who have waived the right to demand a jury will find their cases over before there has been an opportunity to seek a proper settlement. Even if their trial lawyer can maneuver the case into the proper posture for a just settlement, the legal expenses will increase by several thousand dollars because of the jury waiver clause.

In negotiating to remove the jury waiver clause from the lease, the landlord's agent may claim that the clause is non-negotiable because a jury demand results in years of delay during which the tenant can withhold rent. This is simply false, though it is a common misconception in the District.

Under D.C. law, a proper jury demand in Landlord & Tenant Branch results in the case being certified to Civil Division for an expedited trial. Motions continue to be heard in Landlord & Tenant Branch in as few as five days from filing. Trials are set, on average, several months after the case is certified. While continuances are common, judges uniformly require tenants to pay the disputed rent into the Registry of the Court while the suit is pending; failure to make Davis payments, as they are called, usually results in the tenant's pleadings being struck and judgment being rendered for the landlord, and can result in a contempt citation.

If, when all is over, the landlord wins, the amount in the Registry is released to him by the Court. If the tenant wins, that part of the sum in the Registry due back to him is returned. During the pendency of the lawsuit, the pot in the Registry becomes an incentive to both parties to settle the case amicably and reasonably.

Counterclaims, Set-offs, Deductions, and Recoupments: Most commercial leases found locally contain a clause which requires the payment of rent without deduction, set-off, counterclaims, or recoupment. Until very recently, such clauses, which are generally unenforceable in residential leases, were read to have little practical effect in a commercial setting. Two trial judges in the District, as of this writing, have added a whole new spin to these clauses that makes them so damaging that tenants must get them excluded from their leases or face devastatingly unfair litigation tactics by clever landlord's

attorneys. While few landlord's attorneys understand the effect of this seemingly subtle change in the law as of this writing, such ignorance is unlikely to remain a reality for long.

Under the old interpretation of a "no deduction" clause, a tenant was prohibited from withholding rent based on a claim that the landlord owed him money for breach of the lease or for some other independent reason, such as breach of another contract, negligence, or fraud. If the tenant did withhold rent payments and the lease contained a "no deduction" clause, the landlord could issue a notice of breach and subsequently sue for possession of the property. As long as the landlord sued for breach, rather than non-payment of rent, and sought no money damages, the suit papers could be served in relative secrecy and there would be no defense to the landlord's claim for possession. The landlord could have the property back in fairly short order.

As a practical matter, most landlords facing this situation either misunderstood the law or foolishly sought payment of claimed arrearages. In the face of good defense, the claims for breach came marching back into the lawsuit and tenants were able to make their claims in Landlord & Tenant Branch rather than waiting years for an economically unfeasible trial in Civil Division.

Two judges thus far have created a tidal wave in this otherwise stable pond, and some lucky tenant inadvertently placed in this setting is going to have the honor of paying his lawyer thousands to take this issue to the Court of Appeals for final resolution. The judges have decided that a "no deduction" clause is enforceable as written. As such, the only useful defense to a landlord's claim that the rent is unpaid is that the full amount of all claimed rent has been paid in full. Landlord & Tenant Branch, under this dubious interpretation of law, is reduced from a court appointed to administer justice to a landlord's tribunal designed to ensure the collection of any amount of rent claimed.

Of course, no one, judge or otherwise, has argued that a tenant cannot sue his landlord when the landlord breaches the lease. Under this interpretation, if it is upheld by the Court of Appeals, the tenant can only file his claims in Civil Division and wait several years for resolution, while the landlord can freely retaliate during the pendency of the tenant's lawsuit and, whenever appropriate, rush to Landlord & Tenant Branch each and every time the tenant errs.

Monthly Operating Expense Increase Allocations and C.P.I.: It is neither unusual nor unjust in commercial leases of more than one year to shift inflation burdens from the landlord to the tenant. In rent-controlled areas, such as the District, there are statutory and regulatory limits on such shifts for residential leases. Commercial leases are not so limited and can flexibly move cost items such as operating expenses and common area maintenance to the tenant, or assess the tenant for presumed inflation in accordance with some agreed-upon formula. In principle, such clauses seem fair.

These clauses as found in leases throughout the local area are more frequently used as a way to hide additional rent. It is not uncommon to see both an annual rent increase indexed to the consumer price index, which many economists believe to be an overly-high index when used for commercial purposes, and, in the same lease, a separate formula apportioning actual increases in operating expenses or common area maintenance expenses. Thus, the landlord gets paid once for his actual cost increases during the year and, again, for some presumed increase based on an inaccurate index.

Presumably, if the landlord and tenant are going to agree to a pre-set increase for inflation, they should pick one method for that compensation. If the parties prefer a predictable increase pattern, they can set forth the precise rent increases in the lease. Alternatively, they could pick some national index, though an index such as a bank prime rate (minus something for the time-value of money)

seems more commercially stable than the politically "tweeked" C.P.I.

Professionals with a finance orientation may see it as more reasonable to compensate for future inflation by shifting actual operating expense increases or common area maintenance expense increases to the tenant. This approach, while particularly logical over a long-term lease, has some real legal problems. There is evidence to support the view that some landlords understate base operating expenses upon entering new leases. Where this occurs, the first adjustment period can result in a significant shock.

The problem of understating initial operating expenses, or "expense loading" is more likely if the landlord is secretly seeking to sell the building when you enter your lease. The landlord has every reason to understate expenses both to make the building seem more efficient and to fill the building prior to sale. From a new tenant's perspective, the present efficiency of management could mean a substantial future operating expense adjustment.

We recommend that our clients select fixed rental increases in lieu of variable expense increases. Where the landlord is intransigent, we prefer increases indexed to a banking industry standard over a formula that the landlord can manipulate.

Percentage Rent Percentage rent clauses are becoming more common, particularly in retail leases. Beware that such clauses are a violation of professional ethics for some professionals. It is unclear to me why a landlord ought be both a business partner in good times, which a percentage rent clause effectively makes him, and a landlord with summary dispossession powers in bad times, which the last thousand years of law gives him. If the landlord wants a piece of the pie, it seems reasonable that he take a piece of the risk.

Nevertheless, if you are considering a percentage rent formula, make sure to examine how the formula works at all levels of income from losing money to grand success. Seek a percentage rent floor, or some minimum level of income which must be earned before percentage rent applies, and check if the landlord has a right to terminate the lease if the business income remains below the percentage rent floor. While there are strong policy arguments that commercial landlords and tenants ought consider themselves partners in the business venture, the law does not favor that view, and a lease that turns them into partners ought be quite specific in defining that relationship.

Term of Lease: Most landlords will let you select your lease term, though this is less true of sub-let space and other bargain deals. If you select a short term, such as one year, you can avoid expense increase formulae, but the landlord could hit you with a stiff rent increase as soon as market conditions permit. Concepts such as rent control do not apply to commercial leases and 50% annual increases do occur. If you select a long term lease and your business must be closed or down-sized at some time during the term, you will be at the landlord's mercy, for the law provides that rent is due through the end of the lease contract regardless of whether you continue to occupy. Landlords have a very limited duty to seek another tenant to replace you, and they usually will fill all other available space in their building before filling vacated space.

The best term for most business, young or established, is a short or medium term with multiple options to renew and options to expand or shrink. It is unlikely that a landlord will offer prospective tenants maximum flexibility, because each additional option restricts the landlord's ability to control and fill the building. Obviously, you need to try for the best, and, if, during the course of the lease, you anticipate a need to vacate, you need to get a lawyer before the problem becomes a crisis while

there is still time to negotiate.

Attorneys Fees: Another common clause in the standard commercial lease requires that the tenant pay the landlord for all reasonable costs and attorney's fees accrued in collecting rent. Occasionally, the "standard" clause requires the tenant to pay landlord reasonable attorney's fees for any dispute under the lease. The first clause sounds reasonable on its face until the tenant realizes that virtually all disputes between landlord and tenant will be characterized as a rent collection dispute by the time they come to court.

As a practical matter, tenants rarely sue landlords for breaching the covenants of commercial leases. This is not because landlords do not breach leases, but, rather, because suits brought by tenants must be brought in Civil Division and cannot be raised in Landlord & Tenant Branch. As such, a tenant grieving of a landlord's breach must wait several years for the case to come to court and expend thousands more of attorney's fees in extended pleadings and discovery wars. Generally, the lease ends before the litigation.

A common tactic used by commercial tenants is to withhold rent in order to force the landlord to either cure the breach or file suit under the expedited procedures of Landlord & Tenant Branch. While this is an exceptionally dangerous tactic for tenants under District case law and should only be taken under advice of experienced counsel, it is often the only economical way to force a landlord to conform with the provisions of the lease. When the tenant chooses this tactic, the landlord will sue in Landlord & Tenant Division for breach and possession or for non-payment of rent and arrearages. The landlord will be seeking attorney's fees under this attorney's fees provision of the lease and, if the clause allows, will be entitled to a potentially hefty award.

From an educated landlord's perspective, the attorney's fees provision is valuable predominantly as a litigation threat for unwary tenants. Courts rarely make significant attorney's fees awards for a variety of reasons. First, landlords' attorneys generally handle commercial leasehold cases in bulk for significantly discounted rates. Actual fees for individual court appearances can be as little as $25 to $50 per case, though the services rendered for such fees are often insufficient to tolerate a real litigation fight. Many District judges believe they are guided by a rule from the Small Claims Branch which limits attorney's fees to 15% of the amount of money awarded, though there is no case law to support that position, and such a rule is hardly applicable to commercial leasehold fights where property possession and complex contractual interpretation are far more significant than the sum in dispute. Finally, the same judges who are over-taxed by a flood of cases hell-bent for trial appear to believe that slashing attorney's fees awards is a way to encourage settlement. If the landlords and tenants knew about this unstated policy, it might have its intended effect. For whatever reason, a tenant-only attorney's fee provision substantially increases the tenant's maximum risk of litigating, is unlikely to return any significant money to the landlord, and increases the uncertainty of litigating. This gives each side the ability to bluster, rather that reach a reasonable settlement. While an attorney's fees clause hurts both parties commercially by increasing their risk and providing incentive for unnecessary litigation, a one-sided attorney's fees clause hurts the tenant more.

There are several alternatives to consider in negotiating a lease. Either the clause should apply equally to both parties and be broad enough to cover all disputes under the lease whether or not related to the payment of rent, or the clause should be eliminated. If you expect to be arguing unsupportable positions in order to delay eviction while searching for a white knight to buy the failing business, it would be best if there was no attorney's fees provision. If, on the other hand, the lease

calls for significant services to be rendered by the landlord or complicated formulae for computing the obligations of the parties, a mutual attorney's fees provision is best. In no event should you allow the risk to be one-sided.

Conclusion This article identifies some of the more arcane, but significant, lease terms which tenants ought to be able to modify in a few tough negotiating sessions. Under no circumstances should this be your only guide. The law is different in very significant ways in the three local jurisdictions. Money spent on a knowledgeable attorney to negotiate your lease is money well-spent.

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