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Like Sherlock Holmes's dog who didn't bark, the clause that isn't there carries a message.

People and Property: Silent Clauses in a Tenant's Form Lease

Emanuel B. Halper

THE THOUGHT OF GETTING SICK just when a big business deal was about to be finished has always frightened me. I've been concerned that my clients wouldn't be completely understanding if I missed a closing because I had pneumonia or the gout.

To avoid getting sick before a closing, I have to avoid getting sick all the time. So I limit my consumption of hard liquor, carry a folding umbrella in my briefcase, and subscribe to *Prevention* magazine. The result has been robust health most of the time.

Nonetheless, as winter turns to spring, sometimes I find myself susceptible to such ills as influenza and the grippe. And one year, the inevitable happened. My ten-month-old daughter got sick and my wife succumbed in short order. Our family doc-

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tor was in the Bahamas, but his answering service recommended Dr. Fastabula. Fastabula was spending the evening at the Turkish bath. His answering service suggested Dr. Scholl. Scholl had a foot ailment and recommended Dr. Malatesta.

By the time Malatesta arrived, I was convinced that I was coming down with whatever it was. Malatesta chided me for interrupting his poker game by insisting that he visit us personally. He said our ailment was obvious and he could have diagnosed it just as well over the telephone. All three of us had the intestinal flu, and we would be in bad shape for forty-eight hours.

I: Did you say forty-eight hours? I can't afford to be sick. I have an important lease closing scheduled for tomorrow afternoon. Can't you make us better faster?

Malatesta: Not even for money.

I: What am I going to do?

Mrs. Halper: Stay home for a couple of days and relax.

I: Look, Malatesta, be reasonable. There must be something you can do.

Malatesta: You have to learn to calm down and not let clients make you feel so uncomfortable.

I: How do you do that?

Malatesta: I shut off the telephone except for emergencies and play poker three nights a week.

I: Don't your customers get mad at you?

Malatesta: That's the best part of it. You may look at your clients as customers. I see my patients as patients. And patients don't tell me when to work and when to play poker.

I: How do you get them to accept your independence?

Malatesta: Psychology, my friend, psychology. You've got to make them think they're so lucky to deal with you that they'll tolerate any neglect and any abuse.

After writing an illegible prescription and leaving us three free samples of Kaopectate, Dr. Malatesta took off. The engine of his sports car made such a roar that I barely heard the telephone ring.

It was Harry, a real estate developer of modest importance who is considered Numero Uno by my bookkeeper.

I: Yes, Harry. Of course, Harry. Anything you say, Harry. [I hang up the telephone.]

Mrs. Halper: Just listen to you. It's 11:30 P.M. You spent the whole night trying to get a doctor to come here. Now instead of getting some rest, you're working.

I: But Harry needs me. He says the tenant is going to kill the deal unless we get some basic understandings ironed out by tomorrow. All I have to do is to read the lease tonight.

Mrs. Halper: Some reader! Four hours ago you read "Chicken Little" to your daughter and fell asleep after three pages. There goes the phone again. Hello. . . It's for you—Nick Tromba. Now don't get involved with him for a whole night. Remember, you've got a lease to read.

Harry's lawyer falls asleep.

I: Nick. What's doing? . . . They're sick? . . . So am I. . . Tomorrow? I told you, I'm sick. . . They'll come here? That's impossible. That's crazy. What do you brokers want from my life? . . . Oh, Harry said that? Well, I guess it'll be OK. . . .

It was 1:00 A.M. before Nick said goodnight. My wife and daughter had fallen asleep. I was glad my wife hadn't heard the entire conversation. She would not be happy to find out that Harry had decided to bring the closing to our apartment. That meant a complete entourage from Harry's office, a team of negotiators from our tenant, J.B. Smythe Department Stores, Inc., and at least one or two characters from the broker's office.

Tomorrow was to be a big day. I had to be ready to discuss the lease intelligently. Harry was not known for his interest in my health or anybody else's.

BEGIN WORK WITH A CHECKLIST

J.B. Smythe's standard form of lease was not a model of good organization or impeccable English usage. I surmised that it was the intellectual product of a general counsel whose name would have been forgotten long ago except for his signature as notary public on such timeless documents as long-term leases. Perhaps this lease was the result of his negotiation with another obscure and equally illiterate lawyer of his day. And whenever Smythe ran into a problem, they added another section at the end of the form lease to make sure it wouldn't crop up again at a new location.

Before I read even one of the run-on sentences in Smythe's lease, I reached for a checklist of important lease provisions I've compiled over the years. To analyze a document like this, you need a checklist.

A landlord is especially vulnerable when faced with a tenant's form lease. The early English common law looked at a lease as if it were a grant of ownership rights in real estate for a period of years. The law had few established solutions for problems that weren't discussed in the leases. Gradually, court decisions and statutes provided answers for disputes that arose in areas the parties didn't provide for. Some of these solutions were meaningful when they were made, but they may have little relevance to commercial relationships in modern society.

So even if the landlord pays careful attention to the clauses included in the lease, he can find himself with unexpected difficulties. Problems that aren't discussed in the document can still arise. And although a court will find a solution to the problem, the remedy may have more to do with decisions framed within the circumstances of another era than with the parties to the current lease.

That's why I refer to clauses which may be omitted in a particular lease as "silent" clauses. The fact that the lease says *nothing* about a subject can mean *something*. And that something can cost a landlord a great deal of money. So I always begin analyzing a lease form with a checklist of clauses that *should* be included.

TENANT'S USE OF THE PREMISES

A lease that doesn't specifically limit the way a tenant can use the premises can give a landlord plenty of trouble. If a candy store lease doesn't restrict the tenant's use to selling the merchandise you'd expect to find in a candy store, the tenant might have the right to manufacture plastic statues or conduct live pornographic dramatizations. The zoning law might have something to say about manufacturing in a retail zone. But if the tenant uses the premises for illegal purposes, the landlord could be equally liable for the violation.

Some leases touch on the question of tenant's use but fail to drive the point home. Some courts have held that a use clause which states that the tenant *may* use the demised premises as a grocery store, for example, doesn't limit the tenant's use at all. The landlord might be surprised to see a massage parlor operating in the middle of a grocery store, but he would be frustrated too because he might not be able to do anything about it.

On the other hand, the landlord could be in for a bigger surprise if the tenant does want to operate a grocery and finds out that he cannot legally do so from the premises. A court could easily decide that a lease clause which says the tenant *may* use the demised premises for a grocery is intended as a warranty by the landlord that the tenant has the legal right to conduct his grocery business at the demised premises.

An effective use clause states that the demised premises *shall* be used for the specific purpose intended, and not that the tenant *may* use the demised premises for that purpose. The clause must also contain a clear statement that the tenant agrees not to use the demised premises *except* for the stated permitted purpose.

COMPLIANCE WITH LAWS

Another clause often missing in some tenants' standard form leases is the compliance-with-laws clause. The compliance clause insists that the tenant comply with legal requirements relating to the demised premises and relating to the tenant's use of the demised premises. A lease that does not contain a use clause but includes a proper compliance clause nevertheless will protect the landlord against the possibility that the tenant will use the demised premises illegally.

The compliance clause also concerns itself with whether the landlord or the tenant is required to make alterations and repairs stipulated by municipal authorities. Ordinances governing the condition of a building are usually addressed to the owner of the building. If the owner wants to shift his liability to the tenant, the lease should contain a clear statement to that effect.

SIGNS ON THE PREMISES

Here's a tricky area. If the lease is silent on the subject, the landlord might not have any control at all over the signs the tenant can place on the premises. The appearance of a shopping center can suffer a great deal from a few garish, oversized signs on the storefronts.

WHEREAS, WHEREAS, WHEREAS . . .

I kept reading the same word over and over. It was 3:30 A.M. The flu may pass through the body pretty quickly, but it certainly shakes you up while it's around. I fell asleep at my desk.

At 7:00 A.M., the doorbell rang. By the time I realized it wasn't my alarm clock, someone was pounding on the door. The FBI? The CIA? Surely not the IRS!

I rushed to the door. In walked Nick Tromba and three salesmen from his brokerage office. They were ready to work. Since there was nothing to do yet, they agreed to settle for breakfast. Not wanting to be impolite, I whipped up some scrambled eggs and brewed some coffee. Just when I served the food, the doorbell rang again. In came Harry, Big Irving (leasing director), Jack (senior vice-president in Harry's company), Augie (construction director), and Marvin (controller).

Harry had to make a telephone call. Big Irving needed a cup of coffee in a hurry. Jack wanted the bathroom. Augie opened an enormous set of plans and spread them all over the living room. Marvin was starving.

Again the doorbell. Enter Phil and Marty, vice-presidents of J.B. Smythe Department Stores. One is the lawyer and the other is the real estate director, but I always forget which is which. Sometimes they do too. Then another couple arrived, the chairman of the board of Smythe, Vincent Babbione, and his constant companion, the president of the company, B.B. Nachshlepper. They were followed by Mal Fattore of Smythe's insurance department, G. Gordon Nebech of the construction department, and Al Kapores from merchandising.

That made a grand total of sixteen visitors in the little apartment. Upholstered chairs were at a premium. One went to Harry and we were also able to seat Babbione, Nachshlepper, and Al Kapores. Big Irving invited Nick Tromba to sit on the floor of the living room near the radiator. Ultimately, a card game started in that area. G. Gordon Nebech joined Augie on another section of the living room floor. They laid out so many plans you would think we used blueprints for rugs.

Marvin and Mal Fattore stationed themselves in a corner of the dining alcove. It seems as if they spent hours showing off their pocket calculators. Jack spent most of the day on the telephone which was hanging over the range in the kitchen.

Phil, Marty, and I sat around the kitchen table to negotiate our papers. When any of the others got bored, he would come into the kitchen and join the lease negotiation. Phil and Marty were fairly receptive to my requests to make changes to the clauses in the form lease. In fact, by early afternoon we came to an agreement on that subject and I started typing up the changes on my old manual typewriter.

As I typed, Phil and Marty joined the poker game. They thought their day had ended when I finished typing, so they were not overenthusiastic when I pointed out that the Smythe form lease omitted quite a few things I felt were essential. First, I raised the subject of the use, compliance, and sign clauses. Then we went on to discuss the other silent clauses.

TENANT IDENTITY: ASSIGNMENT AND SUBLET CLAUSES

The J.B. Smythe form lease contained no assignment or subletting clause at all. No assignment clause is usually the best assignment clause for a tenant. In most states (Texas is an exception), a tenant has the right to assign his leasehold interest as long as the lease doesn't prohibit assignment.

Similarly, the premises can be sublet regardless of the landlord's preference unless the lease prohibits subletting. A prohibition against *assignment* is not a prohibition against *subletting*, and vice versa. Most important, a lease prohibition against assignment is not automatically a prohibition against the transfer of the stock of a corporate tenant. Since the sale of the tenant's stock has the same effect as an assignment of its leasehold interest, a landlord must specifically prohibit assignment, subletting, and stock transfer if he really wants to control the identity of his building occupant.

I knew it didn't make sense to try to restrict assignment by a department store tenant. But I did suggest that the lease require the tenant to give notice of any assignment so that the landlord would know the identity of the assignee. I also suggested that the assignee be required to assume all the obligations of the assignor under the lease.

PROTECTING THE LANDLORD'S ABILITY TO MORTGAGE THE LEASED BUILDING

Subordination to the Mortgage Lien

Every developer negotiating an occupancy lease should remember that the ultimate test of the quality of his negotiation is whether the lease will be acceptable to an institutional mortgage lender. Many institutional mortgage lenders insist that all of the tenants agree to subordinate the lien of their leases to the lien of the mortgage. A subordination provision in the lease assures this position.

Marty and Phil didn't like the idea of subordination because it gives the mortgagee the right to terminate the leasehold in case of foreclosure, and it puts the mortgagee in a commanding position in case of condemnation or fire damages. But they agreed to include a clause when I suggested that subordination would be required only when the mortgagee agreed not to disaffirm their lease in case of foreclosure.

Estoppel Certificate

When a developer wants to sell or mortgage his building, the buyer or the mortgagee will want to be assured that the lease is in effect and that the tenant doesn't claim default by the landlord. This and other information vital to a buyer and a mortgagee is contained in the estoppel certificate. In the absence of an estoppel clause in the lease, the tenant can refuse to furnish the certificate, and the owner's opportunity to sell or mortgage may be lost.

Condemnation Awards

A tenant is usually better off if the lease contains no condemnation clause, but the absence of a condemnation clause could mean no mortgage for a landlord. Why? The common law usually governs that question when the lease is silent. Under common law, a tenant is entitled to compensation from the landlord if part or all of the leased premises is taken. On the other hand, a tenant is not entitled to rent abatement as a result of condemnation under the common-law rules.

If the lease is *not* subordinate to the mortgage and does *not* contain a condemnation clause, a mortgagee could find himself in a very embarrassing position if the premises actually were taken. The tenant would have a crack at a part and perhaps all of the condemnation award. When premises subject to a mortgage are taken, the only thing a mortgagee may have recourse to is the condemnation award. If it goes to the tenant, the mortgagee will be left high and dry.

A TEMPORARY RELAPSE

My wife and daughter joined us at the negotiating table. While my wife drank some tea and my daugh-

ter sipped apple juice, I tried some coffee. Soon my daughter and I had to leave the kitchen. She seemed complacent and was willing to be put to bed (unusual behavior for this little girl). I experienced shooting pains in my thighs. My forehead was sweating. I plopped into bed.

My wife called Dr. Malatesta immediately. He prescribed four baby aspirins for the child and a hot toddy for dad. He admonished my wife to tilt the balance of the mixture in favor of hard liquor. Terrific. I begged my wife to ask Malatesta to visit us again and suggested that she also call one of my partners so I could get a will prepared.

I'm not sure how she convinced Malatesta to come again, but when he arrived, all he did was teach my wife the most efficient method of making a hot toddy. Then he crawled over to the radiator in the corner of the living room and joined Big Irving, Nick Tromba, and B.B. Nachshlepper in what was now a boisterous poker game.

Feeling a little better, I returned to the kitchen ar d the lease negotiation.

DESTRUCTION AND WAIVER-OF-SUBROGATION CLAUSES

A lease that doesn't have a destruction clause can be troublesome to both landlord and tenant. The rights of the parties after a building burns down vary from state to state. But there isn't any state that provides a sensible rule to govern the parties' rights if they don't do so themselves. It's not too likely that a lease prepared by a chain store tenant will omit the destruction clause, but don't count on it.

Under some state statutes, a tenant can cancel his lease if his premises suffer a good deal of damage unless the lease says something to the contrary. And a landlord who is building a shopping center in reliance upon a long-term lease with a major tenant doesn't want to be faced with the unexpected departure of that tenant because of a fire. The tenant, of course, would like to see the insurance proceeds used to rebuild the building. Yet, if the lease says nothing and the premises are mortgaged, it is likely that the mortgagee will get the proceeds.

Another fearsome danger that stems from the destruction of a building can be mitigated by a "waiver of subrogation" clause. When an insurance company pays a claim for fire damage, it succeeds to the rights of the insured with respect to the claim. This right is called subrogation. Thus, the insurer can sue a party who may have been responsible for the fire, seeking to recover all or part of the policy proceeds paid out. Since many fires can be attributed to the negligence of either the landlord or the tenant, a successful suit against either of them means that the ultimate risk has been shifted to them rather than the insurance company—contrary to the intention of the lease agreement. And since the insurer already has been handsomely rewarded, by receipt of the premiums, for accepting the risk of fire damage, its recovery from the owner or tenant is a windfall. To avoid this result, both

landlord and tenant should check the proposed lease for a clause in which each party waives the right to recover from the other when the negligence of either causes damage that is covered by insurance. It's also wise to provide that the waiver be effective only if it does not invalidate the insurance policy.

TENANT DEFAULT OR BANKRUPTCY

Occasionally, a tenant will present a form lease to a landlord that either omits the default clause entirely or leaves out essential elements. If there is no default clause in the lease, the landlord must rely on local law for remedies. Local laws are diverse and confusing. Can the landlord terminate

the tenant's leasehold interest if tenant fails to perform his obligations under his lease? Does the liability of the tenant survive even after the lease is canceled? Can a landlord recover the fair rental value of the demised premises from the tenant after a default?

One thing state law won't do is give the landlord a right to cancel the lease if a tenant goes bankrupt but doesn't default under his lease. If the tenant files for relief under the federal Bankruptcy Act, the trustee in bankruptcy will be in a position to consider disaffirming the lease for quite a while. During that period, the landlord will be bound under the lease without knowing what the trustee will do. To protect himself from such a predicament, the landlord would like to be able to cancel the lease of a bankrupt tenant. To make sure he can do so, the landlord must see that the lease clearly states this right.

ESCALATION CLAUSES

A landlord should always be alert enough to look for the escalation clauses of a lease. If the premises to be constructed are to be part of a shopping center, the lease should require the tenant to bear at least his pro rata share of real estate tax increases, insurance premiums, and the cost of maintaining the parking lot and other common facilities. If the lease relates to office space, a landlord should propose a clause that requires the tenant to pay his pro rata share of increases in the cost of utility services, cleaning services, and other necessary operating expenses.

LIABILITY INSURANCE

Most landlords know there's a chance that someone who is injured while doing business with one of his tenants will sue the landlord as well. Under our judicial system, it doesn't cost any more to sue the landlord at the same time the tenant is being sued. Tenants customarily carry liability insurance to protect themselves against these lawsuits. Landlords should insist that the lease require the landlord to be named as an additional insured under the tenant's liability policies.

LANDLORD'S RIGHT OF REENTRY

When you lease a building and deliver possession to the tenant, don't expect to be able to pass freely into and out of the premises thereafter. Once it's leased, it's leased. A tenant has the right to keep the landlord out of his premises unless the landlord reserves a right of reentry to himself. A landlord will want to inspect his building now and then to see if the tenant is keeping it in good condition. Mortgages usually provide that mortgagees have the right to inspect the premises, and the landlord must reserve a right of inspection so that he may grant one to the mortgagee.

The right of reentry is needed for other purposes too. If the lease requires the landlord to perform any repairs or alterations, the landlord must be able to get inside the building. The right to reenter should be drafted broadly enough to allow contractors to do their work and store materials conveniently. If the landlord wants to show the premises to prospective purchasers, mortgagees, or new tenants, this right must be included in the reentry clause. Finally, if a landlord wants to place a "for sale" sign or "to let" sign on the premises, this too needs sanction in a special clause reserving rights of reentry.

EXCULPATION CLAUSE

An anomaly of shopping center lease transactions is that in most cases the deal won't work unless the liability of the tenant is unlimited. That is because the mortgagee looks primarily to the income stream created by the occupancy leases for repayment of the mortgage debt. On the other hand, a well-informed landlord will insist that his own liability be limited to landlord's equity in the shopping center. Shopping center tenants seldom sign leases in reliance upon the financial stability of their landlords. Consequently, few tenants object to a clause limiting an individual or partnership landlord's liability to its interest in the shopping center.

Unless the Internal Revenue Code is changed substantially, individual ownership is usually the preferable way to hold real property. As long as that's the case, the exculpation clause is the most important clause a landlord can ask for. Certainly, a landlord does not want to risk all of his personal fortune on the success or failure of any one deal. It hardly needs saying that a landlord can't depend on a tenant's lease draftsman to insert an exculpation clause.

AND SO TO BED

Each of the "silent" clauses I proposed had to be thoroughly discussed. Since I was plagued by the

spasms and pains that accompany intestinal flu, I was fortunate in having a doctor around all day. Malatesta had become so involved in the poker game, he decided to stay. The brokers supplied everyone with cigarettes, beer, and hard liquor. Harry, Babbione, and Nachshlepper occasionally joined the negotiation at the kitchen table. Augie and G. Gordon Nebech hammered out a set of preliminary specifications as they crawled from diagram to diagram on the living room floor.

At midnight, my guests slowly began to leave. By 3:30 A.M., Dr. Malatesta had had enough. He had won $2,500, most of it from B.B. Nachshlepper. Harry and Babbione left a few minutes later. They told me they were more interested in knowing that the lease was signed than in being aware of its provisions.

I crawled into bed and fell into a deep sleep within seconds. Then a familiar voice woke me, crying "Daddy." I dallied a moment hoping that my wife would wake up and heed the call. Not tonight.

My daughter was hungry. That seemed a good sign and I figured Dr. Malatesta would approve if I gave her some milk. She downed it faster than a merchant's real estate director can guzzle a lunch hour cocktail. But as soon as I put her back to bed, she started crying again. So I sang to her. Yankee Doodle, Oh Susanna, Bill Bailey, Hot Time in the Old Town, my college alma mater, my high school alma mater, and thirteen unpublished songs I wrote when I was in the National Guard. She loved it. She had no intention of letting the performance end. Not ever. It was 5:30 A.M.

The solution came to me. If "Chicken Little" put me to sleep, the alterations clause in J.B. Smythe's lease would probably knock the kid right out. So I read it. Whereas . . . Witnesseth . . . by and between the parties hereto, etc., etc. . . . She was snoring.