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N.Y. Real Property Law Journal

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of the New York State Bar Association

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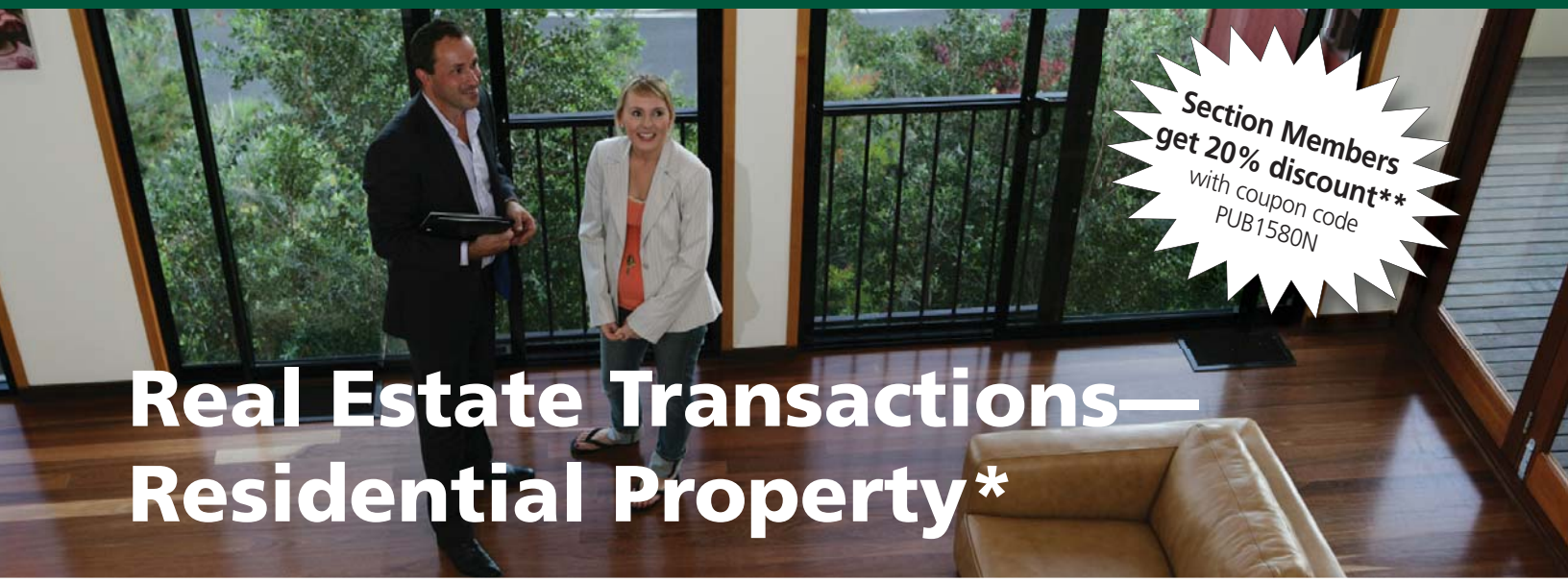

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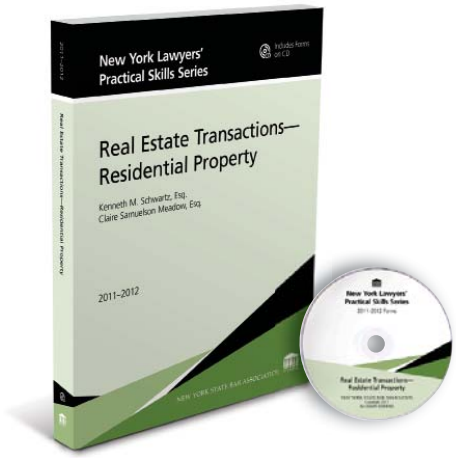

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Message from the Section Chair

I am pleased to report that the Section's fiscal year is off to a wonderful start. We enjoyed a superb Summer Meeting, our membership initiative is under way, our CLE programs are taking shape and we are working closely with our committee chairs.

The Summer Meeting at Crystal Springs was well attended, the weather was hot and perfect and the program was equally hot and excellent. Our First Vice-Chair, Ben Weinstock, organized, chaired and participated in the program. Over the long-weekend Meeting, we heard an interesting presentation by Ben on high-end retail leasing; a comprehensive panel on construction issues including perspectives of the developer, the attorney, the architect, the lender, the contractor and the construction manager—all efficiently moderated by Ariel Weinstock; an interactive enjoyable presentation by Anne Copps on ethics; a fascinating and fast-moving update on recent cases by Peter Coffey and Michelle Wildgrube; a terrific timely presentation by Larry Wolk on mortgage law opinions; an engaging and relevant presentation by Kathy Gutierrez and Philip Korb on the social media revolution; an instructive presentation by Ed Ambrosino on economic incentives; and an informative presentation by Joel Sachs on oil spills on residential property. At the Thursday night dinner, we heard from the CEO of Crystal Springs Resort Real Estate, Andy Mulvihill, who told us about the history, the development and future plans for the Resort. A special highlight at the Meeting was that Seymour James, the President of the New York State Bar Association, joined us for the entire Meeting and, at the Thursday night dinner, shared his vision and plans for the Association's coming year. We thank Ben for producing and chairing a terrific meeting.

While our Membership Committee led by Harry Meyer and Jaime Lathrop is formulating ideas and developing ways to expand our membership, David Berkey and Stacy Wallach are enjoying great success with the Law School Internship initiative. This is a program which pairs law school students interested in real estate with law firms, large and small, seeking to acquire an intern to learn and assist with real estate matters. Brooklyn Law School, St. John's Law School, Hofstra Law School, New York Law School and Touro Law School are all actively participating in this program and are placing student interns. The program is wonderfully successful, we hope to expand it to encompass some upstate law schools, and we could use more host firms—so please consider the benefits of this arrangement and David will gladly provide more details. This is a program which promises to broaden the interest in and appeal of real estate law and practice and to nurture and develop the New York real estate lawyers of the future. We all thank David and Stacy for their fantastic work on this initiative.

Our CLE Committee co-chairs, Larry Wolk and Joe Walsh, are again overseeing and arranging an amazing series of programs in the coming months—the Practical Skills program in November (two sites) on Mortgage Foreclosures and Workouts, the five-site program entitled, "Representing Purchasers and Sellers of Residential Condominiums, Cooperatives and Homeowners Associations," the Advanced Real Estate program covering many diverse real estate topics in an intensive one-day presentation (on December 6, 2012), and the very popular Practical Skills program to be presented at five sites around the State in Spring 2013. In addition to our own direct programs, we are joining the NYSBA Committee on Continuing Legal Education in co-sponsoring a program on Receiverships in New York. In another new CLE venture, we are joining the Committee on Law Practice Management and the NYSBA CLE Department in co-sponsoring a program at four sites in October, entitled, "Attorney Escrow Accounts 101—What Every Attorney Needs to Know in New York." Our own Peter Coffey is a co-chair of this joint program.

In a related CLE development, we joined the NYSBA Committee on Women in the Law in co-sponsoring the 2012 Women on the Move program scheduled to be held in Manhattan on October 30, 2012. The program title is, "Moving Forward: Building Paths to Success" and Nancy Connery and Mindy Stern will attend and represent our Section.

Turning to our Committees, as lenders and borrowers begin to close mortgage loans again, our Attorney Opinion Letters Committee under the leadership of Greg Pressman and Chip Russell has renewed its importance; our Commercial Leasing Committee led by David Zinberg and Beth Holden had a lunch meeting on Monday, September 24; we are working with Karla Corpus and Laureen Harris of the Condemnation, Certiorari and Real Estate Taxation Committee; Ed Filemyr and Peter Kolodny continue to keep us abreast of landlord/tenant litigation as they co-chair our Landlord and Tenant Proceedings Committee; our Low Income and Affordable Housing Committee led by Richard Singer and Laura Monte

has focused on this very important area given the difficulties of the housing market; Mindy Stern and Anne Copps, leading our Not-for-Profit Entities and Concerns Committee, are working on a checklist of real estate issues facing these organizations; and Nancy Connery has very kindly joined Trish Watkins as co-chair of our Professionalism Committee.

I strongly suggest that all of you reading this message review pages 78-79 of this *Journal*, select a Committee of interest to you, contact one of the co-chairs and become an active member. Please also tell your friends, colleagues, clients and fellow lawyers to do the same. You and they will be glad you did so.

Finally, be sure to reserve Thursday, January 24, 2013 to attend our Annual Meeting and Program at the New York Hilton. We will present an interesting, topical and informative program which you will not want to miss.

Steven M. Alden

Tenant's Checklist of Silent Lease Issues
(Third Edition)

By S.H. Spencer Compton and Joshua Stein

ANY LEASE can conceivably raise hundreds of issues, from the glaringly obvious, to the somewhat obvious, to the obscure. The words of the lease suggest many of those issues, starting with "economic" issues and continuing with "noneconomic" ones, most of which will turn out to be "economic" issues at the end of the day, if they ever actually become relevant.

When you negotiate a lease for a tenant, the easy part consists of thinking about and responding to issues that the landlord and its counsel have already raised in the draft lease. For example, if the landlord got the rent or some date wrong, you will ask the landlord's counsel to correct the error. You may ask for longer notice periods, a more extensive opportunity to cure defaults, "reasonableness" as a way to handle any number of issues, a narrowing of any open-ended tenant obligations or landlord discretion, and flexibility on use and transfers. You will also demand absolute clarity on all monetary and other significant obligations, deletion of inappropriate or excessive obligations and restrictions, and correction of errors and internal inconsistencies. To the extent that anything in the lease is incomprehensible, you will try to have it translated into comprehensible language. Finally, you will respond to any other issues that you find based on your review of the language of the lease.

When you identify all these issues, you will ask for changes based on your experience and knowledge and the tenant's specific needs. It is a reactive process that starts with the express language of the lease itself.

You must also identify what is not in the lease. If the tenant will need or want something that the lease doesn't cover, you must ask for it or it won't be there—and it won't be there for the entire term of a document that can remain in place for a very long time. That's a daunting prospect. It forces the tenant's counsel to think outside the agenda that the landlord and its counsel defined within the terms of the lease they circulated.

A landlord's lease form won't always remind the tenant's counsel of everything they might need to think about and negotiate to properly protect their client.

The courts won't necessarily agree with a tenant who later asserts that some missing lease provision "should be inferred" because it's consistent with the basic relationship between the parties. Instead, if it's not there, it is not part of the agreement.

That isn't necessarily the only way that a legal system might deal with leases. For example, in civil law countries, a statute defines most of the rights and obligations between landlords and tenants, filling in a lot of gaps that might otherwise constitute "silent lease issues." The parties simply need to memorialize their basic business terms. They rely on the generally applicable leasing statute for all the other rights and obligations regarding the leased premises. If the statute doesn't make sense for them, they may be able to modify it by contract. But if they don't, then the statute governs their relationship, and they don't have to contractually "think of everything."

In the United States, in contrast, if you represent any tenant, you bear the burden of identifying and dealing with issues that a landlord's typical standard lease does not mention at all, but that may nonetheless matter a lot to your tenant client. These are the "silent issues" in any lease. Unlike the obvious issues covered in any landlord's lease form, the silent issues are hard to identify, because the landlord doesn't do you the favor of reminding you about them.

Genesis of the Checklist

In 1999 and 2000, a subcommittee of the Commercial Leasing Committee of the New York State Bar Association Real Property Law Section developed and published a checklist of silent lease issues for use by attorneys who represent commercial space tenants. That original checklist was republished extensively, drawing many comments and responses from readers. Based on those comments, further thought, subsequent experience, and further review by members of the subcommittee, the authors (again with help from the subcommittee) issued a second edition of the tenant's silent lease issues checklist in 2003.

Since then, the co-authors of the tenant's checklist have continued to keep their eyes open for items to add to the checklist and other changes to make. At one point, they resolved never to publish a third edition, but changed their minds when they realized that the cumulative effect of all their notes and improvements added up to a third edition. Like the previous editions, this third edition seeks to help tenants' attorneys identify and, if they choose to, raise "silent lease issues" when they review a typical landlord's standard commercial lease.

The original "silent lease issues" checklist project expanded over time to include other issues, not just "silent" issues, that a tenant's counsel may wish to raise in lease negotia-

tions. Reminders were also added for some, but not all, of the due diligence that a tenant (or its counsel or other advisers) might want to undertake before the tenant signs a lease. This third edition of the checklist continues that approach.

This checklist mentions each possible issue only once, even if it might reasonably belong under more than one heading. Even when an issue in one section relates closely to some other issue somewhere else, the checklist never provides a cross-reference. Any user who wants the full benefit of this checklist should read it from beginning to end.

This checklist covers most issues alphabetically, which makes no logical sense at all, but creates at least the appearance of order and accessibility. The last few sections of the checklist cover the various stages of the lease negotiation process, which don't logically belong in the same alphabetical sequence. For anyone who negotiates leases for tenants, this checklist offers a useful set of reminders about nearly everything that could matter. This checklist will even help a landlord's counsel, although any landlord's counsel may prefer the Landlord's Checklist of Silent Lease Issues, of which a third edition will soon appear.

What the Checklist Is and Does

This checklist discusses a tremendous range of issues. Those issues represent, or at least touch on, almost every possible issue or event that could arise or occur when two parties have potentially conflicting interests in the same real property over a very long time.

A lease amounts to a private statute. The parties who must live with this statute have no way to change it except by persuading the other party to agree to a change. This might require the writing of a check, and perhaps a large one.

Thus, a lease must get it right the first time. Before embarking upon the relationship that the private statute—the lease—will govern, each party has an opportunity to shape the statute that will govern the relationship. This checklist should help a tenant and its counsel seize that opportunity.

Which Issues to Raise

Depending on the market, the parties, their relationship and history, the nature of the transaction and its timing, the scope and terms of your engagement, and any other circumstances, you may or may not choose to raise issues from this checklist. Even if you do raise these issues, you will not necessarily prevail on any of them. But if you never even raise an issue, you cannot possibly prevail on it. You can't win it if you aren't in it.

You should only "consider" raising each checklist item, as opposed to automatically raising it because you found it on some checklist. Any checklist does not substitute for thought and judgment. And if an issue doesn't really matter or apply to the lease you are working on, don't raise it. You'll lose credibility. Even more important, before you ask for some concession, make sure the lease doesn't already give you that concession. If you raise an issue that the lease already resolved in your favor, you may lead the landlord to scrutinize and worsen what was already there, thus producing a less favorable outcome than if you had said nothing at all.

The fact that any particular lease does not reflect positions suggested here does not necessarily mean that the tenant's counsel did a bad job. To the contrary, to serve its client best, sometimes the tenant's counsel should raise no issues at all and just get the deal signed, or identify and raise issues that are outside this checklist.

Sometimes, a tenant will tell its counsel to "just raise the major issues, and don't bother with the minor stuff." In those cases, this checklist might help counsel raise a few "major" issues, but the client will probably not appreciate it if counsel makes extensive use of this list. Of course, some issues the tenant may consider "minor" may have implications not known to or considered by the client or counsel. Watch out for these. Counsel your client accordingly.

If your client tells you to focus only on the critical issues because of budget, transactional, or time constraints, you may want to focus first on these sections of the lease, and the corresponding issues suggested in this checklist.

1. Use—Section 42
2. Rent (no separate section in this checklist)
3. Operating Expenses—Sections 24, 25
4. Real Estate Tax Escalations—Section 31
5. Assignment and Subletting—Sections 3, 4
6. Security Deposit—Section 37
7. Alterations (Initial Occupancy)—Section 2
8. Services by Landlord, particularly air conditioning—Section 38
9. Electricity—Section 11
10. Utilities, other than electricity—Section 43

If relevant to a particular transaction, counsel should also probably include on the "short" list of "top" issues these topics:

11. Alterations Generally, Not Only for Initial Occupancy—Section 1
12. Failure to Deliver Possession—Section 16
13. End of Term—Section 13
14. Parking, at Least for a Suburban Building—Section 27

The authors counsel against the minimalist approach suggested here. To the contrary, counsel should con-

sider the entire lease and also at least consider raising issues suggested in this checklist. If the client insists on minimalism, counsel will want to establish a record of the client's instructions and the fact that counsel warned of the resulting risks.

On the other hand, if the tenant's business strategy consists of trying to prolong lease negotiations, an easy goal to achieve, this checklist will provide plenty of help. More than almost any other category of real estate negotiations, lease negotiations can take as much or as little time as the parties want. They give the parties an opportunity to think about and deal with an incredible array of issues: all the practicalities related to operation and occupancy of a building over an extended period. For example, the definition of "operating expenses," in and of itself, can raise dozens of knotty issues that may amount to a reinvention of cost accounting and federal income tax law.

In deciding which issues to raise, a tenant may also want to think ahead and assess how those issues may turn out once the tenant raises them. If the lease already covers an issue in a vague way, the tenant may prefer that vagueness and uncertainty over the adverse certainty that might result if the tenant tried to clarify the language in question, and the landlord clarified it in a manner that benefited the landlord. The tenant may prefer uncertainty in the lease, especially if coupled with a high likelihood of a tenant-oriented judge. In other words, keep in mind the principle that sometimes one should not ask a question unless one will like the answer.

This dynamic arises whenever a lease or other legal document is "vague" on any issue. Sometimes we would rather have the vagueness we know rather than the clarity we don't.

What Types of Leases?

This checklist applies primarily to substantial commercial space leases for both retail and office tenants. Most issues here will apply to some leases but not others. You should interpret almost every item in the checklist as if prefaced by the caveats: "if applicable, appropriate, desired, possible, under the circumstances, taking into account the size and nature of the transaction, market conditions, practicalities, the tenant's business agenda and anticipated use of the premises, accounting considerations and current accounting rules, the needs and negotiating positions of the parties, what the tenant expects of lease negotiations, the tenant's instructions to counsel, the timing, and all other circumstances."

Many items on the checklist make sense only for very large tenants that might occupy all or most of a large building. If a smaller tenant raised some of these issues, a landlord might reasonably regard the tenant's requests as bizarre and overreaching, or perhaps even a bad joke. In contrast, for a chain store tenant, making the same request might seem entirely routine.

The checklist makes no effort to explain which issues apply to which types of leases. The checklist also makes no consistent effort to suggest how a landlord might respond to any lease provisions suggested here.

The checklist does not consider "triple-net" leases, ground leases, "bondable" leases, "synthetic" leases, "build-to-suit" leases, leases from a seller to a purchaser of a company, or other specialized leasing transactions, some of which are not really leases at all, but capital transactions masquerading as leases.

The discussion in this checklist sometimes states that a tenant "should" consider or even "should" obtain certain provisions. Each such statement must be taken with a bushel of salt, because the co-authors do not purport to establish or define "standard" requirements for what any lease "should" or "should not" say. Every lease represents its own negotiation, depending largely on the business and marketplace contexts. The making of definitive one-size-fits-all recommendations would thus be inconsistent with reality in the world of commercial real estate leasing. Nevertheless, it focuses the presentation.

This checklist considers lease negotiations from the tenant's perspective. It is a tenant's checklist. The authors and all previous checklist contributors do not necessarily believe that any landlord should accept the tenant's position on any issue suggested in this checklist.

The checklist does not represent a position statement or recommendation by any co-author, publisher, subcommittee member, or any organization with which any of them is affiliated. The checklist does not define a "minimum standard of practice." It's more like a "maximum standard of practice." It does not give anyone a "smoking gun" to prove malpractice if any particular lease omits any particular provision(s) suggested here. This checklist is not exhaustive or complete. It is just a checklist. It's a resource for leasing practitioners. It creates no legal duties or obligations. Users of this checklist are cautioned not to rely on it in any way or for any purpose. Some of its comments and suggestions may be inappropriate, or worse.

Tenant's Checklist of Silent Lease Issues

1. Alterations

1.1 Acceptable Contractors. Attach as an exhibit a list of pre-approved contractors, architects, and other vendors. If the landlord has approval rights, have the landlord pre-approve as many names as possible. If the landlord reserves the right to delete pre-approved names, insist that the landlord act reasonably and, in any case, that the list must always contain at least a minimum number of names in each category. To the extent that the landlord's list does not include the tenant's desired team, fix that before signing the lease. Make sure the landlord can't later remove vendors of particular importance to the tenant.

1.2 Flexibility. The tenant will want to maintain some freedom in choosing its architects, engineers, other consultants and contractors. It will not want to be limited to the landlord's approved list. At a minimum, the tenant should have the right to propose, at any time, additions to the landlord's list for the landlord's reasonable approval.

1.3 Consent Requirements. The landlord should consent in advance to the tenant's initial alterations and any anticipated future alterations. For nonstructural changes, try to eliminate any landlord consent requirement. Instead, just give the landlord at most the right to confirm that the intended work complies with objective and limited criteria that the lease defines. If that doesn't work, try to get the landlord to agree to be reasonable about approving any nonstructural tenant alterations. Prohibit the landlord from requiring the tenant to make any changes in alterations that would increase their cost, except because the tenant's plans do not comply with law or with objective criteria in the lease.

1.4 When Consent Not Required. Try to persuade the landlord to agree to limit any requirement for the landlord's consent to alterations. For example, perhaps the tenant should not need the landlord's consent for decorative or minor (less than a stated cost?) alterations or partition walls. Changes in the economy and work structure may make it necessary for many tenants to have more flexibility than in the past to relocate partition walls or make other nonpermanent changes.

1.5 Proprietary Design Features. If the tenant regards its space arrangements, designs, and office layouts as proprietary information, the tenant may want the landlord to let the tenant make any alterations permitted by law, with no need to obtain the landlord's consent or even to deliver plans to the landlord.

1.6 LEED Compliance. If the tenant seeks to comply with LEED "green building" standards, the tenant may need to include suitable language in the lease, and modify some typical lease provisions. That subject otherwise lies outside the present checklist.

1.7 Multiple Floors. A multi-floor tenant may want the right to construct internal stairs and drill through floors for cabling. Such a tenant may also want the right to use the building's internal fire staircases for access between floors. If the landlord allows the tenant to cut through the slab to install an internal staircase, the landlord will generally require the tenant to restore, either specifically or under a general alteration restoration clause. The tenant should seek to negate that requirement. If the tenant has the right to "give back" a floor to the landlord, what happens if that floor contains communications cables serving the tenant's other floors? The tenant may want the right to leave those cables in operation, even after giving back the floor.

1.8 Risers and Other Passages. The tenant may want to use riser spaces, shafts, chambers, and chases to run ducts, pipes, wires and cables. Although, conceptually, limiting each tenant to its proportionate share of this space seems fair, such a limitation may not allow the tenant to meet its needs, especially if the landlord's building is inadequate (as a whole) to meet the needs of modern tenants. Try to have conduits and risers exclusively allocated to the tenant, not shared. At a minimum, try to control who else may use them, and how. The tenant may want the right to control access to any conduits and risers serving the tenant. Provisions concerning riser use may need to be coordinated with those concerning telecommunications access. The entire area of telecommunications is one where many landlords ignore applicable provisions of federal law that mandate free access. Instead, landlords seek to impose restrictions and fees that may simply be void.

1.9 Hoist. The tenant may want the right to install and use an outside hoist. Conversely, if the landlord decides to install an outside hoist, the tenant may want the right to use it,

and the landlord should agree to remove it as promptly as possible.

1.10 Limit Fees. If the tenant agrees to reimburse the landlord for fees of its architects, engineers, or other consultants in connection with the landlord's review of any alterations, the tenant will want to limit or negotiate those fees. More generally, assuming the tenant uses its own architect and the tenant's architect is competent and licensed, why should the tenant agree to pay the landlord's architect at all?

1.11 Time to Remove Liens. If the tenant's work produces liens, the tenant will want enough time to remove them, taking into account procedural requirements of applicable law and related delays. The landlord should agree not to pay any lien that the tenant has bonded or is otherwise actively and diligently contesting in compliance with the lease.

1.12 Right to Finance Alterations. The tenant may want the right to finance alterations, perhaps even on a secured or quasi-secured basis. Require the landlord to assist the tenant's lender as needed, such as by signing landlord's waivers, or at least subordinations. Consider attaching the required form of waiver or subordination to the lease. If the landlord will not let the tenant grant liens to secure equipment financing, perhaps ask the landlord to provide the financing instead, with repayment built into the rent or documented separately.

1.13 Bonds. If the lease requires the tenant to obtain any type of bond relating to payment for alterations, ask a bonding company whether the tenant can actually obtain the bond in question. Often the answer will be no.

2. Alterations (Initial Occupancy)

2.1 Initial Criteria and Specifications. State the criteria and specifications for the landlord's initial construction of the building, common areas, parking lot, and any related improvements that concern the tenant in any way—not just limited to the premises.

2.2 Entering Premises Before Lease Commencement. The tenant may want the right to enter the premises before the lease "commences"—even if the tenant will have a free rent period after "commencement." The tenant may want to use that pre-commencement period to start preparing the space for the tenant's needs.

2.3 Landlord's Space Preparation. The lease should define how the landlord will prepare the space for the tenant, including the landlord's responsibilities for asbestos abatement or removal, demolition, refireproofing, floor leveling, and closing of floor penetrations. Does the space contain any unusual existing improvements, such as vaults, that the tenant will want the landlord to remove? What level of completion must the landlord achieve? An architect's certificate? A certificate of occupancy? Temporary? Permanent?

2.4 Delayed Completion. If the landlord's work is late or defective, treat this as a failure to deliver possession, or at least provide meaningful consequences, typically day-for-day additional free rent after delivery, escalating (e.g., two days free for each day of delay) if the delay continues.

2.5 Right to Remeasure. Allow the tenant to remeasure the square footage of the premises when the landlord has finished its work, at least for a new building or extensive remodeling.

2.6 Existing Violations. The landlord should agree to cure any existing violations against the building that may prevent or interfere with the tenant's intended alterations. It is up to the tenant's experts to determine whether any such violations exist and whether they would, in fact, interfere with the tenant's work. They very well might not.

2.7 Credit Issues. Is the landlord creditworthy? If the landlord fails to build out or contribute to the tenant's work, what can the tenant do? Most leases say that the landlord has no liability beyond its interest in the premises, if that. At a minimum, the tenant will want a right to offset against rent—with a "default interest" factor—for any landlord contribution not paid or work not performed. The tenant will also want to assure that its offset right remains valid if the landlord's lender forecloses against the property. Toward that end, the tenant might consider whether an "offset" right is such a good idea, given that most nondisturbance agreements provide that a foreclosing lender will not be bound by any "offset" rights in the lease. Instead, the tenant might want to replace the "offset" for nonperformance with language that gives the landlord an opportunity to increase the rent payable for the space if and only if the landlord does what the landlord was supposed to do. This may produce a better result for the tenant (than an "offset" right would) under nondisturbance agreements. If the landlord has a construction loan in place for the very purpose of paying for the tenant's improvements, the tenant could seek a direct right to receive those advances as part of negotiating the nondisturbance agreement with the lender. The

feasibility of such arrangements will depend on state law on permitted uses of building loan proceeds.

2.8 **Building Systems.** Are the existing building systems adequate? Should the landlord agree to complete any upgrades? By when? Should the landlord construct any new installations outside the tenant's premises? What about HVAC, fire safety or other system connections? Directional and wayfinding signage? Does the tenant have any special electrical requirements? Does the tenant require any space outside the premises to install electrical, communications, or other equipment for its own use? A backup generator? Should the landlord install these things? Does the landlord have a backup generator that the tenant would like the right to use?

2.9 **Staging or Storage Area.** Will the tenant need any staging area, "lay-down" area, or storage area for its construction activities and move-in program? If the building has a loading dock, service elevator or outside hoist, the tenant may want the right to some guaranteed usage or priority, particularly while it moves in and out, without charge. Hourly rates for these services can otherwise be quite high.

2.10 **Substantial Completion.** If the landlord performs the tenant's initial alterations, "substantial completion" should require the landlord to have installed and activated all communications systems, utilities, and interior elevator service. Require the landlord to deliver a permanent certificate of occupancy if at all possible in the particular circumstances, because a temporary certificate of occupancy, which expires after 90 days (in New York City), may not suffice. Treatment of this issue will vary by location.

2.11 **Rent Commencement**. The tenant should not pay rent until particular anchor tenants are open for business; the landlord has finished specified construction, including common areas; and the landlord has paid the tenant the agreed construction cost reimbursement.

2.12 **New York City Commercial Rent and Occupancy Tax.** New York City commercial tenants, in certain areas of the city, pay a "commercial rent and occupancy tax" that is almost unheard of outside New York City. In a particularly formalistic (or "creative") application of that tax, city tax officials impose a commercial rent tax on the rent that a tenant would have paid but for an express rent credit that the lease gives the tenant to compensate the tenant for work it did in building out its space. The city treats that credit as if it were a "deemed" payment of rent, hence a taxable event—ignoring the fact that the credit probably results in some other taxable increase in the stated rent under the lease. If the parties achieve the same economic result through a free rent period or some other dollar adjustment of the rent not expressly tied to the cost of the tenant's work, the rent forgone does not trigger a commercial rent tax. So a wise New York City tenant will ask for a free rent period or a general rent abatement rather than a rent credit tied in any way to the cost of the tenant's alterations.

2.13 **Tenant's Build-Out Allowance**. If the tenant performs the initial alterations for its space, then allow the tenant to apply its build-out allowance to any "hard" or "soft" costs. The landlord should disburse any remaining allowance directly to the tenant or as the tenant directs. If the landlord fails to disburse any allowance within some reasonable period (e.g., 90 days) after the tenant properly requests it, then allow the tenant to abate rent to recover the amount due, with interest at some high rate. At lease signing, should the landlord create an escrow fund for the tenant's work allowance?

2.14 **Simultaneous Work.** Prohibit the landlord from doing any nonemergency work in or affecting the space while the tenant performs its initial build-out. If the landlord must enter the tenant's space to perform any work during the tenant's build-out, all landlord's work must conform to the tenant's and its contractors' reasonable instructions and timing requirements.

2.15 **Tax Implications of Build-Out Allowances.** When a landlord contributes funds to a tenant's alterations, that payment may create immediate taxable income to the tenant, though the landlord cannot recoup the same outlay except through depreciation on a schedule of up to 39 years, regardless of the lease term. Only the Internal Revenue Service wins. The tenant may wish to negotiate instead that the landlord owns (and depreciates) the tenant's improvements for tax purposes, in exchange for some other benefit to the tenant. As an alternative, the parties might characterize the allowance as reimbursement for current expenses, such as the tenant's cost of moving, buying out its existing lease, or purchasing tangible personal property like furniture, fixtures or equipment. Although the tenant may still suffer taxable income, the recharacterization will improve the landlord's position by giving the landlord either a current

deduction or a much shorter depreciation period. The parties can shift this benefit to the tenant by adjusting other economics of the lease. Have an engineer or appraiser prepare a cost segregation study to determine which property can be depreciated over such shorter periods. If the amounts are significant, involve a tax lawyer to consider possible tax mitigation or deferral.

3. Assignment and Subletting: Consent Requirement

3.1 Landlord's Consent. Ideally, allow the tenant to assign or sublet without the landlord's approval. This seems particularly justified under particular circumstances where governing law prohibits giving any prior notice of a transaction, such as securities laws prohibiting prior notice of a merger. At a minimum, the landlord should not unreasonably withhold its consent. Try to set standards for reasonableness. Try to provide that the landlord's consent will be automatically given if the proposed transaction meets specified objective and easy criteria (e.g., net worth, reputation, no felony convictions, experience, and proposed use). In the case of a sublease, the amount of subrent to be paid should not be a permitted criterion for approving subleases. The tenant must keep paying the landlord's rent no matter what, so why should the subrent matter, unless the landlord proposes to lower the rent to match the subrent?

3.2 Assignment vs. Subletting. Don't assume the conditions and procedures for assignment and subletting should always match. Even if the lease tightly restricts assignment, a tenant should often have more flexibility on subletting.

3.3 Simple Approval Procedure. Make the approval process as simple and expeditious as possible. And try to complete it early in the assignment or subletting process. Instead of requiring the tenant to submit to the landlord fully executed assignment or subletting documents, ask the landlord to agree to approve or disapprove the transaction in principle—before the tenant even starts its marketing—based solely on the tenant's anticipated pricing. As a fallback, defer the landlord's approval only until the tenant has delivered a term sheet, the identity of a proposed assignee or subtenant, and (in the case of an assignment only) financial information about the proposed assignee. These early clearance procedures seem particularly appropriate if the landlord can recapture the space if the tenant proposes an assignment or subletting.

3.4 Consent Form. Attach as an exhibit the required landlord's consent form to any transfer. Goal: prevent the landlord from adding new conditions and restrictions when consenting to a particular transaction. Although such conditions and restrictions may not conform to the lease, the tenant may agree to them because there is no choice or simply because the tenant is/was not paying careful enough attention (or saving money on lawyers) at the time. The consent form should include language allowing the tenant to assign to any subtenant or assignee all of the tenant's rights against the landlord.

3.5 Carve-Out for Affiliates. Expressly permit any assignments and subleases to affiliates (defined as broadly as possible) or successors, or in connection with the sale of the tenant's business. If the tenant operates multiple locations, a "sale of business" should include the sale of a single location or, worst case, some reasonable group of locations. Define "affiliate" to include trusts, estates, and foundations in which the tenant or its officers are involved. The lease should impose no burdens at all (brokerage commissions, recapture or consent rights, pricing constraints, and the like) for affiliate transactions. For an affiliate transaction, the tenant should merely agree to notify the landlord of the transaction—nothing more.

3.6 Suppliers, Vendors, Customers and Others. Let the tenant sublet (or license space) to its suppliers, vendors, or customers, as appropriate for the tenant's business convenience. Will the tenant or its principals form joint ventures or other new businesses (e.g., "new business incubators") that should have the right to share the tenant's space without any need for landlord approval?

3.7 Lender Approval Requirements. The lease should not require approval from the landlord's lender for subleases or assignments. If it does, get copies of the loan documents, and check them for lender approval requirements, and insist on limiting (or at least receiving copies of) any burdensome changes in lender approval requirements in future refinancings.

3.8 Licensees. The tenant should not need the landlord's consent to grant *bona fide* concessions or licenses.

3.9 Prohibited Transfers. Try to persuade the landlord to commit to providing notice and an opportunity to cure if the tenant violates a lease restriction on transfer. Just like any other default under the lease, a tenant can and should have the right to cure that default—in this case by rescinding the

transfer. The landlord will probably ask that the right to cure apply only to innocent or minor transfers, thus raising a factual dispute likely to create more trouble than it's worth.

3.10 Recapture of Premises. If the tenant requests approval of an assignment or subletting but the landlord elects to "recapture" the space, the tenant may want to have the right to withdraw the request. If the landlord recaptures the premises for any reason, the landlord should reimburse the unamortized cost of the tenant's furniture, furnishings, equipment, and improvements. Any recapture notice by the landlord must be accompanied by mortgagee consent to be effective. If the landlord elects not to exercise a recapture right, then the landlord should not unreasonably withhold consent to the tenant's proposal.

3.11 Assignment/Sublet Involving Other Tenants. The landlord should consent in advance to any assignment or subletting between this tenant and other tenants in the building, whether this tenant provides or receives additional space. Ask the landlord to waive in advance, for the benefit of this tenant, any provisions in other tenants' leases that would prohibit or limit such transactions or discussions, including recapture rights, profit participation, and consent requirements.

4. Assignment and Subletting: Implementation

4.1 Assignor and Guarantor Protections. As a general legal proposition, when the tenant assigns the lease, the original tenant remains liable for any default by the current assignee, or any later assignee. To facilitate future transactions, the tenant may want to try to mitigate that long-term post-assignment exposure, as it may severely constrain the tenant's flexibility when negotiating a future assignment. Try to say that both the assignor and any lease guarantor have no more liability—their liability terminates—if the tenant assigns the lease and satisfies certain conditions. If the tenant cannot obtain this protection, then the tenant may ultimately need to structure any future lease transfer as a sublease.

4.2 Guarantor Protections. Ask the landlord to agree to give any unreleased assignor (guarantor) notice of any assignee's default and an opportunity to cure it. In any such case, the assignor's guaranty liability would terminate if the landlord did not give the notice. An unreleased assignor (guarantor) might also want a right to obtain a "new lease" if the landlord terminates the lease and the unreleased assignor (guarantor) later performs the tenant's obligations.

4.3 Suretyship Boilerplate. If, after an assignment, the landlord and the assignee modify or extend the lease, a typical suretyship boilerplate provision in the lease may say that the unreleased assignor and its guarantor remain fully liable under the modification or extension. Although such boilerplate may make sense in the context of an affiliate guaranty, it makes no sense for an unreleased assignor of a lease where the assignee is an independent third party. Insist that in such case the assignor's and guarantor's liability will never exceed what it would have been under the original lease.

4.4 Stock Transfers. If a lease treats an equity transfer as an assignment for consent purposes, the lease should not then treat it that way for purposes of requiring the assignee to assume the lease, except where the equity consists of a general partnership interest in the tenant. Many landlords' forms are written in a way that might require such an assumption of liability. If the lease deems an equity transfer to constitute a lease assignment, the tenant should exclude mergers, consolidations, initial public offerings, any change of corporate control of a substantial operating company, transfers of publicly traded stock, the sale of all or substantially all of the tenant's assets (or of all assets within some particular category), transfers among affiliates, and any transfer resulting from an exercise of remedies by a bona fide pledgee.

4.5 Assignment of Security Deposit. A tenant will want the right to assign the security deposit to any assignee of the lease. If the security is a letter of credit, the landlord should cooperate in substituting one letter of credit for another (so two letters of credit are never both outstanding at once) if the tenant assigns the lease or changes banks.

4.6 Confidentiality. The landlord should agree to keep confidential any financial information that a prospective assignee or subtenant furnishes, and agree to sign a standard confidentiality agreement upon request. Such an agreement would include a requirement to return any confidential information if a transaction does not close. Similar requirements should apply for any final transfer documents delivered to the landlord. The parties may want to attach as an exhibit the form of confidentiality agreement to be signed, or build it into the lease itself to avoid delays and discussions if the agreement becomes relevant.

4.7 Splitting the Lease. The tenant may want the right to sever a large lease into two or more separate and independent leases, to facilitate assignment in pieces—a more flexible exit strategy. This could produce greater flexibility down the road and perhaps tax benefits depending on the particular circumstances. It also would, in the worst case, allow the tenant to "walk away" from one lease without imperiling the other lease, if the tenant can successfully resist the landlord's desire to cross-default the two leases. Any such cross-default would vitiate the lease-splitting effort.

4.8 Protections for Subtenants. The landlord should agree to give "nondisturbance" or "recognition" rights to subtenants if the subleasing transaction satisfies certain tests. Usually one of those tests will require that the subrent must equal or exceed the rent under the lease. Any such requirement makes the nondisturbance/recognition protections relatively worthless. Instead, the tenant should insist that the landlord protect any subtenant whose subrent is at least "fair market." But what does "fair market" mean? Comparable existing rents? Advertised rents? The phrase invites disputes. In the alternative, if any such sublease ever becomes a direct lease with the landlord, then the rent might adjust to match the lease rent, although this might defeat the whole point as viewed by a prospective subtenant. The lease should also give subtenants as much flexibility as possible, perhaps the same flexibility as the tenant, on future assignments and subletting.

4.9 Participation in "Profits." If the landlord will participate in any net "profits" that the tenant realizes from assignment or subletting, define the tenant's costs as broadly and inclusively as possible. For example, include brokerage commissions, professional fees, build-out, costs (including rent payable to the landlord) of carrying the space vacant during a reasonable marketing period, any free rent period, transfer taxes, cost of furniture included in the transaction, and the unamortized balance of the tenant's original improvements to the space. Try to let the tenant claim all these deductions at the beginning of the sublease term, from the first subrent dollars received, rather than amortize them over the sublease term. If the landlord insists on amortization, then at least try to include an interest factor on the unamortized balance. Once the "profit" for a sublease has been measured, the tenant should avoid paying the landlord's share of it as a lump sum at the time of the subleasing—even with a discount factor—because the tenant may never see the alleged "profit." Instead, any "profit" payments to the landlord should be due only to the extent the tenant actually receives the anticipated "profit." If the subtenant or assignee defaults, allow the tenant to stop paying and perhaps even recalculate (and receive a suitable refund of) any payments already made.

4.10 Multiple Lease Transfers. If the landlord is entitled to a "profit" payment for any assignment or sublease, the tenant may want to negotiate a "basis adjustment" in the case of future transactions. For example, suppose an assignee pays $1 million for a lease assignment, and the landlord receives 50% of that payment. What happens when the new tenant, the assignee, later assigns that lease again? At that point, the landlord has already "taxed" the first $1 million of increased value of the tenant's leasehold. The lease should let the assignee treat that lease purchase payment as part of the assignee's cost of the lease when subleasing or assigning to someone else. The assignee tenant's deductions should include any consideration that the tenant paid to acquire the lease, straight-lined, possibly with an interest component, over the remaining term of the lease.

4.11 Minimum Subrent. The lease should not prohibit the tenant from subletting its space for less than the current stated rent, because that's exactly what the tenant will very likely need to do.

4.12 Estoppel Certificates. To facilitate future lease assignments or sublets, the landlord should agree to deliver estoppel certificates as needed.

4.13 Bills and Administration. If the tenant sublets, try to have the landlord agree to bill the subtenant directly for any services the landlord provides to the subtenant, and any other landlord sundry charges that apply to the subleased part of the premises. Although the tenant cannot expect to be relieved of liability for these charges if the subtenant does not pay, the tenant can avoid time and effort, and a likely series of billing errors and inconsistencies, by extricating itself from the billing process. The same goes for any other function—e.g., requesting overtime HVAC or other building services—where the tenant might otherwise act as a mere communications channel between the subtenant and the landlord. The tenant will still want to see copies of bills and notices of unpaid amounts to avoid unpleasant surprises.

4.14 **Guarantor.** If the tenant can assign without the landlord's consent, the tenant also needs the right to replace any guarantor with a replacement guarantor that meets certain criteria. If the assignee delivers such a replacement guarantor—or if the landlord consents to an assignment without requiring a new guarantor—the first guarantor should be released automatically.

5. Bills and Notices

5.1 **When Notice Is Required**. Define when notice is required, but also try to limit when notice is necessary. The tenant should not have to comply with notice clauses if the tenant is sending, for example, only plans for approval, ordinary communications about the construction process, disbursement requests, and the like. The lease should require compliance with formal (and tedious) notice procedures only for notices that could give rise to meaningful rights and remedies under the lease.

5.2 **Attorneys and Managing Agents.** Let attorneys and managing agents give notices on behalf of their clients. This should apply not only to any attorney or managing agent identified in the lease, but also to any future replacement, whether or not the party making the change has formally notified the other party of the change.

5.3 **Copies.** If the landlord gives the tenant any notice, the landlord should agree to give a copy to the tenant's central leasing personnel, and perhaps to other specified recipients, such as counsel.

5.4 **Delivery.** The landlord should deliver formal notices by personal service or nationally recognized overnight courier. State when notices become effective. Establishing receipt of notice by email can be problematic. Emailed notices seem particularly likely to get lost in the abyss. Thus, the co-authors disfavor allowing formal notices to be given by email. On the other hand, a large organization might set up a special address for emailed notices and nothing else, with the idea that someone will check that address regularly and pay attention to, and act on, all incoming email.

5.5 **Notices Before and After Lease Commencement Date.** Until the lease commencement date, the landlord should agree to deliver all notices to the tenant's existing address, not the premises under the new lease. Even after the commencement date, it may not make sense for formal legal notices to go to the new premises. For example, the tenant may have a central leasing office that should receive and handle all incoming notices. In those cases, do something about the typical lease language that allows the landlord, after lease commencement, to send all formal notices to the leased premises.

5.6 **Delivery Notices.** Require the landlord to provide written notice of delivery of any part of the premises, with a "punchlist" of the work the landlord acknowledges remains incomplete. The premises should not be deemed delivered until the tenant has received that notice and, perhaps, a certain period of time has elapsed. The tenant may also want the notice not to become effective until the tenant has reasonably approved it. As a practical matter, a tenant is often not ready to begin using the space immediately after receiving it from the landlord. The more process, formalities, and delay the tenant builds into the rent commencement date, the less rent the tenant will need to pay for space it is not ready to use.

5.7 **Deemed Waivers.** If the tenant will be deemed to have waived any claims because of its failure to assert them within a specified period (e.g., objections to the landlord's delivery of the premises), then the lease should require the landlord to remind the tenant of the deemed waiver provisions as part of the notice that triggers the waiver.

6. Building Security

6.1 **Description of Program.** Describe (and require the landlord to provide) a security program in accordance with agreed criteria. The program could include package scanning and messenger interception, lobby attendant, the tenant's own lobby desk, security guards, keycards, night access doors, and specified operating hours.

6.2 **Tenant's Security.** Let the tenant establish its own security system and connect that system to the landlord's system.

6.3 **Windows Film.** The tenant may want the right to install blast resistant glass or film on exterior windows.

6.4 **New Measures.** The landlord should be required to obtain the tenant's consent for any new security measures (e.g., messenger interception) or changes in existing measures. This would, for example, allow the tenant to prevent establishment of security measures if the tenant considered them unnecessary overkill. The tenant should also seek the right to require changes to the landlord's security program if the tenant determines changes make sense. A tenant's exercise of these consent or control rights should impose no liability on that tenant for criminal actions of third parties or other adverse events.

7. Casualty

7.1 Right to Terminate. If a material casualty occurs and the landlord either cannot or does not restore the premises within a specified time period, or if the casualty occurs during the last two or three years of the lease term, let the tenant terminate the lease.

7.2 Adverse Impact on Business. Allow the tenant to terminate the lease or abate rent if a casualty or other event (e.g., a terrorist attack affecting some other building)—or restoration from any such casualty or other event—causes any temporary or permanent material change in the tenant's permitted use (e.g., loss of nonconforming use status), access, parking, traffic volume, pedestrian volume, or visibility of the premises.

7.3 Extent of Restoration; Interaction With Loan Documents. Ideally, require the landlord to restore in all cases—whether or not the landlord has adequate insurance proceeds, i.e., whether or not the landlord decided to adequately insure the building. Perhaps, require the landlord to maintain a minimum required net worth or personal guaranty to cover the risk of insufficient insurance. Beware of the terms of subordination, nondisturbance and attornment agreements, which may, in effect, modify the restoration requirements of the lease to conform to those of the loan documents. If the tenant negotiates a broad obligation to restore but the landlord's loan documents let the lender take the money and run, then the tenant loses if, as often happens, the tenant agreed in a subordination, nondisturbance and attornment agreement that the loan documents would govern. A major tenant will usually not tolerate this possible outcome.

7.4 Abatement During Restoration. Try to abate rent, escalations, alteration fees and any other payments during all restoration—both the landlord's and the tenant's—especially if major fixtures must be restored. Avoid any suggestion that rent abatement is available only to the extent that the landlord happens to receive rent insurance proceeds. It should be the landlord's job to maintain suitable rent insurance. The tenant shouldn't bear the risk of the landlord's failure to do so. The landlord should refund prepaid rent and other items. These measures will often be a "win-win" for both parties, because the landlord often can insure the loss (on a property-wide basis) more easily, economically, consistently, and reliably than can all the tenants individually.

7.5 Other Premises. If a casualty affects only improvements outside the tenant's premises, don't allow the landlord to terminate the tenant's lease unless the landlord: (1) makes the tenant whole (e.g., reimburses the tenant's amortized investment in the space), and (2) terminates all other similarly situated leases. And if the tenant's occupancy assumes the continued existence of other nearby buildings (such as a multi-building "retail mecca" destination), allow this tenant to terminate if some level of casualty affects those other buildings, even if it doesn't affect the tenant's building.

7.6 Landlord's Waiver of Right to Sue. Even without a waiver of subrogation, the landlord should agree not to sue the tenant for negligently causing a casualty that a typical casualty insurance policy would have covered.

7.7 Lease Extension. Ask the landlord to agree to extend the lease termination date to compensate the tenant after a loss for any period when the tenant could not use and occupy the premises. Even if the lease terminates, if the premises are tenantable and may legally be occupied, seek some short extension of the lease term to give the tenant additional time to operate and ease the transition to new premises.

7.8 Time to Restore. Limit or perhaps even negate any landlord right to obtain an extension of time to restore in the case of a *force majeure* event. The tenant might reasonably take the position that the tenant simply doesn't want to wait around very long to see if the landlord decides to, and does successfully, restore.

8. Condemnation

8.1 Partial. Require the landlord to restore the premises in the case of a partial condemnation, at least to the extent of available condemnation proceeds. If the partial condemnation affects the premises or more than some percentage of the whole building, the tenant may still want the right to terminate the lease.

8.2 Separate Claim. A tenant wants to be able to submit a separate claim to the condemning authority for: (1) the value of the leasehold estate, and (2) moving expenses, trade fixtures, goodwill, advertising and printing costs, phone lines and damages for interruption of business. Landlords and lenders rarely tolerate item (1), but may accept it provided that the tenant's award does not diminish sums payable to the landlord and its lender.

8.3 Physical Impairments. The tenant may want a right to

terminate or abate rent if any condemnation, including a road widening or other change, materially and adversely affects the tenant's business, such as by impairing parking, access (e.g., loss of curb cuts), traffic volume, or visibility. Similarly, if a condemnation affects nearby property within a multi-building "retail mecca" destination project, then the tenant may want the right to terminate, even if the condemnation doesn't affect the tenant's own building.

8.4 **Landlord Participation.** The landlord should agree not to instigate, support, or cooperate in any condemnation or taking of the tenant's leasehold interests, rights under a reciprocal easement agreement, or any other interest in the property. If the landlord violates that prohibition (for example, if the landlord enlists a governmental authority to cut off the tenant's exclusivity rights to facilitate expansion of the landlord's regional mall), then all rent should abate and the lease should allow the tenant to terminate and recover significant liquidated damages.

9. Consents

9.1 **Quick Exercise.** Require the landlord to grant or deny any required consent quickly. After a certain period, silence should be deemed consent. As a compromise, the tenant might agree to remind the landlord of the response deadline in its consent request or to give a reminder notice if the landlord has not responded within a certain time. Insist that no landlord consent may be unreasonably withheld. And if the landlord cannot unreasonably withhold consent, the lease should say, once, that the landlord also cannot unreasonably condition or delay consent.

9.2 **Reasonableness vs. Objectivity.** Legal documents often use "reasonable consent" as a technique to solve many problems. No one quite knows what it means, beyond inviting litigation. If particular categories of consent seem particularly problematic, consider defining "reasonableness," by defining objective standards that the tenant must meet in whatever matter would otherwise need the landlord's "reasonable" consent. Then, instead of giving the landlord a "consent" right just give the landlord a "confirmation" right, i.e., the right to confirm that whatever the tenant wants to do does in fact meet the objective standards. If the landlord thinks it doesn't, then the landlord bears the burden of saying why.

9.3 **Expedited Dispute Resolution.** Some major leases build in an expedited dispute resolution procedure for certain consents—assignments, subletting, alterations—and even designate the third party who will decide the dispute. If that third party can't serve, then the lease may designate alternatives. Reports from the field indicate that one of the great advantages of such expedited dispute resolution procedures is that they almost never actually need to get used.

9.4 **Pre-Consent.** Does the tenant anticipate any possible future changes in the tenant's needs for which the tenant wants the landlord's consent today (e.g., a pending merger, change of name, change of business)?

9.5 **Grounds for Disapproval.** If the landlord decides not to consent, then the landlord's notice to that effect should specify all grounds for that failure, so the landlord can't manufacture other grounds later. The tenant could go a step further and require that any notice of disapproval must also specify reasonable changes in the proposal that would lead the landlord to approve it.

9.6 **Use of Name.** The landlord should consent to the tenant's use of the building's name and likeness in the tenant's promotional and publicity materials.

9.7 **Site Plan.** For new construction, the tenant may want the right to consent to the landlord's site plan (particularly as it relates to parking) and any substantial changes.

9.8 **Press Releases.** The landlord should obtain the tenant's approval of press releases, tombstones, and announcements about the lease. The landlord should not disclose any terms of the lease without the tenant's consent. Will the tenant want any such press release to identify—or not identify—the tenant's broker, counsel, or other advisers? The lease should not preclude the tenant from posting the lease on any securities disclosure website, if required by law.

9.9 **Tenant Consent Rights.** Does any tenant anticipate any matters for which the landlord should seek the tenant's consent, such as changes in building security? Indicate in the lease that such consent will be required.

9.10 **Damages.** For unreasonable denial of consent, try to trim back the standard lease language by which the tenant waives any right to recover damages. Perhaps the lease should allow the tenant to recover damages up to a specified dollar amount, or at least a reimbursement of the tenant's attorneys' fees in establishing that the landlord acted unreasonably. The tenant's position seems particularly compelling where the lease

requires the landlord's consent in connection with the sale of the tenant's business, and the landlord withholds consent—in violation of the lease—and thus derails the tenant's entire transaction.

10. Defaults and Remedies

10.1 Notice and Opportunity to Cure. The tenant should have the right to notice of, and the opportunity to cure, any monetary or other default. Request a double cure period before the landlord can exercise its right to terminate the tenant's lease. Why should lease termination be easy?

10.2 Default Triggered by Bankruptcy. Although "ipso facto" clauses are typically unenforceable against a debtor-tenant, beware of any event of default triggered by someone else's bankruptcy, for example, that of a guarantor. A landlord can typically declare and enforce any such event of default against the tenant without a problem.

10.3 Limited Liability. Limit the tenant's liability and the liability of the tenant's general partners to their interest in the lease. Allow for release of departing or deceased partners.

10.4 Limitation on Landlord's Remedies. Limit the landlord's remedies (for example, to exclude lease termination or eviction) for defaults or disputes below a threshold level of materiality. Request that the landlord obtain an order from the court before it can exercise any right to terminate the lease. Why should the risk of lease termination hang over the tenant for every possible lease default or alleged default, and hence almost every conceivable (even minor) dispute with the landlord? Also, ask the landlord to waive any right to recover consequential damages from the tenant.

10.5 Nonmonetary Defaults. The tenant might want to eliminate all "nonmonetary" defaults. This can be accomplished by requiring the landlord to convert any "nonmonetary" default into a monetary default by curing it and sending the tenant a bill for reimbursement (a provision common in old Woolworth's leases—though apparently it was not enough to save the chain from oblivion). As an alternative, provide that so long as the tenant remains current in its monetary obligations, the landlord cannot exercise certain remedies (e.g., lease termination) for a nonmonetary default until the landlord has obtained a court order. In practice, of course, a court will often put the landlord in the same position anyway, regardless of what the lease says, such as through the "Yellowstone" procedure in New York.

10.6 Future Equipment Financing. Require the landlord, as well as its mortgagee, to waive or subordinate any statutory or other liens on fixtures, equipment, and other personal property of the tenant, either in all cases or if the tenant's asset-based lender requests it. To allow such a lender to exercise its remedies and remove any financed equipment, the landlord should also agree to enter into a landlord's consent, joined in by the landlord's mortgagee. This document could give the lender a brief lease extension if the lease terminates, and the right to conduct an auction on the premises.

10.7 Holdover Rent. Prorate holdover rent on a per diem basis for partial months. As a practical matter, that may be the single most important concession for a tenant to request in the typical "boilerplate" of any lease, which will usually impose a month's holdover rent—often at double the contractual rent—for a day's delay in departing. Establish a short-term right to hold over at the same rent, to give the tenant some flexibility in case of delays in relocating. Try to negate any holdover rent during some limited period, if the parties are negotiating a lease extension in good faith for the premises, or the tenant is diligently negotiating for space in another building. Try to eliminate holdover rent at any time when a new tenant is not ready to occupy the premises. In New York, Real Property Law section 229 imposes double holdover rent by statute. Have the landlord waive it.

10.8 Mitigation of Damages. The landlord must seek to mitigate damages. (New York still imposes no such requirement on commercial landlords.) For example, the landlord must try to re-let the premises. If the landlord does mitigate its damages, it must credit any money collected against the tenant's liability.

10.9 Waiver of Self-Help. Ask the landlord to waive any right of self-help (to retake possession) and any right to lock out the tenant.

10.10 Acceleration of Rent. If the landlord has the right to accelerate all rent as liquidated damages, first try to eliminate this remedy. If you can't, seek the following: (1) the tenant gets credit for fair and reasonable rental value; and (2) the highest possible discount rate (for example, prime rate rather than four percent per annum).

10.11 Default by Subtenant. Extend the tenant's cure period in the case of nonmonetary defaults

arising from the actions of a subtenant. Try to give the tenant time to enforce the sublease and, if necessary, to obtain possession of the subleased premises.

10.12 Statute of Limitations. Limit the landlord's right to collect unbilled rent, particularly escalations, once a certain time has passed (e.g., 18 months).

10.13 Piercing the Veil. Require the landlord to waive any theory that might let the landlord "pierce the corporate veil" of the tenant named in the lease. The landlord should acknowledge it has no claims against the tenant's principals or affiliates under any circumstances, including tort-based theories relating to the lease or the premises, except to the extent they have actually signed a guaranty. Recognize that the "corporate" or "limited liability company" separateness may not be as sacrosanct as lawyers usually assume it is.

10.14 Reletting Costs. To the extent that the lease requires the tenant to reimburse the landlord's cost to "relet" the space after the tenant's default, try to limit that obligation to apply to only an equitable portion of the landlord's reletting expenses. For example, perhaps the tenant should pay reletting costs only to the extent reasonably allocable to the reletting period within the original lease term. If the reletting covers one year of the remaining lease term and nine later years, the tenant should pay only 10% of the reletting costs.

11. Electricity

11.1 Totalized Submeter Readings. Landlord should totalize readings from multiple submeters, using a third-party service and appropriate security controls to limit access to submetering equipment and computers.

11.2 Usage Survey. Let either party, not just the landlord, initiate a usage survey. The tenant may want, or may want to require the landlord, to periodically test electrical submeters for accuracy.

11.3 Rate for Submetered Electricity. The tenant should pay for submetered electricity using the same tariff under which the landlord purchases electricity. If the landlord purchases electricity from a private provider, the rate the tenant pays should not exceed the public utility's rate. If the landlord is required to stop providing power to the premises (one of those many bizarre hypothetical possibilities that every significant lease seems to address, perhaps because it once happened somewhere somehow), then the landlord should pay the tenant for the conversion costs of obtaining alternate sources of power.

11.4 Sufficient Wattage. The landlord should assure the tenant that the existing electrical system provides enough power for the tenant's present and anticipated needs, usually expressed in watts per usable (or sometimes rentable) square foot.

11.5 Additional Electrical Capacity. The tenant should be able to obtain more electrical capacity if needed, quickly, at a defined or ascertainable cost. The landlord should reserve a certain number of watts per foot for the tenant, even if the tenant will not need it at first. If the tenant later needs more electricity but the building has no available capacity, the resulting delays in obtaining additional capacity may hurt the tenant's business.

11.6 Location for Power Delivery. Specify the delivery point for electrical power.

11.7 Tenant's Emergency Generator. Let the tenant install an emergency generator and fuel tank, or other arrangements for fuel storage and refueling. Allocate ownership, responsibilities (including responsibilities for regular testing and refueling), and costs between the landlord and the tenant. The tenant should have the right, but not the obligation, to remove this equipment at the end of the lease term.

11.8 Backup Electrical Operation. The landlord should give the tenant prior notice before any scheduled electrical shutdown or testing of the landlord's emergency generators. Limit the frequency of such shutdowns and the periods when the landlord can test its emergency generators. These generators, when running, can produce background noise about as subtle as jet engines.

11.9 Building Generator. Give the tenant the right to use the building generator. The landlord should reserve a certain amount of generator capacity for the tenant and agree to keep the fuel tanks full. The tenant may also want the right to monitor the landlord's generator maintenance and testing activities. A landlord will usually expect the tenant to reimburse a share of these costs, but that is ultimately a business negotiation.

11.10 Capacity. The landlord should allow the tenant to reserve additional riser space and additional capacity in the bus duct or other main electrical distribution system.

11.11 Retroactivity. Try to limit the period during which the landlord can retroactively bill the tenant for increased rates or usage.

11.12 Auditing. Allow the tenant to audit electrical bills, the same way the tenant can audit operating expenses, and perhaps under similar procedures. The tenant should also have the right to request that a qualified third party periodically check the landlord's meters for accuracy.

11.13 Maintenance. Require the landlord to maintain and periodically calibrate any submeters, and maintain evidence that the landlord has done so.

12. Elevators

12.1 Freight Elevators for Moving. Ask to use the freight elevators to move in and move out. The tenant should seek the use of several elevators—e.g., all the passenger elevators in the building—on weekends and at night for the same purposes. Ideally, all this elevator usage, or at least a certain number of hours of usage, should be free, both for the move in and the move out.

12.2 Night Service. The lease should provide that "night service" for elevators (restricted or limited service) cannot begin before a specified time. Require the landlord to have a minimum number of elevators in service at all times.

12.3 Changing Elevator Banks. Prohibit the landlord from reconfiguring elevator banks. If the tenant's space is the first stop, it should remain so.

12.4 Exclusive Service. The tenant may want exclusive elevator service for certain floors. The tenant may want idle cars parked at, or returned to, the tenant's floor for the tenant's convenience.

12.5 Routine Repairs. Require the landlord to perform routine elevator repairs and maintenance only outside business hours, and within a certain turnaround time (shorter if multiple elevator cars are out of order).

12.6 Waiting Time. Specify the maximum average waiting time for elevators. Establish measures to monitor elevator performance. In particular, a major office tenant might require the landlord to install in the ground floor elevator lobby a video display showing the elevator system and the status of each car. This would give the most likely critics of elevator performance—people waiting for an elevator—an immediate ability to know what to complain about (e.g., too many cars out of service). Establish consequences if elevator performance falls short of agreed benchmarks.

12.7 Security Measures. Give the tenant the right to approve any institution or modification of elevator security measures, including 24-hour keycards and turnstiles to the elevator area. Does the tenant want to require any such measures?

12.8 Service Contract. Require the landlord to maintain an elevator service contract that obligates the maintenance contractor to respond to a stuck elevator within a certain very short time frame.

13. End of Term

13.1 Duty to Restore. The tenant will want to disclaim any obligation to restore (i.e., remove the tenant's alterations) at the end of the lease term. As a compromise measure, the tenant might agree to remove any of the tenant's improvements that are unusual, particularly difficult to remove, or improperly made, or if the landlord reasonably required restoration as a condition to consenting to the tenant's work. But, what's "reasonable"? Instead, try to specify an objective test for determining what the tenant must remove. It may make sense to attach an exhibit, defining specific items that the tenant must remove at the end of the term. The lease might still need to deal with possible additions to the list if the tenant did more work later in the lease term. Require the landlord to give a reminder notice at least a certain number of months, but no more than some shorter number of months, before the end of the lease term if the landlord intends to enforce the restoration requirement.

13.2 Restoration. If the tenant must restore, then let the tenant: (1) perform any necessary restoration rather than pay the landlord to do it; (2) enter the premises on favorable terms for some reasonable time after the end of the lease term as needed; (3) during the post-term restoration period, pay only an equitable *per diem* payment (or nothing at all) rather than holdover rent; and (4) meet only a "substantial completion" standard rather than a higher standard that might apply to delivery of new space. Once the tenant notifies the landlord that the work is done, the landlord should have a short time to object. Silence should be deemed approval. Require the landlord to specify all objections, in reasonable detail, within the objection period. If the landlord's objections are minor and the tenant resolves them within a reasonable period, then the tenant should no longer be required to pay any rent (if the tenant agreed to pay any rent) during the post-term restoration period.

13.3 Condition of Returned Premises. The tenant should have no duty to return the premises in any particular condition. For example, it should have no obligation to replace a worn-out compressor in the last year of the lease term.

13.4 Removal of Personal Property. Let the tenant enter the premises for a short time after the lease expires to remove the tenant's personal property.

13.5 Demolition Clause. If the tenant cannot negotiate away a "demolition" clause, then don't allow the landlord to terminate under that clause unless the landlord: (1) gives reasonable notice; (2) acts in good faith; (3) terminates the leases of all other tenants; (4) has entered into a binding noncancellable demolition agreement; (5) has obtained a demolition permit; and (6) deposits the lease termination payment in escrow. If the tenant can think of anything else to require, the tenant should do so, all toward the goal of delaying the lease termination as long as possible.

13.6 "For Rent" Signs. The landlord should not post "for rent" signs until the lease term has actually ended. The landlord should agree to remove any "for rent" signs as soon as the landlord has signed a new lease for the space, or perhaps even when the landlord and the next tenant have entered into a nonbinding term sheet.

13.7 New Location Sign. For a reasonable time after the lease has terminated, the tenant may want the right to install a sign directing customers to the tenant's new location.

13.8 Prepaid Rent. Upon any termination not arising out of the tenant's default, the landlord must promptly refund prepaid rent and other payments, with accrued interest. If the landlord doesn't do it promptly, perhaps charge an administrative fee.

13.9 Subtenant Problems. Sometimes a tenant cannot vacate solely because a subtenant fails to surrender its own subleased premises, which might consist of only a small part of the tenant's premises. To protect the tenant in such a case, try to limit the tenant's liability, by limiting such liability only to the part of the premises that the subtenant failed to surrender or, at most, to the entire floor that includes those premises. Absent such a concession, the tenant may find itself liable for holdover rent for an entire multi-floor leased premises, even though the tenant moved out and the subtenant's holdover affects only a tiny corner of one floor. Tenants should understand this risk when evaluating prospective subtenants and negotiating subleases. As one way to mitigate the risk, the tenant might have the sublease expire six months before the main lease, at which point the tenant would require the subtenant to deliver appropriate estoppel certificates and other assurances (such as an increased security deposit or a stipulated judgment of eviction) to back its obligation to vacate, and the sublease might convert to a license arrangement. A strong tenant might ask the landlord to agree to bear the risk of subtenant holdover.

13.10 Receipt and Release. Require the landlord to issue a receipt and release upon request at the end of the lease term.

13.11 Inspection. Require that the parties jointly inspect the premises at the end of the lease term to identify, in a written punchlist, any issues the landlord intends to raise. If the landlord doesn't raise them at the inspection, then the landlord can't raise them later.

14. Escalations (Generally)

14.1 Proportionate Share Computation. In computing the tenant's proportionate share, if the rentable square footage (the numerator) includes the tenant's share of the common areas, confirm that the denominator also includes all common areas. If the square footage of the building increases, then the denominator should also increase accordingly. Exclude basement and mezzanine space from the numerator. Avoid contributing to the landlord's land banking or costs of carrying dead space.

14.2 Over-Reimbursement. Do all of the tenants' percentages add up to 100 percent, or is the landlord being over-reimbursed for escalations? Are the anchor tenants paying their share, or is that share being shifted to the other tenants? If the latter, this tenant probably can't do anything about it, but may want to take the cost shifting into account in negotiating other terms of the lease.

14.3 Mixed Uses. In a mixed-use building, including office with retail on the ground floor, does the landlord treat all tenant types the same way or at least equitably? Should the landlord do that? Should certain parts of the project be excluded from the tenant's escalation formulas? More generally, the existence of multiple uses in the same building can make any allocations much harder to understand and much more subjective, i.e., it creates much more room for abuse, and makes the abuse that much harder to find. If possible, the tenant should contribute only to an allocation of costs within the particular single-use component of the project that the tenant actually occupies. The tenant may want to go a step further and negotiate a fixed contribution to expenses, or even a "gross" rent number.

14.4 Occupiable Space. The lease should allocate escalations based on occupiable space (as the denominator), not occupied space. Let the landlord pay the full operating costs for all unoccupied space.

14.5 Multiple Escalations. The lease should not allow multiple escalations that give the landlord duplicative recoupment of a cost increase, or double-count any charges included in operating expenses or elsewhere. For example, the marketing director's salary should be either an operating expense or a charge to the marketing fund, but not both. Anything treated as "real estate taxes" should not also be treated as "operating expenses." These principles can be expressed both generically and by combing through and comparing the various definitions, watching for overlap.

14.6 Lease Termination Mid-Year. Apportion escalations if the lease terminates during a calendar year. Otherwise, the landlord could argue that annual calculation procedures and payment schedules obligate the tenant to contribute to an entire year's escalations.

14.7 "Base Year." Any "base year" should fully include all expenses. Did the landlord not yet incur any ordinary expenses in the base year? Did any exclusions apply? Was the landlord not providing full building services? Was the building new, so the landlord could rely on contractors' warranties instead of paying for regular repair and maintenance?

14.8 Cap on Escalations. The tenant might try to negotiate an annual limit on escalations—either a specific dollar figure, a percentage, a percentage of the consumer price index ("CPI"), or the comparable cost increases in a "basket" of comparable buildings, if such information can be obtained.

14.9 Free Rent Period. Does the "free rent" period apply to escalations or just base rent?

14.10 "Porter's Wage" Escalation. For "porter's wage" escalations (relatively rare in modern leases), the lease should exclude fringe benefits and the value of "time off." Try to limit the measure to reflect only the base hourly rate. If you cannot exclude fringe benefits, try to define how to calculate them.

14.11 Consumer Price Index Adjustment. To the extent that lease includes a CPI adjustment, try to have that adjustment measure any increase consistently from the starting year of the lease, rather than from the preceding year's CPI. This will usually work better for the tenant, as it will give the tenant the benefit of intervening decreases in the CPI. The adjustment clause should specify exactly which CPI index intend to use, and what happens if that index stops being issued.

14.12 Escalations Below Base. State that if an escalation amount falls below the original base, the tenant should receive a credit against fixed rent.

14.13 Fixed Rent Increases. To avoid controversy over calculating escalations, negotiate fixed rent increases in place of all pass-throughs of expenses.

14.14 Waiver of Escalations. The landlord should waive any escalations not billed within a certain period.

15. Estoppel Certificates

15.1 By Whom. Both the landlord and the tenant should agree to furnish estoppel certificates. How often?

15.2 Who Can Rely. Allow subtenants and assignees to rely on the landlord's estoppel certificate, not just lenders. If the tenant delivers an estoppel certificate, negate any right for the landlord to rely on it; only allow third parties to rely.

15.3 Form. Attach an acceptable form of estoppel certificate as an exhibit to prevent subsequent issues or creative efforts by the landlord to turn future estoppel certificates into lease amendments. Limit the assurances the tenant must provide, both substantively and by adding "knowledge" requirements and as many other qualifiers as possible. Avoid restating any lease terms, except where they can't be determined from the face of the lease, such as the actual commencement date if uncertain. Tell the lender, or anyone else relying on an estoppel certificate, to read the lease. They should rely on the estoppel certificate only for comfort that the landlord and the tenant have not secretly amended the lease, and to confirm facts outside the four corners of the lease.

15.4 Legal Fees. Require the landlord to reimburse the tenant for the tenant's reasonable legal fees in researching, reviewing, and preparing future estoppel certificates.

15.5 "Knowledge." Qualify appropriate sections of any estoppel certificate to apply only to the tenant's knowledge, especially for issues of additional rent. Also, think about what "knowledge" means. Actual knowledge? As an alternative, say that the tenant reserves its rights on these claims. A typical 10-day requirement to deliver an estoppel certificate doesn't give the tenant enough time to conduct adequate due diligence to knowingly surrender claims involving complicated and potentially debatable billing of operating expenses and util-

ity charges. This is particularly true when the tenant is a large company with multiple departments involved in overseeing the lease.

15.6 Conflict of Terms. If the estoppel certificate and the lease conflict, the lease should govern. The delivery of an estoppel certificate should not be deemed to waive or modify any rights or remedies of the tenant.

15.7 Failure to Sign. Negate any liability of the tenant (e.g., claims of "tortious interference") if the tenant does not sign the estoppel certificate. Limit the landlord's remedy to an injunction, a deemed estoppel, or a nuisance fee. This is just like the landlord's desire not to incur liability for derailing a transaction if the landlord unreasonably withholds consent to an assignment or transfer.

16. Failure to Deliver Possession

16.1 Remedies. Let the tenant terminate or receive a substantial rent abatement if the landlord does not deliver possession by a certain date. Also try to get day-for-day, or better, rent credit for the delay. Require the landlord to pay for or provide temporary space or pay the tenant's holdover damages in its present space. If the lease sets a formula for any payment or credit to the tenant for delayed delivery, courts may treat it as "liquidated damages," although when a New York court did so, that particular ruling was reversed on appeal. *See Bates Adver. USA, Inc. v. 498 Seventh, LLC*, 739 N.Y.S.2d 71, 75 (1st Dep't 2002). Just in case, though, add the typical recitations that attempt to validate any liquidated damages clause. Beyond establishing consequences for the landlord's failure to meet a delivery date, establish consequences if the landlord fails to meet individual interim milestones. Those milestones might relate, for example, to completion of HVAC upgrades or construction of demising walls, the walls that separate this tenant's space from common areas and space leased to other tenants.

16.2 Lender's Approval. If the lease is conditioned on a lender's (or anyone else's) approval, set an outside date for approval and let the tenant terminate if the landlord misses that date. Try to have the landlord deliver the approval when the parties sign the lease, particularly if the tenant is under time pressure to resolve its occupancy arrangements.

16.3 Termination of Lease. If the tenant terminates the lease because the landlord does not timely deliver possession or obtain any required approval, the landlord should refund all payments and redeliver any other documents (such as letters of credit) delivered on lease signing. Also ask the landlord to agree to compensate the tenant for the tenant's costs.

16.4 Late Delivery of Premises. The landlord should push back all rent abatements and adjustments as well as the expiration date (and base years, at some point) if the landlord delivers the space late.

16.5 Relocation. If possible, delete any clause that allows the landlord to relocate the tenant to other space. Otherwise, if the tenant agrees to give the landlord a right to relocate the tenant, require: (1) the new premises must be physically higher (or no more than ___ floors lower) than the existing premises; (2) the landlord must pay all direct and indirect relocation costs (e.g., new letterhead, announcements, rewiring costs); (3) the configuration, size, and layout of the new premises must meet the tenant's reasonable approval; (4) the tenant need not relocate until the new premises are fully built out, and legally occupiable, all at the landlord's expense; (5) a free rent period; and (6) instead of relocating, allow the tenant to terminate the lease, particularly if less than a certain period remains in the lease term. The landlord should also have no right to relocate the tenant more than once.

16.6 Seasonal Businesses. For seasonal businesses, the tenant may not want to be obligated to initially open for business during its slow season. Try to control periods or dates during which the landlord may deliver the premises. A certain day of the week? Only outside the winter holiday season?

17. Fees and Expenses

17.1 Reasonableness. Limit fees and expenses to any that are reasonable, actual, and out-of-pocket. Do not agree to allow fees "as established by landlord" or as "modified from time to time" or "based on landlord's standard schedule." The tenant should not be required to pay fees for any review of plans (or possible subtenants) by the landlord's internal personnel, even if those persons are professionals.

17.2 Legal Fees and Expenses. Make the obligation to reimburse attorneys' fees run both ways. Whoever prevails should recover attorneys' fees, including the value of in-house counsel's time. Exclude legal fees and expenses relating to a claimed default if no default exists or the landlord otherwise does not prevail.

17.3 Indemnification. The tenant should be responsible only for the direct consequences of its own acts and omissions. Keep any indemnity narrow. Negate tenant liability for consequential damages.

18. Heating, Ventilation, and Air-Conditioning ("HVAC")

18.1 Specifications. Specify required HVAC service, with variations by day of week and season, both during and outside business hours. Require the landlord to air-condition all interior public areas. Obtain the right to test air quality and other characteristics from time to time. Remember that HVAC includes "heating" and "ventilation," not just air conditioning, so the specifications should address those services as well.

18.2 Rates. The lease should state the rates (and the basis of rates) for overtime HVAC. Squeeze out any profit component. If the landlord later charges any other tenant a lower rate, the landlord should agree to notify this tenant, and this tenant should get the benefit of that lower rate.

18.3 Installation. If the landlord must install any HVAC system, the lease should also require the landlord to get the system working properly. That means installing all meters, controls, and thermostats, in locations satisfactory to the tenant, and testing and balancing the system.

18.4 Allocation of Charges. Allocate overtime HVAC charges among multiple simultaneous users. Otherwise, the landlord may charge each tenant the full cost to the landlord of providing overtime HVAC for the entire building.

18.5 Notice for Overtime. Minimize or eliminate any prior notice requirement for overtime HVAC. Even if the tenant misses the notice deadline, the landlord should agree to try to provide overtime HVAC.

18.6 Discount. The landlord should give the tenant a discount on overtime HVAC if the tenant commits in advance to specified levels of usage for a specified period. With sufficient notice, the tenant should still have the right to withdraw or change its usage commitment.

18.7 Water Treatment. Require the landlord to add appropriate chemicals to any HVAC-related water lines to prevent pipe corrosion and system breakdowns. The landlord should maintain records of these treatments and give them to the tenant upon request. The tenant may want the right to test the HVAC system to confirm that the landlord is properly treating the water lines.

18.8 Miscellaneous Issues. Should the tenant have the right to install supplemental HVAC? How much condenser water must the landlord provide? Chilled water? Who owns the equipment? How much will installation and usage cost? Who must repair/restore? Should the tenant be able to reconfigure building standard HVAC as needed for supplemental service? Will the tenant need access to fresh-air louvers? Where?

19. Inability to Perform

19.1 Force Majeure. Give force majeure protections to the tenant, not just the landlord. The landlord must give notice of a "force majeure" event within a specified time, or lose the right to claim that event as force majeure. Any delays that result from a contractor that the landlord required the tenant to use (or perhaps even merely approved) should constitute "force majeure" for the tenant's obligations.

19.2 Right to Cure. If the landlord fails to perform an obligation, let the tenant cure the failure to perform, even if the landlord can argue that its failure is caused by "force majeure." If the landlord fails to reimburse the tenant's cure costs, with interest at some high rate, then let the tenant offset rent.

19.3 Force Majeure Exceptions. Although "force majeure" clauses always have a certain logic and fairness to them, should the tenant always allow the landlord the potentially open-ended extensions of time that a "force majeure" clause might justify? If the lease requires the landlord to restore after casualty within a certain time, should the landlord be entitled to an endless extension of time? What about delivery of the premises? What about maintenance of the roof? At some point, the "force majeure" clock should stop ticking or the "rent abatement" clock should start ticking, perhaps at double speed—even for "force majeure" delays.

20. Insurance

20.1 Common Standard. The tenant should have no obligation to provide more insurance than similar tenants customarily maintain in similar buildings, or to provide insurance at rates that are not reasonable.

20.2 Type of Insurance. Allow the tenant to carry blanket insurance, self-insure, or use a "captive" carrier. In the case of a large corporate tenant, the insurance requirements should conform to the tenant's company-wide insurance program. If that program later changes, the lease should allow the tenant's insurance deliveries to conform to the tenant's changed program.

20.3 Waiver of Subrogation. Insurance policies should contain a waiver of subrogation clause. The lease should then contain matching waiver and release language.

20.4 Property and Liability Insurance. The landlord should carry property and liability insurance, and give the tenant evidence of that insurance on request. The tenant may also want the right to see copies of the landlord's insurance policies, a requirement that landlords often impose on tenants.

20.5 Effect of Sublease. To the extent that the tenant subleases the premises, the lease should state that the subtenant's insurance coverage and insurance certificates (if otherwise substantially in compliance with the lease) will meet the tenant's insurance obligations. On the other hand, small subtenants will often expect to provide less insurance than a direct tenant. Avoid any suggestion in the lease that every subtenant's insurance must meet the insurance standards of the direct lease.

20.6 Landlord's Deductible. A major tenant may care about the size of the landlord's deductible (both a minimum and a maximum) and how the landlord will fund that deductible in the event of a casualty. Whose risk is the deductible? Will that payment constitute an operating expense?

20.7 Terrorism Insurance. If the tenant believes terrorism insurance may rear its head again as an issue in the world of commercial real estate, think about whether the lease should deal with it in any particular way. For example, the tenant might conclude that operating expenses should exclude any costs related to terrorism insurance. Make it the landlord's problem as a risk of owning real estate.

21. Landlord's Access

21.1 Prior Notice. How much and what type of prior notice should the landlord give to gain access to the tenant's premises?

21.2 Purpose of Access. Limit the landlord's access to certain defined purposes (e.g., repairs, inspection, or to show the premises to prospective future tenants within the last few months of the lease term only).

21.3 Frequency. Limit how often the landlord can enter the premises.

21.4 Sensitive Areas. Should the lease prohibit or restrict landlord access to "special spaces" (bank vault, securities vault, network control rooms, and the like) for cleaning and other purposes? If the tenant regards its entire operation as proprietary and "top secret," then perhaps the lease should not allow the landlord access at all, absent an emergency.

21.5 Time of Access. Should access be limited to certain hours (business hours, after hours)?

21.6 Authorized Personnel. Precisely who among the landlord's employees, agents and contractors should have access?

21.7 Presence of Tenant's Representative. The tenant may want its representative to be present whenever the landlord is on the tenant's premises. This is particularly important in any area where the tenant has sensitive, dangerous, or expensive personal property.

21.8 Disruption and Security. Require the landlord to minimize interference with the tenant's business and comply with the tenant's reasonable instructions and security requirements, even if this requires the landlord to use overtime labor. If the landlord's personnel or contractors cause any damage or theft, make the landlord responsible.

21.9 Landlord's Installations. If the landlord wants to reserve the right to install pipes and conduits somewhere in the premises, the tenant may want to limit exactly where—such as only within existing walls or above ceilings, or at locations that the tenant reasonably approves. Require the landlord to minimize and repair (or pay to repair) any damage associated with the installation or maintenance of these conduits. Expressly negate any right for the landlord to install any new structural supports or other improvements not requested by the tenant within the premises. Perhaps also provide for significant liquidated damages if the landlord violates the restrictions in the preceding sentence.

21.10 Storage of Materials. If the landlord stores materials in the premises for making repairs, limit that right to apply only to those materials necessary for repairs within the premises. This can be particularly problematic if the premises includes a terrace—a tempting storage area for long-term exterior projects. In any case, the landlord should store materials in the premises (or an adjacent terrace) only for short periods.

21.11 Repair Work Outside Business Hours. If the landlord's work in or affecting the premises will cause inconvenience, noise, odors, or the like, the landlord should work only outside business hours. If the tenant needs the landlord to repair any critical area or function quickly, require the landlord to do so, even if the landlord must hire overtime labor.

21.12 Hazardous Materials. If the landlord will use hazardous materials for any work in or affecting the premises, the landlord should agree to notify the tenant in advance and provide

"material safety data sheet" disclosures. If the landlord will make the premises uninhabitable during business hours, should the landlord provide substitute space?

22. Leasehold Mortgages and Tenant's Financing

22.1 Landlord's Consent. Ask the landlord to consent in advance to the tenant's grant of leasehold mortgage(s). The landlord should also agree to execute a recordable memorandum of lease. Any leasehold mortgagee should have the rights to: (1) receive notice of default from the landlord; (2) cure; and (3) obtain a new lease from the landlord if the original lease terminates, except a scheduled termination in accordance with its terms. For the lease to be truly "mortgageable," it needs much more than this.

22.2 Equity Pledges. If the tenant's owners pledge their equity as collateral for a loan, the pledgee may want protections under the lease like those of a leasehold mortgagee.

22.3 Financing, Generally. Does the tenant anticipate entering into any other financing arrangements, such as equipment or inventory financing, that might affect the landlord, the lease, or the premises? If so, add appropriate language to the lease to preserve the tenant's flexibility. Plan ahead to obligate the landlord to comply with any likely requirements of the tenant's equipment lessor or other financing source.

23. Maintenance and Cleaning

23.1 Structural Repairs. Require the landlord to maintain and repair the "structure" of the building (including the roof, the foundation, and other structural elements) and maintain and repair common areas, parking lots, garages and sidewalks. Define "structure" (broadly) to avoid future disputes over what it means. Try to have it cover as much of the building as possible except most improvements unique to a particular tenant.

23.2 Building and Systems Maintenance. The landlord should maintain electrical, plumbing, sewage, HVAC, and other building systems, at least to the point of entry into the premises. Require the landlord to maintain service contracts. Let the tenant and its advisors inspect building systems and monitor or confirm the landlord's maintenance program.

23.3 Standard for Maintenance. The landlord should maintain the building and common areas in an attractive and first-class manner, which the tenant may want to define in a specific way. That obligation should extend to any empty shop spaces, and all common areas on any multitenant floor, whether or not fully occupied. "Maintenance" should include the provision of security. Require the landlord to repaint, recarpet, and repave periodically.

23.4 Cleaning Standards. Specify standards for the landlord's cleaning services, both within the premises and in common areas. Limit the scope of possible "extras." Try to define the pricing of "extras. " Cleaning standards are an economic issue and potentially a huge profit center for a landlord. Review and negotiate them accordingly. If the cleaning standards say the landlord does not need to clean any "computer areas," how much space will this exclude for a modern office? If the landlord wants to disclaim any responsibility for cleaning of certain areas (food preparation, etc.), obtain a credit for the value per square foot of the "building standard" cleaning not provided. As an alternative, ask the landlord to give the tenant an allowance. Then the tenant should only be responsible to pay for any cleaning in the space that is above standard.

23.5 Cleaning Hours. Specify the earliest time at which cleaning may commence, and the time by which it must finish.

23.6 Cleaning Personnel. The tenant may want the right to approve individuals or cleaning crews that provide cleaning services to the space. The tenant may also want to request background checks for these individuals. If the staffing changes, the tenant may want the same rights for any replacement cleaning staff members. The tenant may also want to require bonding of the cleaning staff.

23.7 Right to Terminate. The tenant may want to be able to terminate the landlord's cleaning services and take over cleaning of all common areas or just the premises, with a rent credit. If the landlord maintains storage and locker areas specific to the premises, for the landlord's cleaning staff, then if the tenant takes over cleaning, the tenant will want the right to use those storage and locker areas.

23.8 Garbage Removal. Define the location, access, timing, and other arrangements for garbage removal. The landlord should provide separate recycling containers or areas.

23.9 Repairs Covered by Insurance. Require the landlord to make repairs—even if otherwise the tenant's obligation—where the need arises from an event covered by insurance that the landlord carried or should have carried.

24. Operating Expenses—Calculation and Auditing

24.1 Statement by Professional. An independent managing agent or (better) a certified public accountant should prepare the landlord's statement of operating expenses. Attach as a lease exhibit the landlord's operating expense statements for the preceding few years. Ask the landlord to confirm that: (1) these were the statements actually used for pass-throughs to existing tenants; and (2) the landlord will calculate future operating expenses the same way.

24.2 Time for Revision. Set a time limit for the landlord's revisions to operating expense statements—and make that limit subject to a "time of the essence" qualifier. The tenant may want to require the landlord to issue an audit confirmation letter waiving any unbilled charges beyond a certain point from when the operating expense statement is prepared.

24.3 Gross-Up. In any year the building is not fully occupied, operating expenses are often "grossed up" as if the building had been fully or nearly fully occupied during the entire year. Confirm that the base year and adjustment year are treated consistently and that the "gross-up" calculations make sense.

24.4 Timing of Operating Expense Statement. The landlord should provide the annual operating expense statement within a reasonable time (90 to 180 days) after fiscal year-end. To give the landlord an incentive for promptness, the tenant might insist that monthly estimated operating expenses payments must stay the same (for the next year) until the landlord has completed its operating expense statement justifying an increase. And if the statement shows a decrease, then the tenant should immediately obtain the benefit of that decrease (with interest?) and a suitable rent credit.

24.5 New Expense Items. Building management standards sometimes change over time, usually upwards (e.g., higher security standards or new types of insurance or new regulatory compliance costs). When that happens, the landlord may incur new categories of expense that the landlord did not incur during the base year, which would require the tenant to bear the entire cost of that new expense, not just increases above the base year. Therefore, if the landlord later incurs new categories or items of expense that were not being incurred when the lease was signed, the tenant may want to require the landlord to "gross up" the base year to reflect what this expense would have been if the landlord had already been incurring it the day the lease was signed.

24.6 Right to Review and Challenge. The tenant should have the right to examine and question the landlord's operating expense calculations. Require that any expense the landlord incurs be reasonable, ordinary and customary, not just actual. Allow the tenant to challenge any expense as unreasonable. Those rights should survive any lease termination. The lease should give the tenant reasonable time to: (1) notify the landlord that it wants to audit expenses; (2) conduct and complete the audit; and (3) specify if, and how, it contests the landlord's calculations. Avoid any schedule that requires the tenant to provide more detail than is reasonable at any particular stage of the process. If the tenant discovers egregious errors, let the tenant reopen operating expenses from earlier years, even if the time to do so has otherwise expired.

24.7 Books and Records. Require the landlord to keep books and records for a specified number of years in a single place under a unified system. In the likely event this information is stored electronically, give tenant the ability to access it in useful electronic form (e.g., spreadsheets rather than PDF files). Allow the tenant to copy those books and records for any audit of operating expenses.

24.8 Base Year. The tenant's right to audit should also cover the base year, expiring no earlier than the expiration date for the right to audit the first operating year. The tenant may wish to audit the base year at the same time that it audits the first operating year.

24.9 Landlord's Responsibility for Audit Cost. The landlord should pay the cost of audit (credit it against the next month's rent) if the audit discloses an overcharge of more than some stated low percentage. Beware of language that refers not to an overcharge but to an overstatement of operating expenses; that's a harder threshold to meet.

24.10 Most Favored Nation; Landlord's Discovery of Error. If some other tenant's audit discloses a discrepancy, the landlord should automatically give this tenant the benefit of any resulting adjustment to operating expenses, even if this tenant does not ask for it. If, on a particular issue, the landlord makes a better deal with any other tenant, this tenant should get the benefit. If the landlord fails to timely disclose any benefits of the types contemplated in this paragraph, then the

landlord should pay interest at a high rate, and perhaps also an administrative fee. Don't call it a penalty, though.

24.11 Choice of Auditing Firm. The lease should not limit the tenant's right to engage a firm of its own choosing, such as a contingent fee lease auditor, to examine the landlord's books and records.

24.12 Parking Lots. Treat the cost of filling potholes and restriping as an operating expense, but resurfacing as a capital expense to be borne by the landlord without reimbursement. Require resurfacing at least once every ___ years. Exclude any parking lot maintenance costs for at least ___ years after the commencement date.

24.13 Cost of Capital Improvements. If the estimated cost of any capital improvement or replacement for which the tenant is responsible exceeds a specified amount, perhaps varying based on the remaining term of the lease, then allow the tenant to terminate the lease or require the landlord to contribute to the cost. Base that contribution on the expected useful life of the improvement or replacement as compared against the remaining lease term. Beware of unrealistic limits on the amortization period for any capital or quasi-capital outlays by the landlord.

24.14 Tenant-Specific Exemptions. Look for justifications to support exemption from particular expenses (e.g., elevator expenses for a ground floor tenant).

24.15 Confidentiality. If the landlord requires the tenant to sign a confidentiality agreement for any future lease audit, insist that the form of agreement be attached to the lease, or that the agreement be built into the lease. (Why do we need a separate agreement?) Either approach avoids the risk of extended delays in trying to negotiate a confidentiality agreement when the need arises.

24.16 Credit. Try to get credit for any income the landlord derives from common areas (e.g., signage).

24.17 New Buildings. Part of the business negotiation of a lease in a new building will relate to the negotiation of the base year for any escalations. The parties are both at greater risk here, because the building has no operating history. Initially, the base year should reflect regular base operating costs and should not include savings that result from new construction (for example, lack of maintenance costs because a contractor's warranty covers all problems). The tenant may want to adjust the base year to a year (or average of several years) in which the landlord has achieved a certain occupancy level (e.g., 100 percent).

25. Operating Expenses—Exclusions

The tenant may desire to exclude at least these items from operating expenses:

25.1 Above-Standard Cleaning. Costs of cleaning portions of the building that have cleaning requirements higher than the tenant's (e.g., cleaning some other tenant's employee cafeteria or special mahogany conference rooms).

25.2 Americans with Disabilities Act. Americans with Disabilities Act of 1990 ("ADA") compliance costs, particularly when triggered by operations of other tenants.

25.3 Advertising. Advertising expenses, including the cost of maintaining any website.

25.4 Art. The purchase, maintenance, or insurance of any artwork or sculpture.

25.5 Bad Acts. Costs incurred as a result of the landlord's negligence or intentionally wrongful acts (good luck finding and proving either of those).

25.6 Breach of Lease. Costs incurred because any party breaches any lease.

25.7 Capital. Costs that under generally accepted accounting principles consistently applied would be considered capital outlays or are otherwise outside normal costs and expenses for operation, cleaning, management, security, maintenance and repair of similar buildings. As an alternative, perhaps allow capital expenditures if: (1) the tenant approves any expenditure above a certain level or (2) an expenditure is justified by the cost of repairs or undertaken to reduce operating expenses, and then only to the extent that the landlord demonstrates actual cost reduction.

25.8 Collateral Source. Any cost reimbursed by insurance proceeds (or that would have been reimbursed if the landlord had carried customary insurance), any condemnation award, or any indemnification from any third party.

25.9 Construction. The cost to perform initial construction and to correct initial construction defects, as well as such costs for any future alterations or additions.

25.10 Contributions. Any charitable or political contributions the landlord might decide to make.

25.11 Development-Related Payments. Exactions paid to any governmental body or community organization, including those for infrastructure, traffic improvements, curb cuts,

roadway improvements, transit costs, "impact fees," statues of government officials, and so on.

25.12 Environmental. Costs of testing for, handling, remediating, or abating asbestos and other hazardous materials or electromagnetic fields; the cost to remove chlorofluorocarbons or accomplish other future retrofitting driven by future environmental concerns not yet imagined; or the cost to purchase environmental insurance. If the landlord decides to make changes to achieve some level of LEED compliance, make that the landlord's cost, not the tenant's.

25.13 Excessive Management Fees. Management fees beyond those charged in comparable buildings, particularly where the property manager is an affiliate of the landlord.

25.14 Executive Salaries. Salaries for officers above the level of building manager.

25.15 Fines. Fines and penalties the landlord must pay as a result of failure to comply with law, code, etc.

25.16 Food Court. Costs related to food court tenants to the extent they exceed normal costs. As an alternative, allocate food seating area as tenant space (paid for by the food court tenants), perhaps with extra weighting because of the heavy cleaning requirements.

25.17 Holidays. Any holiday decorations or gifts. In the alternative, impose a reasonable limit on these costs.

25.18 Mall Advertising. Any mall advertising program, or, as an alternative, cap the amount of the tenant's contribution.

25.19 Other. Next year's newest area of legal concern (for inspiration, check the latest carve-outs from "nonrecourse" treatment in mortgage finance transactions).

25.20 Other Tenants. Any costs for a service not provided to this tenant and included in its rent (for example, the incremental cost of a higher level of service provided to office or retail tenants); costs reimbursed or reimbursable by specific tenants other than through pro rata rent escalations (e.g., fees for excessive use of utilities); or costs caused by the acts or omissions of particular other tenants.

25.21 Ownership-Related Costs. Ground rent; mortgage interest, principal and transaction costs; build-out of tenant space; clean-up of any landlord's construction projects; and general and administrative expenses (overhead).

25.22 Payments to Affiliates. Fees and expenses paid to the landlord's affiliates in excess of market rates. (But what's market and how do you know? The tenant may want preapproval rights.)

25.23 Professional Fees. Brokerage fees and commissions; legal fees and expenses to negotiate and enforce leases; and accounting fees.

25.24 Telecom Installation. Either exclude costs or offset them against the income the landlord receives.

26. Options

26.1 Additional Space. The tenant may want an option, right of first refusal or right of first offer for additional space.

26.2 Sublet Excess Space. As a fallback, negotiate a wide-open right to sublet excess space until needed.

26.3 First Refusal Mechanics. For a right of first refusal, seek a "second bite at the apple" if the landlord later decides to market the space in smaller pieces or on terms different from those originally contemplated. Also, scrutinize the conditions that trigger the right of first refusal. Landlords' form leases often let the tenant exercise a first refusal right only if the space has become "vacant and available." What does this mean? If the landlord negotiates a new lease for the space before an old lease expires, does that new lease mean the space is not "vacant and available"? The test should be whether an existing lease will (or has) expire(d) or terminate(d). The landlord should agree not to negotiate any extension or renewal that could impair the tenant's claims to the space. Try to attach an exhibit to the lease identifying exactly when the tenant's right of first refusal will arise, to the extent presently knowable.

26.4 Excess Space Notices. Whether or not the tenant has preemptive rights to extra space, the landlord should agree to advise the tenant regularly of any space that becomes available, giving as much notice as reasonably possible under the circumstances. As a practical matter, if the tenant wants the space, the parties may be able to negotiate something at that point.

26.5 Recapture from Other Tenants. If the landlord can exercise its right to recapture space from another tenant, the tenant may want the authority to require the landlord to exercise its recapture right for the tenant's benefit. The recaptured space would then become part of this tenant's premises.

26.6 Early Termination Options. The tenant may want early termination options, either complete or partial ("shed rights"). But what happens if the terminated space includes criti-

cal communications facilities serving the rest of the tenant's space? The tenant will want the right to leave those in place.

26.7 Renewal Option. Often tenants will seek a right to renew the lease term. In such cases, the tenant must scrutinize and confirm it can live with whatever conditions, requirements and procedures the landlord tries to attach to the renewal option. Landlords have been known to require that rent can never go down during the renewal term and the renewal right can be exercised only by the initial tenant. Try to time the process to give the tenant time to move if the rent, as finally determined, is unacceptable. Also, allow the tenant to assign any renewal options as part of a lease assignment.

26.8 Appraisal. If rent during the option term depends on an appraisal, allow the tenant to withdraw its option exercise if the tenant disapproves of the new rent as finally determined. In practice, this may give the tenant some reasonable ability to re-negotiate the rent (a one-way downward negotiation opportunity), regardless of what the appraisal says. Set objective appraisal criteria. Does the definition of "fair market rental value" make sense? Does it give the landlord "credit" for value-enhancing measures (e.g., a tenant improvement allowance) that the landlord will not in fact deliver to the tenant? If the tenant won't receive such an allowance upon renewal, the definition of "fair market rental value" should not pretend otherwise. And if the tenant paid for above-standard interior work, then "fair market rental value" should not reflect the value of that work. "Fair market value" should instead assume that the landlord delivered the space in the same condition as on the starting date.

26.9 Purchase Option. The tenant may want the right to purchase the building if the landlord intends to sell it or if the equity owners of the landlord intend to sell a substantial portion of their equity. If the landlord converts the building into a condominium, the tenant may want a preferred right to purchase one or more units.

26.10 Reminder Notices. Require the landlord to send reminder notices of any upcoming option exercise deadline, but not more than ____ days, or less than ____ days, before the deadline. Extend the deadline and the lease expiration date if the landlord delays sending notice.

26.11 Short-Term Extension. Try to negotiate the right to a short-term lease extension, at the tenant's option, to avoid holdover problems if the tenant suffers delays in moving. The landlord will probably want some significant prior notice before the tenant exercises any such short-term extension right, but if the tenant agrees to too much time, then the short-term extension right becomes worthless, as it cannot deliver the flexibility that the tenant needs.

26.12 Base Years. For any lease renewal, reset the base years for escalations, or make sure the rent revaluation process assumes continuation of the old base years (nonstandard but theoretically a slight bit better for the tenant).

26.13 Rule Against Perpetuities. Think about the possible impact of the rule against perpetuities on any option rights in the lease or ancillary to the lease.

26.14 Option Timing. Scrutinize and work through all the time periods for any option, and confirm that the tenant will be able to take the actions required within each time period. Do all the time periods work together? Do they give the tenant enough time for its internal review and approval processes in deciding whether to exercise a renewal option? If the tenant exercises an option defectively, require the landlord to notify the tenant promptly and allow some additional time to exercise the option correctly.

27. Parking

27.1 Specific Requirements. Define the location, number, and pricing (or assurance of no fee) for parking spaces, reserved and unreserved. If any other tenant has the right to reserved parking, then this tenant should also have reserved parking equivalent in amount, proximity, type (covered, uncovered), and signage, adjusted for relative occupancy. Attach a parking diagram as an exhibit. Prohibit the landlord from changing the parking arrangements without the tenant's consent. In any case, the tenant may want to seek some number of reserved, covered, indoor, or otherwise "premium" parking spaces.

27.2 Bicycles and Motorcycles. The landlord should provide parking for bicycles, mopeds and motorcycles in a convenient location. If the tenant wants to allow bicycles, skateboards, and the like into the tenant's space, make sure the lease allows it, without making special arrangements such as use of the freight elevator or giving advance notice.

27.3 Building Expansion. If the landlord expands the building, the overall parking ratio shouldn't worsen.

27.4 High Parking Uses. The tenant may wish to prohibit nearby high parking uses (e.g., movie theater, trade school, restaurant). Some of these uses are, however, regarded as being less objectionable than they once were.

27.5 Location/Amount of Employee Parking. Insist that the landlord enforce employee parking restrictions against other tenants.

27.6 Snow/Maintenance. Require the landlord to clear snow promptly from, and otherwise maintain, the parking area.

27.7 Lighting. Set standards for lighting of common areas and parking decks—especially important to a 24-hour operation.

27.8 Patterns. Prohibit the landlord from interfering with or changing traffic patterns in the parking lot areas.

27.9 Fences. The tenant may want the right to require the landlord to install a fence to segregate parking areas from adjacent heavy-usage facilities.

28. Percentage Rent

28.1 Rent Abatements. Rent abatements or other rent reductions should not reduce percentage rent breakpoints (to avoid an anomaly where the breakpoint drops because of negotiated rent abatements, resulting in percentage rent payments increasing by a like amount).

28.2 Partial Year Gross Sales. Annualize first year and last year gross sales, with a seasonal adjustment, to prevent excessive percentage rent if the tenant opens or closes in its peak season.

28.3 No Partnership. State that the parties do not intend to establish a partnership or joint venture.

28.4 Exclusions from "Gross Sales." Depending on the type of business, the lease should exclude or subtract certain items from "gross sales," such as: sales made by concessionaires, sales not in the ordinary course of business, sales to employees up to a certain percentage or only if at a discount, sales taxes, refunds, returns, credit card fees, custom tailoring, and monogramming. The tenant will want to avoid any suggestion that the landlord can collect percentage rent on the tenant's catalog or Internet sales.

28.5 Time Limits. Impose time limits on the landlord's right to audit. Prohibit use of contingent fee auditors. If the landlord performs an audit, then the landlord should give the tenant a copy of the audit report even if it produces no adjustments.

28.6 Termination Right. The tenant may want to request the right to terminate the lease if its sales fall below some specified threshold. If either party terminates because of a termination right like this, then the tenant may want the landlord to reimburse the tenant's unamortized leasing and improvement costs, perhaps up to a cap.

28.7 Revenue Maximization. The tenant should avoid any obligation to operate or to "maximize" revenues. The tenant should not make any representations on the volume of its business. Expressly negate any "implied" obligations along these lines.

28.8 Special Categories. The tenant may wish to negotiate a lower percentage rate for particular low-margin activities or categories of sales.

28.9 Free Rent. Any free rent period should abate percentage rent too.

28.10 Use. Tie percentage rent to the tenant's use of the premises. What happens if the tenant assigns to another operator with a different use? Request that the lease allow assignment even if this changes the amount of percentage rent, provided the assignee agrees to pay at least the same total rent as the assignor did in its last year of operation.

29. Quiet Enjoyment

29.1 No Default. Beware of "quiet enjoyment" conditioned on no default. Condition quiet enjoyment instead only on the landlord's not having terminated the lease.

29.2 Sidewalk Sheds and Scaffolding. The tenant may want the right to reduce the rent if a sidewalk shed, fence, or scaffolding for any construction project in the building impairs access or visibility. For any such installation: (1) try to set limits (duration; minimum clearance; cannot block windows; just posts for 30' up, then roof above posts; frequency; and purpose); (2) seek the right to install advertising signs at the landlord's expense and at no charge to the tenant; (3) prohibit any other advertising signs, particularly for competing businesses; and (4) require the landlord to remove promptly all unauthorized postings or graffiti on any sidewalk shed or similar temporary fence, and to light the underside of any installation described in this paragraph. For retail tenants, try to prohibit such structures during peak sales seasons. A significant daily no-fault fee for the landlord's maintenance of any of these structures might solve many problems.

29.3 Dumpsters, Staging Areas, Lay-Down Areas. Try to control where the landlord may install these items. Prohibit them in parking areas.

29.4 Remedies. If the landlord breaches the covenant of quiet enjoyment, the tenant cannot easily prove the amount of the injury or damages. Provide for liquidated damages or some other mechanism to quantify

damages, ideally measured on a daily basis. Include the necessary recitations to validate any liquidated damages formula.

30. Radius Clauses

30.1 Physical Scope. Try to limit the physical scope of any radius clause, i.e., a clause that prohibits a retail tenant from competing within a certain distance of the premises. Ideally, limit the radius to only a mile or two, depending on the site and the tenant's plans.

30.2 Exclusions. If the tenant must agree to a radius clause, carve out: (1) existing stores; (2) any new stores purchased in a future corporate transaction; (3) relocation of existing stores within any retail property where the tenant is already doing business; (4) any stores operated by any possible future acquiror of the tenant's business; and (5) any other brand names that the tenant operates.

30.3 Termination. Try to terminate the radius clause at a certain date; if the tenant has achieved a certain level of percentage rent; or if the landlord has achieved a certain occupancy level.

30.4 Near End of Term. In the last few years of the lease term, the radius clause should terminate, to facilitate a graceful shift to a new location. In the alternative, allow the tenant to open a new store nearby provided that the tenant protects (or partly protects) the landlord from any decrease in percentage rent during the remaining lease term.

31. Real Estate Tax Escalations

31.1 Definition of Property. Confirm that the property to which the real estate tax escalation applies does not include other parcels or improvements; or, if it does, understand the likely future real estate taxes on those parcels or improvements.

31.2 Substitute or Additional Taxes. Devote close attention to how "substitute or additional taxes" are defined. Confirm that they are truly appropriate for pass-through to the tenant. One might more appropriately treat them as equivalent to income taxes.

31.3 Landlord's Tax Protest. For the base year, review any landlord tax protest filing to understand the landlord's theories for low value. Will those theories inevitably vanish next year, producing built-in increases? In the lease, express the base-year real estate taxes as a specified number of dollars per square foot. Avoid referring to the taxes payable in a particular tax year, because such a reference could increase escalations if the landlord successfully protests base-year taxes. Base-year taxes never go up; they just go down if the landlord gets lucky.

31.4 Installment Payments. Require the landlord to pay real estate taxes in installments, as taxes are due. In any event, calculate tax pass-throughs as if the landlord were paying in installments over the longest period allowed.

31.5 Special Assessments. The landlord should pay special assessments in installments and treat them as taxes only to the extent they fall within the lease term.

31.6 Right to Contest. Require the landlord to contest taxes or, if the landlord does not, give the tenant the right to do so in the landlord's name or in the tenant's own name, as necessary. Check statutory and case law requirements as to who may contest taxes. For example, in New York a tenant that leases only part of a building lacks standing to contest taxes. The parties may need to make other arrangements, and the lease should provide for those. Whether the tenant leases all or only part of the building, any tax contest will still require cooperation and delivery of necessary information and signatures by the landlord. Require the landlord to contest taxes if a certain proportion of tenants so request. Require the landlord to warn the tenant of any tax contest deadline to give the tenant enough time to contest if the landlord does not wish to do so.

31.7 Tax Refunds. Require the landlord to pay the tenant its share of tax refunds promptly, even if the lease has expired. The landlord should also notify the tenant of any such refunds promptly when received. If the landlord fails to do so, or the tenant needs to remind the landlord, then the landlord should pay a default interest rate or some multiple of the amount due to the tenant. Landlords have been known to forget to give former tenants their share of any subsequent refunds of real estate taxes they paid. This can produce a nontrivial profit center for the landlord, and a significant issue in negotiating a later purchase and sale of the building.

31.8 Tax Protest Costs. Any contingent fees paid to real estate tax counsel should be arm's length and commercially reasonable. What's "commercially reasonable"? The landlord should not collect a separate "management fee" for its services in contesting real estate taxes. That's a burden of ownership.

31.9 Base-Year Reassessment. If the reassessment for the base year goes down, try to reduce base rent by the amount of the tax savings, to make up for the

resulting increase in real estate tax escalations.

31.10 Abatement or Deferral Program. The landlord should agree to apply for any available tax abatement or deferral program. The risk of loss of tax abatements already granted (e.g., for failure to comply with governmental procedures) should belong to the landlord, not the tenant. For any future abatement or deferral programs, negotiate whether the benefits belong to the landlord or the tenant and, if the latter, identify exactly what cooperation the landlord must provide and when. How exactly does the application process work? Beware of repricing the base rent in a way that indirectly returns to the landlord any tax abatement/deferral benefits that the tenant expected to obtain. Some argue that the value of every geographically targeted tax abatement or deferral program will simply be negotiated into rents and hence land values within the targeted area, and therefore have no effect except to increase local land values at the expense of the local taxing authority.

31.11 Artificially Low Assessments. If, under local assessment rules, the first year's free rent produces an artificially low tax assessment that year, then the assessment may automatically rise by the same amount in future years. The tenant may then, over the years, pay extra tax escalation payments far beyond the value of the free rent. This depends very much on local tax assessment procedures, but the tenant must understand them.

31.12 Exclusions. Real estate tax escalations should exclude: penalties and/or interest; excise taxes on the landlord's gross or net rentals or other income; income, franchise, transfer, gift, estate, succession, inheritance, and capital stock taxes; taxes on land held for future development ("outparcels"); increases in real estate taxes resulting from construction during the lease term if not done for the benefit of tenants generally, or if it does not create additional proportionate rentable area; termination of interim assessment; loss or phase-out (whether or not scheduled) of abatement or exemption; corrections of underpayments in previous periods; acquisition of development rights from other property; increases resulting from the landlord's failure to deliver required information to the taxing authority or other failure to comply with the taxing authority's requirements; and, if possible, sale of the property. If the landlord transfers unused development rights in a way that reduces the landlord's net real estate tax expense, confirm that the tenant will participate in any savings that result.

31.13 New Buildings. Depending on when in the progress of the building project the lease is being negotiated, the tenant should confirm that the base year will reflect complete construction and full assessment of the building. This may require a retroactive adjustment of base taxes, depending on how the particular jurisdiction handles new construction.

32. Representations and Warranties

The tenant may wish to ask the landlord to provide representations and warranties, including these:

32.1 Asbestos and Hazardous Materials. The premises are free of mold, asbestos and other hazardous materials. The landlord should provide any document required to confirm that status for purposes of building permit applications, such as a New York City ACP-5 form, showing that the tenant's work will be a non-asbestos job. The landlord should indemnify the tenant against liability (and delay-based losses) arising out of any environmental conditions that existed before the tenant took possession, whether or not the landlord caused them. And the landlord should agree to clean up those conditions.

32.2 Certificate of Occupancy. Attach a true, correct, and complete copy of the certificate of occupancy as an exhibit. The landlord should represent that the tenant's use as permitted under the lease won't violate the certificate of occupancy or the landlord's other leases or agreements.

32.3 Commissions and Brokerage Fees. The landlord has paid or will pay all brokerage fees and commissions for the lease. If the tenant cares about its relationship with the broker, the tenant may want the right to offset rent and pay the broker (particularly for any commissions due on future renewals or expansions) if the landlord does not.

32.4 Impact and Hookup Fees. The landlord has paid or will pay all impact fees, hookup charges, and other governmental exactions imposed on the project, and will not recapture them through any escalation.

32.5 Rights of Third Parties. The landlord's entry into the lease does not violate any rights of third parties, such as the prior tenant that was evicted from the space or other tenants in the building.

32.6 Submetering. All equipment is in place and in good working order for any submetering of utilities the lease contemplates.

32.7 Utilities. Adequate utility locations and capacity are available both within the building and at the premises.

32.8 Violations. The premises are subject to no outstanding violation of any code, regulation, ordinance, or law, and the landlord agrees to cure existing violations at the landlord's expense, not recaptured through any escalation.

32.9 Validity of Lease. Each party represents and warrants to the other that the lease has been duly authorized, executed and delivered, and is valid and binding.

32.10 Zoning. The property is properly zoned and the tenant's permitted use under the lease is legal.

32.11 Construction Plans. Landlord plans no construction at the property, except ordinary tenant improvements.

32.12 Notices; Plans. The landlord has received no notice of any condemnation, including any grade change of any street or any partial condemnation. The landlord plans no changes in parking or circulation. The landlord has no present plans to do anything that would require the tenant's approval or require entry into the tenant's premises.

33. Requirements of Law

33.1 Responsibility for Compliance. The landlord should be responsible for compliance with existing and new laws (including ADA) if the compliance applies generically to the property (e.g., "mere office use") or any noncompliance already existed before the lease was executed.

33.2 Regulatory Flexibility for Tenant. Allow the tenant to sell or assign the lease (or go dark) if required by law or through a settlement with any government agency.

33.3 Americans with Disabilities Act of 1990. The tenant should have no duty to bring any elements of the existing building into ADA compliance (e.g., elevator buttons), unless (perhaps) the tenant actually alters that particular element of the building. Make the landlord responsible for ADA and all other baseline legal compliance.

33.4 New Requirements. The landlord should comply with any new legal requirement if the potential noncompliance did not result from the tenant's actions, and failure to comply may impair the tenant's alterations or use as the lease contemplates, or could otherwise adversely affect the tenant.

33.5 Permits. The landlord should agree to cooperate with the tenant in obtaining permits, and other governmental approvals that tenant may need, such as by signing permit applications (even before approving the tenant's work) and providing necessary existing information. Establish a tight turnaround time for any necessary landlord signatures. Don't allow the landlord to use the permit signing process as a back door technique to disapprove work that the lease otherwise obligates the landlord to allow.

33.6 Change in Zoning. The landlord should allow the tenant to terminate if a change in zoning or other law (or inability to obtain or maintain necessary permits or adequate parking) prevents or impairs the tenant's operation of its business, in whole or in part.

34. Restrictions Affecting Other Premises

34.1 Competing Stores. Prohibit the landlord and its affiliates from renting to competing tenants within a certain area, particularly where the landlord operates its properties under an identifiable brand name. For a major tenant, prohibitions of this type may raise antitrust issues, which are beyond the scope of this checklist. New York law invalidates this type of prohibition in bank leases, allowing anyone damaged by such a prohibition to recover treble damages. New York Banking Law Section 674-a.

34.2 Use of Building. Prohibit the landlord from changing the use of the overall building or any part of it—such as turning the older and less rentable half of a regional mall into a call center or community college. Restrict the type of retail tenancies or other uses in the building (e.g., no fast food). Consider issues of density, traffic, parking, demographics, compatibility, likelihood of picketing or controversy, security concerns, and other potential problems affecting building use and other tenants.

34.3 Prohibited Uses. For retail properties, prohibit flea markets, carnivals, petting zoos, clothing drop-off boxes, kiosks (especially if competitive or within a certain distance of the entrance or windows of the premises), drive-up booths, and the like, elsewhere on the landlord's property, including common areas. For office buildings, prohibit uses that attract large volumes of people, particularly if incompatible with first-class business offices (e.g., poverty benefit or advocacy offices, drug rehabilitation clinics, welfare offices, certain types of auction houses).

34.4 Additional Construction. Limit the location and type of any additional construction the landlord can perform (e.g., on "outparcels").

34.5 Minimum Operating Hours. Establish minimum operating hours for the property as a whole or for specific other tenants.

34.6 Landlord's Activities and Kiosks. Limit the landlord's activities and installations on the sidewalk (or common area of a mall) within a specified area near the premises.

34.7 Scope of Restrictions. To the extent that the lease restricts the landlord's activities, consider how broadly those restrictions should apply. Ideally, they should affect both the existing structure and any future expansion in which the landlord has any interest, or for which the landlord or an affiliate presently controls the site. Try to have the landlord agree not to enter into a reciprocal easement agreement or otherwise facilitate any nearby construction by others unless the counterparty agrees to honor the same restrictions. The tenant may even want the right to approve any future reciprocal easement agreement or amendments to the existing agreement.

34.8 Public Areas. The tenant should control (or have the right to require, within reason) future changes to public areas, lobbies, elevators, parking lots and other common areas. Require the landlord to renovate and update these areas periodically to keep them consistent with first-class standards as they change from time to time. Require the tenant's approval for the plans for all such work, or at least the visible part (e.g., finishes) of the landlord's work. The tenant may want the right to require the landlord to prohibit smoking in public areas even if governing law does not.

34.9 Exclusive Uses. The tenant may want exclusive rights for certain uses. As a fairly ordinary example, a coffee store may want the exclusive right to sell coffee within the landlord's shopping center. A careful landlord will push back and try to fine-tune any exclusives to assure they don't impair the landlord's overall leasing program. Every time the landlord chips away at the exclusive, this may make it less useful and valuable for the tenant. The tenant will want to make sure that any exclusive still serves its intended purpose and protects the tenant's investment.

34.10 Adjacent Work. If a third party will pay compensation for inconvenience caused by work on an adjacent or nearby site, should the landlord or the tenant receive it?

34.11 Beware of Ownership Variations. To the extent the landlord agrees to any provisions suggested above, beware of limiting those provisions to any property "owned by the landlord and its affiliates." Third parties, often not even affiliates of the landlord, may own parts of what appears to be a single integrated building. In these cases, the tenant will need to focus on the governing easements and declaration documents for the building as a whole, triggering a level of investigation often reserved only for major tenants.

35. Rules and Regulations

35.1 Nondiscriminatory Enforcement. Require the landlord to impose and enforce its rules and regulations in a nondiscriminatory way. If the tenant so requests, the landlord should impose and enforce those rules and regulations against other tenants.

35.2 New Rules. New rules should be reasonable and of the type customarily imposed for similar buildings. New rules should require the tenant's approval. If the landlord wants to give the tenant a short period to object to any new rules, insist that the landlord give the tenant formal notice of any new rule, along with a reminder of the short period in which the tenant may object.

35.3 Interference With Permitted Use. The tenant should have no obligation to comply with any rule or regulation if such compliance would interfere with tenant's use permitted under the lease, or otherwise does not conform to the tenant's rights under the lease.

35.4 Third Party Enforcement. The lease should prohibit any other tenant from enforcing the lease against the tenant. Expressly negate any third-party beneficiaries of the lease, or anything in it.

36. Sale of Property

36.1 Assumption of Obligations. Upon any sale of the landlord's property, the purchaser should assume all obligations—including all existing undischarged obligations—of the landlord, including the obligation to return the tenant's security deposit; refund any previous rent overcharges; and allow the tenant to conduct any permitted audits. The purchaser should also assume the landlord's insurance requirements and any net worth restrictions. Some landlord's lease forms say that the old landlord is not responsible, but neither is the new one. The tenant theoretically ends up with claims against no one.

36.2 Transfer of Security Deposit. Require the landlord to trans-

fer the security deposit to any purchaser of the property and assure that the purchaser gives the tenant a written confirmation of receipt. Insist that the tenant have the right to offset rent if the landlord does not comply with these requirements.

36.3 Rental Payments to Purchaser. The tenant should not be required to pay rent to a purchaser until the tenant has received notice of the sale and purchase and directions on where and how to pay.

36.4 Only One Landlord. If the landlord transfers its interest in the building, the tenant should never have two landlords—even if they speak with one voice.

37. Security Deposit

37.1 Interest. Require the landlord to hold the security deposit in an interest-bearing account with all interest to be paid to the tenant. Many landlords require an administrative fee, like that contemplated by statute in New York (N.Y. GEN. OBLIG. LAW § 7-103(2) (McKinney 1963)). Although a landlord's form may not quantify such a fee, the tenant should insist on doing so, or eliminate the fee.

37.2 Letter of Credit. The tenant should be entitled, at any time, to substitute a letter of credit or other alternative form of security. If the tenant thereafter fails to maintain the letter of credit, the landlord should be free to draw upon it, but such failure should not constitute a lease default and the tenant should continue to have the right to deliver a letter of credit. If the tenant delivers a letter of credit backed by a reimbursement agreement signed by a third party (e.g., the tenant's venture capitalist), then the landlord should also agree to give that third party a copy of any notice from the landlord, or at least any notice of default or other notice that could result in a letter of credit draw. If the lease no longer requires a letter of credit at some point, require the landlord to sign whatever cancellation documents the letter of credit issuer requires.

37.3 Return. The landlord should promptly return the security deposit after the lease expires. But what happens if landlord doesn't?

37.4 Reduction. Let the tenant reduce the security deposit over time, at least if the tenant is not in default. If the tenant has any concern about the landlord's creditworthiness, such reductions make particular sense in the last year or two of the lease term.

38. Services by Landlord

38.1 Existing Systems. Let the tenant use existing cabling and other systems. The landlord should agree not to damage or remove such systems. These rights should extend to the tenant's use of wiring pathways located on the underside of the tenant's floors. For the tenant to gain access to those pathways, the landlord may need to exercise access rights under the leases of the "downstairs" tenants. The landlord should agree to do so for this tenant's benefit.

38.2 Performance Standards. Set performance standards or criteria for any landlord services (e.g., comparable to those provided in a "basket" of other buildings). Provide that if the building experiences an unreasonable number of false alarms or life safety system breakdowns or problems, the tenant can perform an audit, perhaps at the landlord's expense, and require changes. The landlord should be responsible for any failure to supply services to the tenant unless (perhaps) that failure is due to causes beyond the landlord's control. The landlord should, though, perhaps have some obligation to control those circumstances, or at least establish measures so that services can continue even if predictable surprises occur, such as power outages.

38.3 Service Shutdowns. Limit the landlord's ability to shut down building services, particularly for essential tenant functions (e.g., HVAC or electricity for data center). Require ample prior notice, and let the tenant reschedule the shutdown.

38.4 Engineering Issues. Counsel should work with the tenant's engineers and other consultants to identify needs, standards, and specifications for all building services, particularly heating, ventilation, and air conditioning, and the landlord's alterations.

38.5 Strike. If a strike occurs, the landlord should agree to establish a separate gate for the striking union in order to minimize any interference with the tenant. If the landlord or any other tenant uses a labor force that causes disharmony with the tenant's labor force, require the landlord to remove the former labor force from the building. Most leases express only the converse proposition. Delegate to the tenant the landlord's legal authority to exercise the landlord's right to remove trespassers, protesters, etc.

38.6 Management Company Replacement. The tenant may want a right to require the landlord to replace the management company or the leasing broker if specified standards are not being met.

38.7 Windows. Allow the tenant to abate rent if windows are bricked up or covered over for any reason. The landlord should install (and repair/replace) sunscreen or other film on windows if needed, or at least give the tenant the right to do so.

38.8 Promotional Fund. Should the landlord agree to operate—or not to operate—any promotional association, fund, or other similar activities? Should the lease require that all other tenants participate?

38.9 Nonoccupancy Credits. If the tenant is not in occupancy, the landlord should give the tenant credit for any variable costs that the landlord avoids, such as cleaning. Such a provision appears in some government leases, but rarely, if ever, in commercial leases.

38.10 Receipt of Deliveries. Specify the location, arrangements, timing, and fees (none) for the tenant's receipt of deliveries. Try to allow deliveries at any time of day or night. Coordinate with the security program as necessary.

38.11 Contact Person. Require the landlord to designate a single exclusive (or at least "primary" or "backup") contact person for all questions, problems, and issues about the premises, with a 24-hour emergency telephone number to call if problems arise outside business hours.

38.12 Overtime Services. The cost of any overtime services should be shared with any other tenants using such services at the same time. The tenant should receive a "most favored nation" rate.

38.13 Lobby or Parking Lot Renovations. If the landlord undertakes lobby or parking lot renovations, the landlord must complete them quickly and give the tenant access to the premises equivalent to that which existed before work began. The landlord should shield from view any unsightly construction areas. Prohibit any (nonemergency?) construction work during the tenant's peak months of business. The tenant may want to have the right to give the landlord reasonable instructions regarding how the landlord performs any work that affects the premises or its access or visibility.

38.14 Work Outside Premises. What construction projects or alterations might the landlord undertake outside the leased premises that might cause the tenant concern or hurt the tenant's business? Try to identify them and negotiate appropriate restrictions or rent credits.

38.15 Continuation of Services. The landlord should continue to provide services to tenant even if the tenant is in default. The tenant should lose services only if the landlord has validly terminated the tenant's lease.

38.16 Other Tenancies. If a tenant cares about the existence and continuation of other nearby tenancies (e.g., a high-end retail store that wants to be part of a high-end retail environment), the lease will often impose cotenancy requirements. The tenant may have the right to terminate if the landlord doesn't line up or retain a certain level of neighboring leases. The tenant need not open unless a certain number of nearby high-end retail leases have opened or open simultaneously. And if major nearby spaces "go dark," the tenant may also have the right to terminate. As an alternative to terminating, the tenant may also have the right to switch to percentage rent without a floor, typically only for a certain period.

38.17 Confidentiality. If the lease requires the tenant to give the landlord any financial, sales-related, or other sensitive information about the tenant, the landlord should agree to keep it confidential. Generally, the tenant should insist that the landlord keep the lease, and all its terms, confidential. That would include, for example, a promise that neither the landlord nor the landlord's counsel will disclose (or use against the tenant in other negotiations) any concessions that the tenant made in negotiating this particular lease. If the tenant provided the lease form, then the tenant should insist that the landlord and its counsel will preserve the confidentiality of the lease form, and not re-use it for other transactions, whether with this tenant or anyone else.

39. Signage and Identification

39.1 Signage Requirements. The lease should describe the signage requirements (for lobby, floor lobbies, elevators, exterior entry areas, driveways, roadway pylons, rooftop, common areas, and other exterior locations) for the tenant and any subtenant(s). Allow the tenant to install temporary signage during construction and change its signage over time. If signage space is limited, the tenant should be given the right to use the next available signage space. Make the tenant's signage rights as transferable as any other rights under the lease. Also allow the tenant to use its logo or distinctive typeface or other graphic elements. If the tenant intends to illuminate its signage, the lease should allow that.

39.2 Other Parties' Signage. Establish requirements for, and otherwise set controls for, other tenants' signage and the landlord's overall signage program,

including future changes. The tenant may want to limit identifying signage for other tenants, particularly those competitive with the tenant.

39.3 **Signage Position**. Does the tenant want the top position on any pylon sign? Second from top? Largest position on any other sign(s)?

39.4 **Name of Building.** Prohibit the landlord from naming the building after the tenant, any other tenant, or any competitor of the tenant. Make it clear that the landlord has no right to use the tenant's name for anything. Does the tenant want affirmative naming rights? Prohibit the landlord from using the tenant's name in any landlord advertising.

39.5 **Directory Entries.** Require the landlord to provide building directory entries for the tenant and any subtenant or assignee. If the landlord tries to limit those entries, do those limitations make sense? Does the tenant contemplate needing directory entries for parties other than the tenant and its subtenants or assignees, such as joint ventures or other new entities? Prohibit any other tenant from being more visible or using its logo in the building directory unless this tenant has the same right. Don't limit the number of the tenant's directory listings at all if the landlord uses a computerized directory.

39.6 **Flagpoles.** The tenant may want the exclusive right to use any flagpoles at the property. As an alternative, the tenant may want to limit the flags that the landlord or any other tenant may fly on those flagpoles.

39.7 **Billboards.** Prohibit the landlord from installing billboards or other signs anywhere on the building or outside the windows of the building, even if such billboards or other signs are allegedly transparent from the interior of the building. Prohibit the landlord from blocking the tenant's signage.

40. Subordination and Landlord's Estate

40.1 **Proof of Fee Estate.** The landlord should represent that it owns the fee estate. Perhaps attach a copy of the landlord's deed or title policy as an exhibit.

40.2 **Nondisturbance Agreement from Mortgagees and Ground Lessors.** At the time of lease signing, the landlord should deliver a nondisturbance agreement from every mortgagee or ground lessor. Attach the form of nondisturbance agreement to the lease and require future mortgagees to sign it when they close their loans, and future ground lessees to sign it when they come into the picture. Beware of allowing the landlord to deliver such an agreement after the lease has been signed, with a right for the tenant to terminate if it is not timely delivered. In practice, such a right will rarely be exercised. That may, of course, say something about the practical importance of these agreements.

40.3 **Conditions for Subordination.** If the lease is "subordinate," condition that subordination on the landlord's having delivered specified nondisturbance protections from holders of senior estates, ideally in the form attached to the lease. Don't settle for "best efforts." The lease should not require the tenant to "subordinate" to any mortgage if that mortgage is subordinate to any mortgage or any other lien that has not given the tenant nondisturbance protections. Foreclosure on that other, more senior, mortgage could wipe out both the more junior mortgage and the tenant's leasehold estate.

40.4 **Debt Service Should Not Exceed Rent.** When the tenant leases all or most of the space or an entire building, the tenant may want the landlord to agree that the debt service payable under any fee mortgage will not exceed the rent under the lease.

40.5 **Negotiations of Nondisturbance Agreements.** Require the landlord to reimburse the tenant for the tenant's reasonable legal fees for any future nondisturbance agreement negotiations.

40.6 **Compliance With Mortgages.** Avoid any covenant by the tenant to be bound by, and do nothing to violate, any present or future mortgages. Such a provision may amount in part to an "end run" around negotiated nondisturbance rights and priorities as well as other lease provisions, starting with casualty, condemnation, restoration, and use restrictions.

40.7 **Rent Redirection Notice.** If the landlord's lender delivers a rent redirection notice to the tenant, state that the tenant may comply without liability even if the landlord disputes its lender's right to deliver the notice. The landlord should agree to reimburse the tenant's legal fees in reviewing, analyzing, and figuring out how to respond to any such notice from a lender.

40.8 **Landlord's Lender's Approval Rights.** Understand the approval rights of the landlord's lender under its loan documents (e.g., assignment, subletting, alterations, lease amendments, etc.) and try to trim back if excessive. Ask the lender to pre-approve as much as possible. Going forward, try

to eliminate lender approval requirements. Ask the landlord to agree never to enter into any loan arrangements (or amendments to existing loan documents) that would prevent the landlord from agreeing to subsequent minor or ministerial amendments of this lease, excluding any that could materially adversely affect the lender.

40.9 Definition of Landlord. Include successors and assigns in the definition of "Landlord."

40.10 "Replacement" Mortgages. If the tenant agrees to be "subordinate" to mortgages—without nondisturbance protection—in any way that might come back to haunt the tenant (for example, casualty and condemnation issues), limit the "subordination" to refer only to any mortgages that are currently in place, and not to any replacement or future mortgages.

41. Tenant's Remedies Against Landlord

41.1 Set-Off and Termination. The tenant may cure the landlord's defaults (after notice), set off the cost of cure (with interest at a high rate) against rent, and terminate the lease. The tenant can set off against rent for claims against the landlord or any judgment against the landlord that is returned unsatisfied (or, if the landlord is in bankruptcy, then based upon the mere filing of a claim in the bankruptcy). The tenant may want similar remedies if any representation or warranty by the landlord is inaccurate. Review the assumptions that support the tenant's decision to enter into the lease. For example, let the tenant terminate if the nearby courthouse, train station, army base, university, or other business-driving installation moves or closes. Let the tenant terminate if the municipality enacts a minimum wage law and it affects a substantial portion of the tenant's employees.

41.2 Abatement. The tenant may want the right to abate rent if essential building services (access, electricity, other utilities, elevators, air-conditioning, etc.) are disrupted, or if the landlord is in default for longer than a specified period (after notice?). Trigger rent abatement rights based upon ____ or more days of problems during any ____ day period, rather than requiring that any single problem must continue for ____ days before the tenant may abate. If any such rent abatement continues for more than a certain period, then let the tenant terminate.

41.3 Self-Help. The tenant may want emergency self-help rights (including the right to install temporary equipment or service arrangements) if a water leak, power failure, or communications failure imperils the tenant's computer systems, communications systems, or other mission-critical equipment or operations. Allow only a very short period before this self-help right accrues for any fundamentally important function of the tenant, such as the tenant's network control center or computer system. The landlord should reimburse the tenant's reasonable self-help expenses.

41.4 Payment Not a Waiver. The tenant's payment of rent with knowledge of a landlord default should not waive the default.

41.5 "Exculpation" Clause. When an "exculpation" clause limits the landlord's liability to the landlord's interest in the property, try to include the following within the definition of the landlord's interest in the property: rental income, insurance proceeds, escrow funds, condemnation awards, the landlord's interest in security deposits, and sales and refinancing proceeds. For certain major landlord obligations—e.g., completion of build-out or return of a security deposit—consider whether "exculpation" makes sense or whether, to the contrary, the tenant should insist on some level of creditworthy assurances from someone beyond a single-asset landlord, or perhaps a letter of credit.

41.6 Other Tenants' Closure. The tenant may want the right to terminate the lease (or pay only percentage rent) if specified other retail tenants shut down. This could even apply to an office building if occupancy drops to a level where the tenant's staff feels uncomfortable working in the building even if the landlord continues to provide services.

41.7 Other Business Relationships. Do the landlord and the tenant have any other relationship (e.g., purchase and sale of a business) that might give rise to tenant claims against the landlord for which the tenant should be entitled to offset against rent if the landlord does not pay after some extended notice and warning period?

42. Use

42.1 Any Lawful Use. Try to allow "any lawful use" or at least "any lawful retail/office use" of the premises.

42.2 Permitted Uses. Describe permitted uses generically to avoid restricting future use by a subtenant or assignee (e.g., "medical or other health practitioner's offices" or "executive offices" rather than "podiatrist's offices" or "main headquarters of XYZ Corp."). If the tenant anticipates making unusual uses of the space (e.g.,

for basketball courts, pets, bicycles hanging from the ceiling, sleeping facilities, etc.), confirm that the lease and applicable law will not prohibit these uses.

42.3 Future Change of Use. Build in flexibility for future change of use if any possibility exists of a change in circumstances (e.g., likely technological obsolescence of the tenant's business).

42.4 Incidental Uses. Obtain preapproval for incidental uses, such as automated teller machines ("ATM"), food, training, duplicating, ancillary retail, gym, day care, other amenities, network control center, etc. If necessary, the tenant can usually agree that these facilities will be open only to the tenant's employees and invitees who are already on the premises to do business with tenant.

42.5 Duty to Operate; Recapture. A tenant will prefer to have no duty to open or operate, implied or otherwise. If the landlord counters with a request for a recapture right if the tenant goes dark for a specified period, carve out permitted closures (e.g., for "force majeure event," alterations, inventory taking, other brief closings). Limit the time within which the landlord may decide to recapture. Require the landlord to reimburse the tenant's leasing and improvement costs if the landlord recaptures in these cases.

42.6 Satellite Dishes and Antennas. The landlord should allow the tenant to install satellite dishes and antennas on the roof, either at no charge or for a defined or ascertainable charge. Allow the tenant to relocate this equipment if necessary to improve performance. The landlord should agree to prohibit future rooftop users from interfering with the tenant's use.

42.7 Rooftop, Generally. The tenant may also want the right to install its own backup generators, supplemental air-conditioning, and other equipment on the roof or elsewhere. If this will require structural reinforcement, the landlord should consent to it, and ideally pay for it. For any rooftop or other off-premises equipment, the tenant will also want the landlord's consent, without charge, to the running of any wires, cables, connections, and lines between the premises and the tenant's rooftop equipment. A tenant will prefer not to be obligated to remove any equipment or connecting lines at the end of the lease term.

42.8 Use of Sidewalk. A ground floor tenant may want the right to install awnings, canopies, and crowd control barriers on the sidewalk. Will the tenant otherwise need to use the sidewalk or the exterior of the building for special events, temporary installations, or other purposes? Exterior loudspeakers? Exterior laser or light displays?

42.9 Conflict With Other Leases. The lease should not say that the tenant's use may not conflict with other leases or mortgages—unless this lease defines exactly what those other leases or mortgages prohibit.

42.10 Common Facilities. Allow the tenant to use building common facilities, such as cafeteria or health clubs, auditoriums, conference facilities, and common lavatories if the leased premises do not include lavatories. The lease should state the minimum operating hours (24 hours in many cases) and maintenance and cleanliness standards for common facilities and any cost for such uses.

42.11 Exclusive Use. The lease should give the tenant the exclusive use of terraces or other identified outdoor space or facilities adjacent to the tenant's premises. The landlord should maintain and clean these areas according to specified standards.

42.12 24 Hour/365 Day Access. The tenant should obtain 24-hour access, 365 days a year, via elevator or (if the elevator is broken) stairway. Unless the leased premises are on a very low floor, think about establishing consequences (monetary payments) if the elevators break down to the point where the tenant can't obtain access to the floor, though this level of breakdown rarely actually happens.

42.13 Reception, Security, Other Facilities. Will the tenant want to install any reception, security, package handling, messenger, or other facilities in the lobby, basement, ground floor, or other common area of the building? If so, the lease should allow them and negate any obligation to pay rent for the affected space.

42.14 Storage Areas. In addition to the premises, the tenant may want to lease storage space available in the building. Any such arrangements should be coterminous with the lease and not, for example, a revocable license.

42.15 Competitors. Even for nonretail space, try to prohibit the landlord from leasing space in the building to the tenant's competitors (creating a risk of a competitor's taking the tenant's staff, customers or clients). Specify other prohibited uses.

43. Utilities, Generally (Except Electricity)

43.1 Entry Point. The landlord should bring all utilities to a

defined entry point on the perimeter of the premises, not just wherever the landlord decides to bring them. Decide what entry point works best for the tenant, for each utility service.

43.2 **Special Requirements.** Require the landlord to allow the tenant or its service providers to install T-1 and fiber optic lines, multiple points of entry, and other telecommunications facilities, including cabling and connections from service providers to the premises. Recognize that these technologies and related tenant requirements will change over time.

43.3 **Free Choice of Carrier.** Allow the tenant to use any carriers or utilities it wishes for telecommunications and other services. The landlord must, without charge, cooperate as needed, such as by signing papers, providing closet space in the basement, providing pathways as needed, and providing information. Requirements of federal law may actually mandate some of this. The tenant's counsel should check just what law requires and what must be negotiated. Of course, law could change.

43.4 **Excess Capacity.** If generators or fuel systems in the building have excess capacity, require the landlord to preserve that excess capacity (without allocating it to other tenants) to maximize the backup value of those systems to this tenant.

43.5 **Alternative Providers.** Limit the landlord's right to change power or telecom providers.

44. Preliminary Arrangements and Considerations

44.1 **Brokerage.** Is a brokerage agreement in place? Are the commission negotiations completed?

44.2 **Term Sheets and Letters of Intent.** Attorneys should deal with term sheets and letters of intent early in the lease negotiation process to raise and resolve major issues while it is relatively easy (and inexpensive) to do so. These preliminary documents should state they do not bind anyone, except relating to such matters as confidentiality.

44.3 **Board Approval.** If the tenant will require its own internal board or other approval to ratify a contemplated transaction, provide for that condition in all letters of intent, term sheets, lease drafts and other preliminary documents.

44.4 **Tax Incentives.** Can the tenant qualify for any tax incentives, abatements, deferrals, rebates, subsidies, or other governmental benefits? Check the timing requirements and pitfalls for any application. Often, a tenant must apply before "committing" to a new location.

44.5 **Warranties.** If the landlord has the benefit of any warranties for the building, the tenant may want to be a beneficiary of those warranties and have the right to enforce them directly against the warrantor.

44.6 **Premises Off Market.** During the lease negotiations, ask the landlord to agree to remove the space from the market and not to negotiate with other parties for a specified period. In particular, ask the landlord to remove any "for lease" signs at the premises, while the parties negotiate. Should the parties agree to a break-up fee? A reimbursement of expenses and attorneys' fees if the deal dies?

44.7 **Tenant's Professionals.** Select, coordinate and negotiate the contracts of the tenant's other professionals: architect, broker, engineer, facilities consultant, signage designer, space planner, and so forth. Try to get architects started early. Architects usually cost less than either lawyers or rent. The tenant's architect should review the lease while it is being negotiated.

44.8 **Tenant's Procedures.** Understand the tenant's (and the landlord's) internal approval procedures, including any documentation requirements and likelihood for delay.

44.9 **Backup Lease Negotiations.** Consider negotiating multiple leases at the same time, though perhaps at various stages of negotiations, to be able to recover quickly if the lease negotiations for a particular premises break down or the landlord decides to lease to some other tenant.

45. Due Diligence

As noted above, no one should regard this checklist as exhaustive or complete. This is particularly true as it applies to the following list of "due diligence" investigations that the tenant's counsel may wish to perform, or make sure other tenant advisers perform:

45.1 **Existing Condition of Premises.** Is the existing condition of the premises satisfactory? What personal property is included? Should the landlord be required to remove—or be required to leave in place—any existing improvements or personal property? Is there anything about the space, or the building as a whole, that the tenant would not want the landlord to change? If so, the lease should prohibit the landlord from making such changes, or else the tenant won't be able to stop them.

45.2 **Title Search.** Perform a title search and review, or an online search to confirm, ownership of the fee (easily available in many areas). Check any prior

recorded documents that might affect this tenant. Review the landlord's certificate of occupancy. Perform other municipal searches.

45.3 Square Footage. Calculate the actual square footage and scope of the premises. Do all of the landlord's exclusions and inclusions of space make sense? For example, should the elevator lobby be part of the premises? Does the landlord propose that the premises include any mechanical space or equipment that the tenant won't really use? And compare the landlord's "rentable" square footage (sometimes rather creatively calculated) against the actual "usable" or "carpetable" square footage (as measured) of the premises. What space in the building does the landlord treat as "building common areas," thus increasing the rentable square footage of this tenant's premises? Do any of those "building common areas" really benefit only particular tenants rather than all tenants in the building? After adjusting for the "loss factor" (the percentage reduction from "rentable" to "usable" space), do the economics still make sense? Might the tenant be paying for any unusual spaces or installations that really should be entirely irrelevant to the leased premises?

45.4 Special Permits. Do any unusual uses require special permits or that special measures be taken to obtain necessary permits (e.g., liquor licenses, sidewalk cafes)? How long will that process take, and what will it require? What other permits might the tenant need, such as public assembly? If the tenant anticipates delay or possible failure in obtaining one of these permits, the tenant should, at a certain point, have the right to terminate the lease.

45.5 Ventilation. Does the space provide adequate ventilation, or adequate pathways for the tenant to install new ventilation?

45.6 Escalations. The tenant, and particularly its accounting and leasing personnel, may want to consider at least these due diligence issues on escalations:

(A) *Capital Projects.* What capital projects are under way or contemplated today? Does the tenant agree with how the landlord plans to treat them?

(B) *Historical Operating Expenses.* What are the historical amounts for operating expenses and taxes? Review the underlying financial information, presentation, characterization and documents, including sample escalation statements.

(C) *Pre-Programmed Increases in Tax Assessment.* Investigate any built-in future increases in the tax assessment (e.g., termination of interim assessment, upcoming loss or phase-out of existing abatement or exemption). Is the building fully assessed? Does anything about the tax assessment for the building suggest future increases are unusually likely? For any major lease, issues like these may justify retaining special counsel just to advise on real estate taxes.

45.7 Telecommunications Capacity. Investigate available capacity and pathways for telecommunications and other utilities.

45.8 Technological Requirements. Check the tenant's network and other technological requirements.

45.9 Rooftop. Check lines of sight for a rooftop satellite dish or antenna. Can the roof support any heavy equipment the tenant will install? Will the tenant be able to get the equipment up to the roof?

45.10 Present Occupancy. What is the present occupancy of the premises to be leased? What is the practical likelihood of delays in possession?

45.11 Tenant's Existing Lease. Review the existing tenant's lease for expiration date, holdover penalties, etc. If the tenant will need a short extension, ask for it early in the process, as the tenant's existing landlord may become less accommodating over time.

45.12 Disposition of Present Premises. If the tenant has "too much" time remaining on the tenant's existing lease, how does the tenant plan to dispose of the premises it now occupies? Does the tenant understand any uncertainties and risks in that process?

45.13 Engineering. The tenant's engineers should consider a range of issues, including the adequacy, directness, and feasibility of pathways for utilities and services for the premises, and more mundane issues such as floor load capacities.

45.14 Security. Does the landlord's security program meet the tenant's expectations?

45.15 Submeter. If the premises are submetered, does any submeter serve space outside the premises?

45.16 Operating Requirements. Does the tenant have any unusual operating requirements, procedures or expectations? Specific expectations on usage of loading docks, freight elevators, security guards, or lobby operations? Anything outside the premises? Identify these and state them in the lease.

45.17 Environmental Concerns. Consider whether an environmental review is necessary.

45.18 Violations. Check for any notices of violation filed against the property that could impair the tenant's ability to obtain necessary permits. Also, check for any litigation against the landlord.

46. Lease-Related Closing Documents

At closing, any significant lease transaction may require a number of documents other than the lease itself. Counsel should resolve these documents as part of the process of negotiating the lease. They might include any of the following:

46.1 Memorandum of Lease. Mention any "exclusive use" rights and other lease provisions that restrict the landlord's activities on other premises. Record the memorandum against all affected real property (e.g., "outparcels").

46.2 Nondisturbance Agreement. See the "lender's form" nondisturbance agreement as soon as possible, so it can be negotiated and signed along with the lease. Attach it as an exhibit as the standard for future nondisturbance agreements.

46.3 Reciprocal Easement Agreement. For a new retail mall or mixed-use project, the tenant may want to have a role in establishing and approving any reciprocal easement agreement that the landlord intends to record against the project.

46.4 Recognition Agreement and Estoppel from Ground Lessor. If the landlord actually leases the building from a third party (a "ground lease"), any space tenant may want appropriate protections and assurances from the underlying fee owner. The tenant should generally insist on having that agreement in place at the same time the tenant signs its lease.

46.5 Written Authority for Agent. If the landlord's agent signs the lease (or any future amendment or estoppel certificate), the landlord should deliver a copy of a written authorization to sign.

46.6 Additional Consents. Does the landlord need any consents or approvals? This is especially important if the landlord is a governmental entity or charity. Approvals could be internal or require cooperation from lenders, ground lessors or other third parties. The landlord should represent and warrant that it needs no further consents or approvals, and deliver copies of any necessary consents or approvals at closing.

46.7 Opinion of Landlord's Counsel. One could limit such an opinion to authorization and execution and related issues, without entering the morass of issues—angels dancing on a pin—raised by "enforceability."

46.8 Transfer Taxes. Beware of transfer taxes generally. The calculation and allocation of any transfer taxes on the creation of the lease, including the treatment of any transfer of personal property, should be embodied in a closing document. In New York, some leases attract transfer tax, whether or not the parties record a memorandum of lease. Transfers of personalty may attract a sales tax. Prepare all necessary transfer tax returns, including required calculations and exhibits (e.g., copy of the entire lease, if required). Get them signed and filed.

46.9 Title Insurance. Consider obtaining a policy of leasehold title insurance, or at a minimum an updated title search.

46.10 Unusual Security Arrangements. Unusual security arrangements—letters of credit, delivery of marketable securities, and the like—should be structured and documented. The landlord's lender and conceivably other third parties may also need to get involved in these discussions. Those third parties may ultimately become the "critical path" to signing the lease. They often have rigid documentation requirements applied by rigid people.

46.11 Leasehold Insurance. Consider separate casualty insurance coverage for a valuable leasehold. If the lease requires insurance, comply with those requirements (e.g., insurer's ratings, additional insureds, evidence of insurance).

46.12 Insurance Advice. Send the insurance and casualty provisions of the lease to the tenant's insurance advisor for review and comment. Confirm the tenant's broker can actually issue the contemplated insurance coverages, and in a timely manner.

46.13 Landlord's Approvals. Obtain and confirm the landlord's approval of plans and specifications for initial work. Attach the plans and specifications as a schedule to the lease. If the tenant enters into any immediate subleases, have the landlord approve those at the time of lease signing.

46.14 Diagram of Premises. Include an exhibit consisting of a precise diagram of the premises. Confirm that the tenant, the broker, and other advisors reviewed and approved the diagram. Try to make this happen early in the process. The landlord may think it is "obvious" that certain spaces should be excluded or included, but the landlord may be wrong.

46.15 Guaranty. Any guaranty of a lease will raise its own issues. A discussion of these issues lies beyond this checklist.

46.16 Internal Approvals. Any documents necessary to evidence the tenant's internal approval of the contemplated lease (resolutions, consents, or the like).

46.17 Rent Bill. Instructions for how to pay rent under the lease, if not incorporated into the lease, and calculation of the first rent bill.

46.18 Brokerage Commission. Evidence of payment of any brokerage commission.

46.19 Client Instructions. If the client instructed counsel to do anything less than a full lease review and negotiation, counsel should maintain some written record of those instructions and a record that counsel warned the client about the risks of "minimalism" in lease negotiations. Memories are short.

47. Post-Closing Items

Like any other real estate transaction, a tenancy under a lease may require post-closing legal attention in order for the tenant to preserve its rights. The following are a few items that the tenant's counsel may want to handle or at least mention to the tenant:

47.1 Advice and Administration Memo. The tenant may desire its counsel to prepare a memorandum to summarize any proactive and nonobvious actions that the tenant should take to protect its position under the lease. Such a memo might, for example, describe the deadlines and process for objecting to the landlord's delivery of the space; escalation statements; or provision of building services.

47.2 Ticklers for Deadlines. The tenant may want to make tickler file entries for tax protest deadlines, option and/or renewal exercise dates, letter of credit renewal dates, and any other deadlines.

47.3 Future Filings. If the lease contemplates that the tenant will make any nonintuitive filings, or take any other nonstandard actions, the tenant's counsel may wish to bring those matters formally to the tenant's attention. This list might also include any necessary filings for available governmental incentives.

47.4 Escalation Audits. Note the deadlines to initiate any audit of the landlord's operating expenses or other escalations. For the first year of operating expenses, audit the operating expenses not only for that year but also for the base year.

47.5 Tax Protests. The tenant should understand the deadlines for tax protests and any actions the tenant should take to preserve and exercise any rights to require the landlord to protest taxes.

47.6 Commencement Date Letter. When the commencement date has actually occurred, confirm it in writing, and reconfirm the expiration date and any other dates keyed off the commencement date.

47.7 Options; Rent Adjustments. The parties should memorialize all option terms and rent adjustments in writing.

47.8 Estoppel Certificates. If the landlord asks the tenant to sign an estoppel certificate, the tenant should take it seriously, start researching the facts immediately, and take advantage of the opportunity to put pressure on the landlord to solve any problems that the tenant identifies. Courts do take estoppel certificates seriously. The tenant should not simply "sign and return." If the lease allows the tenant to require estoppel certificates of the landlord, the tenant may occasionally wish to do so, just to avoid future issues or surprises.

47.9 Future Lease Transactions. Any future lease amendments (or negotiated termination of the lease) may require consent from the landlord's mortgagee. Raise that issue early in the discussion. The landlord may otherwise think the tenant won't really insist.

47.10 Recordation. If the parties signed a memorandum of lease, then the tenant should make sure it actually gets recorded, and recorded correctly.

47.11 Effect of Memorandum of Lease. If the tenant recorded a memorandum of the original lease, then New York law in effect requires an amendment to the memorandum to be recorded (and accompanying transfer tax returns to be filed) whenever the parties amend the lease. Even if the amendment changes nothing that the recorded memorandum of lease disclosed, New York law requires the additional recording to give notice of the mere fact that the lease was amended. The tenant should insist on such an additional recording. For simplicity, both the landlord and the tenant may prefer to embody any future amendment in a single recorded document, assuming nothing in it must stay confidential.

47.12 Notices. If the tenant has relocated its main office or legal department, then the tenant may need to notify all its contractual counterparties of the new address. This may require the tenant to do some digging

in its contract files. If the tenant has filed any notice of address for service of process with any Secretary of State's office (e.g., the tenant's state of formation and any state where the tenant has qualified to do business) or corporate service company, the tenant should update those filings as well. Who else needs to know about the tenant's change of address, and what level of formality will that change of address require? Don't assume an ordinary emailed or bulk-mailed announcement will do the job. Similarly, going forward, the tenant should watch for change of address notices from the landlord or a mortgagee (for example, every time the building is sold or refinanced). The tenant should update its records accordingly.

47.13 Nondisturbance Agreements. If a future mortgage lender requires the tenant to sign a nondisturbance agreement for a closing, insist that the agreement not become effective unless the lender signs and returns it to the tenant at closing or within a short time thereafter.

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Please comment on this checklist. Changes, additions, and other improvements are welcome. The co-authors will take them into account as appropriate for future updates and republications. If you have suggestions for this checklist, please contact either co-author. For contact details, see the copyright notice.

Notices to Renew Commercial Leases: Where Contract and Equity Collide

By Michael Regan

Equity has long served as a basis to save a commercial tenant from the consequences of failing to comply with an option to renew a long-term commercial lease. Pursuant to the doctrine of "substantial forfeiture," "equity will intervene to relieve a commercial tenant's failure to timely exercise an option to renew a lease where (1) such failure was the result of 'inadvertence,' 'negligence' or 'honest mistake;' (2) the non-renewal would result in a 'forfeiture' by the tenant; and (3) the landlord would not be prejudiced by the tenant's failure to send, or its delay in sending, the renewal notice."[1] Two recent appellate decisions on the subject of "substantial forfeiture" have garnered considerable interest from legal commentators and raised questions about the desirability and proper scope of this well-established equitable doctrine.

In *135 East 57th Street LLC v. Daffy's Inc.*, the First Department affirmed the judgment of the Supreme Court, New York County (James A. Yates, J), declaring that the commercial tenant's late notice of renewal was excused on equitable grounds.[2] The decision was widely commented on[3] because the First Department held that loss of customer goodwill established at the tenant's retail store constituted a sufficient "forfeiture" to justify extending the lease on equitable grounds.[4] One commentator opined that it was improper for the First Department to consider the tenant's potential loss of goodwill in reaching its decision, and lamented that the "pendulum may be swinging back to allowing empathy and sympathy [to] override a contractual provision."[5]

As discussed below, however, the First Department's decision in *Daffy's* is entirely consistent with prior precedent. The long line of cases preceding *Daffy's* establishes that loss of goodwill is a time-honored consideration in determining whether a "substantial forfeiture" would result from finding that a commercial lease was not properly renewed. Indeed, the modern "forfeiture" defense traces its roots at least thirty-five years back to the Court of Appeals' decision in *J.N.A. Realty Corp. v. Cross Bay Chelsea, Inc.*[6]

In *Baygold Associates, Inc. v. Congregation Yetev Lev of Monsey, Inc.*, the Court of Appeals recently had occasion to revisit *J.N.A. Realty* and placed certain limits on the application of this equitable doctrine.[7] While the Court of Appeals in *J.N.A. Realty* described the doctrine of "substantial forfeiture" as a "general equitable principle,"[8] the Court in *Baygold Associates* described the doctrine as "narrow" in scope, and further stated that the doctrine is only applicable where a tenant-in-possession makes substantial improvements to the property or would suffer a loss of customer goodwill.[9] In particular, the Court felt that it was inappropriate to apply the doctrine where a "sub-subtenant" in possession made valuable improvements to the property instead of the tenant attempting to invoke the doctrine.[10] In his dissenting opinion, Judge Smith took issue with what he described as the majority's attempt to place "arbitrary" limits on what should be a flexible doctrine.[11]

The holdings in *Daffy's* and *Baygold Associates* also highlight two important factors in deciding commercial-lease renewal issues: (1) the diligence of the tenant; and (2) the prejudice to the landlord. These two factors are just as important as the nature of the hardship that may befall the tenant if the lease is terminated. Indeed, based on these considerations, the decisions reached in *Daffy's* and *Baygold Associates* are almost predictable.

The Decision in *Daffy's*

In its decision, the First Department observed that the commercial tenant, Daffy's Inc. ("Daffy's"), is a "popular discount clothing retailer that operates 7 stores in Manhattan and 18 retail stores in all, and has operated its store at 135 East 57th Street in Manhattan since the lease term began on November 7, 1994."[12] The Court noted that "the term of the lease expired on January 31, 2011, and that the lease gave Daffy's the option of two five-year renewal terms, the first of which was to be exercised no later than January 31, 2010."[13]

Daffy's controller inadvertently failed to calendar the January 31, 2010 deadline for providing notice of renewal to the landlord.[14] As a result, Daffy's did not provide written notice of intention to renew the lease until February 4, 2010, when it sent such notice by e-mail and fax. The landlord immediately rejected this notice on the grounds that it was untimely and not delivered in the precise manner prescribed by the lease. In response to the landlord's rejection of the notice, Daffy's sent the renewal letter in the manner prescribed by the lease on February 9, 2010—still almost a year before the expiration of the current lease term.[15]

The "difficult issue" to be decided, the First Department observed, "is whether Daffy's evidence established the type of forfeiture for which equitable relief is appropriate under the rule articulated in *J.N.A. Realty*."[16] The Court held that Daffy's could not credibly claim a forfeiture as a result of alleged improvements that it made to the leased space.[17] However, Daffy's also introduced evidence

concerning the threatened loss of goodwill established at this particular store, as well as other equitable factors, to wit:

> [T]he 57th Street store in particular had become highly successful and popular…the company had searched for alternative space…and had not identified any prospects, and…even if it found a viable site, it would require the better part of a year to open a new store.[18]

The First Department held that "the evidence was sufficient to support a finding that Daffy's 57th Street store in particular had garnered substantial goodwill in its approximately 15 years at the location, which goodwill was a valuable asset that would be damaged by its ouster from the premises."[19] The Court also held that "the location was shown to be 'one of [Daffy's] top producing retail locations, and [the landlord] failed to establish that any prejudice resulted from [Daffy's] breach.'"[20]

The Prior Precedent

Based on prior precedent, the First Department's consideration of loss of goodwill as part of its analysis in *Daffy's* should not come as a surprise. Indeed, in its decision, the First Department discussed and relied upon two decisions of the Court of Appeals from the 1970s—*Sy Jack Realty Co. v. Pergament Syosset Corp.*, and *J.N.A. Realty*—in which the respective tenants' potential loss of goodwill played a prominent role in the Court of Appeals' decisions on this very issue.[21]

In *Sy Jack Realty*, the tenant had leased space from the landlord for a period of fifteen years to conduct its retail business.[22] The tenant's letter to renew the lease was sent prior to the deadline, but was never delivered. However, the Court of Appeals noted that the landlord had actual notice of the tenant's intent to renew before it proceeded to obtain a new tenant or take any action to terminate the lease.[23] The Court of Appeals also recognized that the tenant stood to lose a valuable asset in the form of goodwill if the lease was not renewed: "Since a long-standing location for a retail business is an important part of the good will of that enterprise, the tenant stands to lose a substantial and valuable asset."[24]

The Court of Appeals in *Sy Jack Realty* recognized an equitable principle relieving a tenant of the consequences of failing to strictly comply with a lease renewal provision:

> [W]here an option is contained in a lease or other contract involving an estate in land, some courts of equity, especially in recent years, have tended to view the offer as not automatically lapsing on expiration of the option period, as for instance, in case of renewal of a long term lease, where to do so would involve substantial forfeiture and the lessor has not materially changed his position in reliance on the optionee's failure to exercise his option with the stated time.[25]

In *J.N.A. Realty*, the Court of Appeals reaffirmed the principle announced in *Sy Jack Realty* that equity may intervene to preserve the goodwill generated from a tenant's long-standing location for a retail business.[26] The Court of Appeals adopted the "general equitable principle" articulated by Cardozo in his dissenting opinion in *Graf v. Hope Bldg. Corp.*,[27] that, on this issue, "the gravity of the fault must be compared with the gravity of the hardship."[28] Consistent with this "general equitable principle," the Court of Appeals in *J.N.A. Realty* looked beyond the tenant's improvements to the property and also noted that "if the location is lost, the restaurant would undoubtedly lose a considerable amount of its customer good will."[29]

Thus, the First Department in *Daffy's* simply applied the long-standing principle that loss of goodwill is a proper consideration in deciding whether to excuse a commercial tenant from the consequences of failing to comply with a lease-renewal provision. In fact, the First Department considered a commercial tenant's potential loss of goodwill in deciding other recent lease-renewal cases preceding *Daffy's*.[30]

Consistent with the "general equitable principle" announced in *J.N.A. Realty*, the First Department in *Daffy's* took other factors into account as part of its consideration of the equities, including the fact that: (i) Daffy's had searched for and could not find alternative space; (ii) it would take Daffy's a year to open a store at a new location; and (iii) most of the store's 114 employees would lose their jobs and benefits if the 57th Street store were to close.[31]

Such a flexible equitable analysis was applied in the body of case law that emerged subsequent to *Sy Jack Realty* and *J.N.A. Realty*. For instance, in *Grunberg v. George Assoc.*, the First Department took into account the tenants' potential loss of goodwill and the fact that tenants had "increased their insurance coverage and ordered a new line of merchandise" based on their belief that the lease had been renewed.[32]

In *Dutchess Radiology Associates, P.C. v. Narotzky*, the Third Department considered the fact that the tenant (aside from making permanent and valuable improvements to the property) had "leased and had installed a magnetic resonance imaging scanner which cost $1,206,000."[33] The Third Department observed that "[t]o move this machine would not only require plaintiff to remove part of a wall, but it would cost plaintiff thousands of dollars to alter new premises to fit its specifications."[34]

In *Hunt v. Carlson*, the Third Department noted that, in addition to spending over $200,000 to rehabilitate the leased parking lot, the

plaintiffs had also "purchased an entire shopping center next to the parking lot which is the only parking area servicing the shopping center."[35] Clearly, the plaintiffs stood to lose the benefit of a valuable investment (the shopping center) if they could not take advantage of the option to purchase the parking lot. Thus, the Third Department held that "plaintiffs have sufficiently shown that they would suffer a substantial forfeiture if the terms of the lease were strictly enforced."[36]

Therefore, the decision in *Daffy's* does not represent something new or different from the body of case law that preceded it. Pursuant to *Sy Jack Realty* and *J.N.A. Realty*, courts may certainly consider loss of goodwill in determining the existence of a "substantial forfeiture," and seemingly have the freedom to entertain other forms of detrimental reliance or hardships. The decision in *Daffy's* is entirely consistent with that principle.

Baygold Associates: A Recent Limitation on the Doctrine of "Substantial Forfeiture"

Subsequent to the First Department's decision in *Daffy's*, the Court of Appeals revisited its decision in *J.N.A. Realty* in *Baygold Associates*. Just as in *Daffy's*, the Court in *Baygold Associates* addressed the issue of whether a *bona fide* "forfeiture" was threatened to justify excusing a tenant's non-compliance with a lease-renewal provision on equitable grounds.[37]

In *Baygold Associates*, however, the Court of Appeals dealt with an "out-of-possession" tenant—Baygold Associates, Inc. ("Baygold")—that was twice removed from the property, because the premises had been subleased to another entity and then "sub-subleased."[38] The owners of the property disputed that Baygold had complied with the provision to renew the lease and thereafter advised Baygold that it would be deemed a month-to-month tenant as of September 30, 2007.[39]

After Baygold commenced a declaratory judgment action with respect to its rights under the lease, the Supreme Court concluded that Baygold had failed to comply with the renewal provision and could not invoke the doctrine of "substantial forfeiture."[40] The issue on appeal was whether non-renewal of the lease would result in a legally cognizable forfeiture by Baygold.[41] In support of that argument, Baygold offered the following evidence: (i) Baygold made $1 million in improvements to the premises between 1972 and 1985, twenty years before the dispute arose; (ii) the tenant-in-possession (the sub-sublessee) made improvements to the premises between 1985 and 2007; and (iii) Baygold's forbearance in collecting "substantial rent increases" based on the expectation that the lease would last for the entire fifty-year term.[42]

The Court of Appeals held that an out-of-possession tenant such as Baygold could not take advantage of the "narrow equitable doctrine" set forth in *J.N.A. Realty*.[43] The Court further held that "[t]he forfeiture rule was crafted to protect tenants in possession who make improvements of a 'substantial character' with an eye toward renewing the lease, not to protect the revenue stream of an out-of-possession tenant like Baygold."[44] The Court also held that Baygold could not establish a "substantial loss," because Baygold had profited from its lease since 1985 "while having expended no monies on improvements," and thus "reaped the benefit of any initial expenditure[.]"[45] Further, in an apparent effort to limit the scope of this equitable doctrine, the Court stated that "our holding in *J.N.A. Realty* is restricted to tenants who make 'considerable investment in improvements' to the premises in anticipation of the lease renewal or would 'lose a considerable amount of…customer good will' should the lease not be renewed[.]"[46]

It is interesting to note that while the Court of Appeals appeared to limit the doctrine of "substantial forfeiture" to two bases—substantial improvements and loss of goodwill—the Court cited two decisions that considered other equitable factors. For instance, in citing *Popyork, LLC v. 80 Court Street Corp.*,[47] the Court of Appeals noted that the fast-food tenant had spent $550,000 to acquire the former tenant's rights under the lease, plus another $300,000 in improvements during its three years of operation.[48] In citing *Bench 'N Gavel Restaurant, Ltd. v. Time Equities, Inc.*,[49] the Court noted that the tenant had spent $125,000 to purchase the business and lease, plus another $100,000 for renovations a year before the tenant failed to properly renew the lease.[50] Thus, other forms of monetary investment (such as money spent to acquire rights under a lease) appear to be acceptable to invoke the doctrine, so long as they are not "too attenuated" from the tenant's interest in extending the lease.[51]

However, it is difficult to appreciate a significant difference between monies initially spent to acquire a leasehold interest (which the Court of Appeals appears to view as a valid basis for invoking the doctrine) and forbearance from collecting substantial rent increases with the expectation that the lease would be extended (which the Court felt was insufficient).[52] In both scenarios, the tenant has established a financial loss based on the expectation that the lease would run its full course. Perhaps the key difference for the Court was that Baygold was an "out-of-possession" tenant which merely profited from its sub-lease, whereas the tenants in the other cases were using the property to operate their respective businesses.

In his dissenting opinion in *Baygold Associates*, Judge Smith seemed troubled by what he perceived to be an attempt to draw "arbitrary" lines in the "general equitable principle" stated in *J.N.A. Realty*.[53] Judge Smith took issue with the fact that the majority made "no attempt to answer" why the doctrine of "substantial forfeiture" should not apply when a subtenant is in possession of the

property and pays for the improvements.[54] Clearly, Judge Smith believes that the doctrine should be applied in a flexible manner pursuant to the unique facts of each case:

> Here, it is a subtenant and not the tenant who has made the improvements, but the result of the tenant's inadvertence is no less a forfeiture. Because the tenant failed to send a certified mail notice by the prescribed date, the subtenant loses investments that cost, according to evidence in the record, several hundred thousand dollars; [Baygold] loses the revenue it anticipated from the sublease; and the landlord gets the improvements for nothing.[55]

Timing and Prejudice

At the heart of every commercial-lease renewal issue are two important factors—the diligence of the tenant and prejudice to the landlord. Indeed, before engaging in an analysis of the nature of the tenant's threatened loss in *Daffy's*, the First Department stated that "[w]e note initially that the four-day delay in providing the one-year's notice required by the lease did not prejudice the landlord."[56]

As part of their equitable analysis, courts consider whether the landlord has relied to its detriment on the tenant's non-compliance with a lease-renewal provision, including whether the landlord has sought or obtained a valuable new tenant.[57] Thus, commercial landlords should take solace in the fact that the "door swings both ways" in analyzing the equities of a tenant's failure to comply with a renewal provision of a commercial lease.

For instance, in *Sy Jack Realty*, the Court of Appeals affirmed the Appellate Division's application of the equitable rule against forfeitures, in favor of the tenant, "in view of the fact that the [landlord] had actually received notice before it took any steps to find another tenant or to lease the space[.]"[58] On the other hand, in *J.N.A. Realty*, the Court of Appeals held that it was error for the Supreme Court to deny the landlord an opportunity to present evidence that "he had negotiated with another tenant after the option to renew had lapsed."[59]

The tenant must also act in a diligent manner in order to gain equitable protection. Where the tenant's delay in seeking to invoke the option is unreasonable, courts are more inclined to strictly enforce the renewal provision. For instance, the Second Department has held that a tenant's nine-month delay was unreasonable and too prejudicial to the landlord.[60] By contrast, where a tenant's delay is short and results in no prejudice to the landlord, courts have been more inclined to grant equitable relief to the tenant.[61]

Courts also examine whether the landlord has sought to benefit from a tenant's ignorance or has otherwise acted in an unfair or unreasonable manner. In *J.N.A. Realty*, the Court of Appeals emphasized the fact that the landlord regularly had notified the new tenant of significant events under the lease, but failed to mention the imminent deadline to exercise the option.[62] The Court also found it significant that "there is some indication in the record that [the landlord] had previously used this device in an attempt to evict another tenant."[63] Equally distasteful to the Court of Appeals was the fact that the landlord waited over four months after the tenant's deadline had expired before notifying the tenant of its default.[64]

There is no question that the issues of timing and prejudice figured prominently in the First Department's decision in *Daffy's*. The First Department noted that Daffy's had provided written notice by e-mail and facsimile just four days after the deadline, and almost a year before the lease term would expire.[65] Of course, the landlord could not and did not claim that it took significant steps to obtain a new tenant in those four days.[66]

Despite having actual notice of Daffy's intent to exercise the option just days after the deadline, the landlord in *Daffy's* rejected the written notifications by e-mail and facsimile because the lease required that such notice be sent in a different manner.[67] As a result, Daffy's had to send the notice again.[68] Therefore, just like the landlord in *J.N.A. Realty*, it is clear that there was some gamesmanship on the part of the landlord in *Daffy's*.

On the other hand, in *Baygold Associates*, the landlord established that it would be prejudiced by an extension of Baygold's lease under the circumstances.[69] The Court of Appeals noted that "[i]n July 2007, the Rubenfelds, as successors to [the original owner], entered into a contract with defendant Congregation Yetev Lev of Monsey, Inc.…for the sale of the premises."[70] If the lease was extended to avoid a purported "forfeiture" by Baygold and the sub-subtenant in possession, the owner of the building and the contract-vendee would have suffered their own forfeiture, because the sale would not be consummated. Although the issue of prejudice was not highlighted by the majority in *Baygold Associates*, it is easy to imagine that the owner's plan to sell the property was a significant factor in reaching the majority's decision.

Conclusion

As noted by the majority in *Baygold Associates*, application of the "substantial forfeiture" doctrine "must always depend on the facts of the particular case."[71] It is precisely for that reason that Judge Smith resisted the majority's attempt to mark inflexible limits on the application of what the Court in *J.N.A. Realty* described as a "general equitable principle."[72] Indeed, in *Daffy's*, the First Department considered equitable factors beyond the traditional considerations of substantial improvements and loss of goodwill, such as loss of employment by Daffy's employees and the fact that it would take a year

for Daffy's to open a new store.[73] However, if the tenant's delay was longer and the landlord had established prejudice, the First Department might have been less impressed with these arguments. On the other hand, in a set of facts like *Daffy's*, where the landlord suffered no prejudice and was exalting form over substance, the First Department clearly felt that a consideration of the "bigger picture" was in order.

It will be interesting to see what ramifications the Court of Appeals' decision in *Baygold Associates* will have on future cases. It is possible that courts will read the holding in *Baygold Associates* as a "narrow" limitation on the types of equitable considerations that may properly be considered, i.e., substantial improvements to the property and loss of goodwill by a tenant-in-possession, and little or nothing else. However, the decision in *Baygold Associates* may also be understood to represent a firm response to a particular type of plaintiff—an "out-of-possession" tenant—who attempted to stretch the doctrine of "substantial forfeiture" beyond what the Court of Appeals perceived to be its intended purpose. If the latter is true, the decision in *Baygold Associates* should not necessarily foreclose a more sympathetic or suitable plaintiff (as the case may be) from raising less conventional equitable arguments as called for by the unique facts of the particular case.

Endnotes

1. *See* Baygold Assoc., Inc. v. Congregation Yetev Lev of Monsey, Inc., 19 N.Y.3d 223, 225, 970 N.E.2d 829, 830, 947 N.Y.S.2d 794, 795 (2012) (citing J.N.A. Realty Corp. v. Cross Bay Chelsea, Inc., 42 N.Y.2d 392, 394, 366 N.E.2d 1313, 1314, 397 N.Y.S.2d 958, 959 (1977)).
2. *See* 135 E. 57th St. LLC v. Daffy's Inc., 91 A.D.3d 1, 7, 934 N.Y.S.2d 112, 117 (1st Dep't 2011).
3. *See, e.g.*, Brendan Pierson, *Daffy's Wins Bid to Keep its Lease Despite Late Notice of Renewal*, 246 N.Y. L.J. 1 (2011); Andrea Lawrence, *Equity Intervenes to Salvage a Commercial Tenant's Untimely Exercise of an Option to Renew*, N.Y. Real Estate J. (Jan. 17, 2012), http://www.nyrej.com/52494; *see also* Adam Leitman Bailey, *Appellate Division Rules on Commercial Leasing: When Sympathy Trumps Contractual Rights*, The Cooperator, Jan. 2012, http://www.cooperator.com/articles/2376/1/Appellate-Division-Rules-on-Commercial-Leasing/Page1.html (discussing the decision in *Daffy's*).
4. *See Daffy's*, 91 A.D.3d at 6, 934 N.Y.S.2d at 117.
5. *See* Bailey, *supra* note 3.
6. 42 N.Y.2d 392, 394, 366 N.E.2d 1313, 397 N.Y.S.2d 958 (1977).
7. *See Baygold*, 19 N.Y.3d at 225, 970 N.E.2d at 830, 947 N.Y.S.2d at 795.
8. *See J. N. A. Realty Corp.*, 42 N.Y.2d at 399, 366 N.E.2d at 1317, 397 N.Y.S.2d at 962 (defining the general equitable principle through the words of Cardozo in that the "gravity of the fault must be compared to the gravity of the hardship").
9. *Baygold*, 19 N.Y. 3d at 228, 970 N.E.2d at 832, 947 N.Y.S.2d at 797.
10. *Id.* at 229, 970 N.E.2d at 833, 947 N.Y.S.2d at 798.
11. *Id.* (Smith, J., Dissenting) (stating that that majority made an arbitrary distinction when applying the rule from *J.N.A. Realty Corp.*).
12. *See Daffy's*, 91 A.D.3d at 3, 934 N.Y.S.2d at 114.
13. *See id.*
14. *Id.*
15. *Id.*
16. *Id.* at 4, 934 N.Y.S.2d at 115.
17. *Daffy's*, 91 A.D.3d at 5, 934 N.Y.S.2d at 116.
18. *Id.* at 6, 934 N.Y.S.2d at 116.
19. *Id.*
20. *Id.* at 6-7, 934 N.Y.S.2d at 117.
21. *See* Sy Jack Realty Co. v. Pergament Syosset Corp., 27 N.Y.2d 449, 452, 267 N.E.2d 462, 464, 318 N.Y.S.2d 720, 722 (1971) (holding that when the leasing party has a significant financial investment in the location and the lateness of the renewal notice was the result of an honest mistake and does not prejudice the landlord, equitable relief may be claimed); *see also* J.N.A. Realty Corp. v. Cross Bay Chelsea, Inc., 42 N.Y.2d 392, 399, 366 N.E.2d 1313, 1317, 397 N.Y.S.2d 958, 962 (1977) (arguing that equitable relief if not necessarily barred because of the leasee's neglect to perform).
22. *See Sy Jack Realty*, 27 N.Y.2d at 451, 267 N.E.2d at 463, 318 N.Y.S.2d at 721.
23. *Id.* at 452, 267 N.E.2d at 463, 318 N.Y.S.2d at 721.
24. *Id.* at 453, 267 N.E.2d at 464, 318 N.Y.S.2d at 722.
25. *Id.* at 456 n.1 (quoting 1 Samuel Williston, The Law of Contracts 249 (3rd ed. 1957)).
26. *See J.N.A. Realty Corp.*, 42 N.Y.2d at 398, 366 N.E.2d at 1316, 397 N.Y.S.2d at 961.
27. 254 N.Y. 1, 9-10, 171 N.E. 884, 887 (1930) (Cardozo, C.J., dissenting).
28. *J.N.A. Realty Corp.*, 42 N.Y.2d at 399, 366 N.E.2d at 1317, 397 N,Y.S.2d at 962 (quoting *Graf*, 254 N.Y. at 13, 171 N.E. at 888).
29. *Id.*
30. Zaid Theatre Corp. v. Sona Realty Co., 18 A.D.3d 352, 355, 797 N.Y.S.2d 434, 437 (1st Dep't 2005) ("Plaintiff has operated a movie theater at the premises for over 25 years, and its goodwill is a valuable right warranting equitable protection."); Nobu Next Door, LLC v. Fine Arts Housing, Inc., 3 A.D.3d 335, 335, 771 N.Y.S.2d 76, 77 (1st Dep't 2004) ("The goodwill of a business is a valuable right to which equitable protection extends.").
31. *See Daffy's*, 91 A.D.3d at 6, 934 N.Y.S.2d at 116.
32. 104 A.D.2d 745, 747, 480 N.Y.S.2d 217, 218 (1st Dep't 1984).
33. 192 A.D.2d 1049, 1050, 597 N.Y.S.2d 238, 239 (3d Dep't 1993).
34. *Id.* at 1050, 597 N.Y.S.2d at 239.
35. 136 A.D.2d 853, 855, 523 N.Y.S.2d 699, 701 (3d Dep't 1988).
36. *Id.*
37. *See Baygold*, 19 N.Y.3d at 227, 970 N.E.2d at 831, 947 N.Y.S.2d at 796.
38. *See id.* at 225-26, 970 N.E.2d at 830, 947 N.Y.S.2d at 795.
39. *See id.* at 226, 970 N.E.2d at 831, 947 N.Y.S.2d at 796.
40. *See id.* at 226-27, 970 N.E.2d at 831, 947 N.Y.S.2d at 796.
41. *See id.* at 227, 970 N.E.2d at 831, 947 N.Y.S.2d at 796.
42. *See Baygold*, 19 N.Y.3d at 227-28, 970 N.E.2d at 832, 947 N.Y.S.2d at 797.
43. *See id.* at 228, 970 N.E.2d at 832, 947 N.Y.S.2d at 797 (citing the limitations of the "narrow equitable doctrine").
44. *See id.* (explaining the purpose of the forfeiture rule).
45. *See id.* at 227-28, 970 N.E.2d at 832, 947 N.Y.S.2d at 797 (establishing the reasons why Baygold would not incur a "substantial loss").
46. *See id.* (citing *J.N.A. Realty Corp.*, 42 N.Y.2d at 399-400, 366 N.E.2d at 1317-18, 397 N.Y.S.2d at 962).
47. *See Baygold*, 19 N.Y.3d at 227-28, 970 N.E.2d at 832, 947 N.Y.S.2d at 797 (citing Popyork, LLC v. 80 Ct. St. Corp., 23 A.D.3d 538, 538, 806 N.Y.S.2d 606, 607 (2d Dep't 2005)).

48. *See id*.

49. *See id.* at 227-28, 970 N.E.2d at 832, 947 N.Y.S.2d at 797 (citing Bench 'N' Gavel Rest., Ltd. v. Time Equities, Inc., 169 A.D.2d 755, 756, 565 N.Y.S.2d 121, 123 (2d Dep't 1991).

50. *Id*.

51. *Id*.

52. In fact, the majority in *Baygold* seemed to leave the door open for other courts to consider an argument such as "deferment" of rent payments, as deemed appropriate in those individual cases. *See Baygold*, 19 N.Y.3d at 229, 970 N.E.2d at 832-33, 947 N.Y.S.2d at 798-99.

53. *See id.*

54. *See id.* at 229-30, 970 N.E.2d at 833, 947 N.Y.S.2d at 798.

55. *Id.* at 229, 970 N.E.2d at 833, 947 N.Y.S.2d at 798.

56. *Daffy's*, 91 A.D.3d at 4, 934 N.Y.S.2d at 115.

57. *See, e.g., J.N.A. Realty Corp.*, 42 N.Y.2d at 400, 366 N.E.2d at 1318, 397 N.Y.S.2d at 962; *Sy Jack Realty Co.*, 27 N.Y.2d at 452, 267 N.E.2d at 463-64, 318 N.Y.S.2d at 721 (noting that the landlord "had actually received notice before it took any steps to find another tenant or to lease the space"); Beltrone v. Danker, 228 A.D.2d 763, 764, 643 N.Y.S.2d 720, 721 (3d Dep't 1996) ("[O]f greater significance, is the fact that defendants have made no showing that they have a prospective tenant or that they were otherwise prejudiced as a result of plaintiffs' two-month delay in giving notice."); Dan's Supreme Supermarkets, Inc. v. Redmont Realty Co., 216 A.D.2d 512, 512-13, 628 N.Y.S.2d 790, 791 (2d Dep't 1995) (where tenant waited nine months after the deadline had passed before attempting to exercise its option, and the landlord "introduced evidence establishing that it has been negotiating with another large supermarket chain," the tenant was not entitled to enjoin the landlord from leasing the premises to another supermarket).

58. *Sy Jack Realty Co.*, 27 N.Y.2d at 452, 267 N.E.2d at 463, 318 N.Y.S.2d at 721.

59. *J.N.A. Realty Corp.*, 42 N.Y.2d at 396, 366 N.E.2d 1315-16, 397 N.Y.S.2d at 960.

60. *Dan's Supreme Supermarkets, Inc.*, 216 A.D.2d at 512-13, 628 N.Y.S.2d at 791.

61. *See, e.g., Daffy's*, 91 A.D.3d at 4, 934 N.Y.S.2d at 115 (1st Dep't 2011) (four-day delay); *Beltrone*, 228 A.D.2d at 764, 643 N.Y.S.2d at 721 (two-month delay).

62. *J.N.A. Realty Corp.*, 42 N.Y.2d at 395-96, 366 N.E.2d at 1315, 397 N.Y.S.2d at 960.

63. *Id.* at 396, 366 N.E.2d at 1315, 397 N.Y.S.2d at 960.

64. *See id.*; *see also Sy Jack Realty Co.*, 27 N.Y.2d at 451, 267 N.E.2d at 463, 318 N.Y.S.2d at 721(finding that after the March 31, 1969 deadline had passed, "the [landlord] took no action whatsoever until [May 5, 1969]").

65. *Daffy's*, 91 A.D.3d at 4, 934 N.Y.S.2d at 115.

66. *See id.* at 6-7, 934 N.Y.S.2d at 117 (concluding that the landlord failed to prove any prejudice as a result of the breach).

67. *Daffy's*, 91 A.D.3d at 3, 934 N.Y.S.2d at 114.

68. *Id.* (noting that Daffy's responded to the landlord's rejection by submitting a renewal letter "in the manner prescribed by the lease").

69. *See Baygold*, 19 N.Y.3d at 227, 970 N.E.2d at 831-32, 947 N.Y.S.2d at 796-97.

70. *See id.* at 226, 970 N.E.2d at 830, 947 N.Y.S.2d at 795.

71. *Id.* at 229, 970 N.E.2d at 833, 947 N.Y.S.2d at 798 (citing *J.N.A. Realty Corp.*, 42 N.Y.2d at 400, 366 N.E.2d at 1318, 397 N.Y.S.2d at 962).

72. *J.N.A. Realty Corp.*, 42 N.Y.2d at 399, 366 N.E.2d at 1317, 397 N.Y.S. at 962.

73. *See Daffy's*, 91 A.D.3d at 6, 934 N.Y.S.2d at 116-17.

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Land Banking in New York Begins—How Our Towns and Cities Are Using the New York Land Bank Act to Fight Blight and Encourage Renewal

By Erica F. Buckley, Benjamin P. Flavin, and Lewis A. Polishook

Introduction

Last July, New York became the most recent state to pass land bank legislation. With the passage of Article 16 of the Not-for-Profit Corporation Law, also known as the New York Land Bank Act, New York joined 11 other states that permit the formation of land banks to combat property blight and the effects of the mortgage foreclosure crisis. Although land banks are not new, they have received growing recognition as a vehicle to assist in ameliorating the current foreclosure crisis. On May 17, 2012, New York State Urban Development Corporation d/b/a Empire State Development ("ESD") approved five applications to establish New York's first land banks throughout the state. This article provides an overview of the New York Land Bank Act and examines how the five New York jurisdictions chosen to pioneer this new redevelopment tool intend to use it to combat the ongoing property crisis in New York State. In brief, each of the jurisdictions that will start a land bank faces distinct challenges. Despite these differences, the five applications show that, if properly implemented, land banks can be used to remedy the ill effects of the foreclosure crisis by planning not only for the revitalization of fallow properties, but also for the creation of affordable housing and necessary services to communities including green spaces, retail, commercial, and industrial areas.[1]

Background of the New York Land Bank Act

Broadly speaking, a land bank is a quasi public-private organization created to take, manage or develop distressed property.[2] New York's Land Bank Act allows cities, counties, towns and villages to partner with school districts and the private sector to take control of vacant, abandoned or tax-delinquent properties. New York Not-for-Profit Corporation Law ("N-PCL") § 1601 states: "Land banks are one of the tools that can be utilized by communities to facilitate the return of vacant, abandoned, and tax-delinquent properties to productive use."[3] Land banks are not a new concept in the United States; they have been used successfully by state and local governments to reclaim tax-foreclosed and abandoned properties for over 40 years.[4] Eleven other states have enacted land bank enabling legislation.[5] In 2008, the New York State Legislature first passed legislation authorizing the creation of up to three land banks.[6] Governor Paterson vetoed the bill because the legislation provided no mechanism to fund the creation and operation of the land banks, and given the State's current financial condition, recommended that the program be negotiated during the budgeting process.[7] Land bank legislation was reintroduced in the 2009 session but did not pass.[8]

The New York Land Bank Act

On July 29, 2011, on the third Legislative try, Governor Cuomo signed the Land Bank Act into law.[9] The Legislature's findings, codified in the statute itself, state that, "[t]here exists a crisis in many cities and their metro areas caused by disinvestment in real property and resulting in a significant amount of vacant and abandoned property."[10] The sponsors of the Land Bank Act relied heavily upon statistics compiled by the Cornell Cooperative Extension Erie County Chapter that detail the state of fallow property in the City of Buffalo as a justification for land bank legislation in New York.[11]

The Act cites several impediments to resolution of this "crisis," including, "multiple taxing jurisdictions lacking common policies, ineffective property inspection, code enforcement and property rehabilitation support, lengthy and/or inadequate foreclosure proceedings and lack of coordination and resources to support economic revitalization."[12]

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New York's Land Bank Act allows cities, counties, towns and villages to partner with school districts and the private sector to take control of vacant, abandoned or tax-delinquent properties. The statute itself states that: "Land banks are one of the tools that can be utilized by communities to facilitate the return of vacant, abandoned, and tax-delinquent properties to productive use."[13] The Legislature envisions that N-PCL Article 16 will help "strengthen and revitalize the economy of the state and its local units of government by solving the problems of vacant and abandoned property in a coordinated manner and to foster the development of such property and promote economic growth."[14]

Under the Land Bank Act, cities, counties, towns and villages that wish to create land banks must adopt a local law, ordinance, or resolution to enable a land bank to take properties by foreclosure proceedings.[15] Two or more governmental units may form a lank bank together through the use of an intergovernmental cooperation

agreement.[16] School districts are also permitted to participate in the formation of a land bank.[17]

Land banks are formed as type C not-for-profit corporations and are governed by a board of directors comprised of members from the public and private sector, the exact composition to be determined at the creation of the land bank. Type C not-for-profits are not-for-profit corporations that may be formed for any lawful business purpose to achieve a lawful public or quasi-public objective.[18]

Land banks in New York are eligible to receive grants and loans from federal, state, and local governmental bodies and from other private sources.[19] Lank banks are also authorized to issue bonds for any of their corporate purposes.[20] New York land banks may acquire real property through foreclosure proceedings, by purchase contracts, lease purchase agreements, installment sales contracts, land contracts, and may accept transfers from municipalities upon such terms and conditions as agreed to by the land bank.[21] As cities, counties, towns and villages address mass foreclosures and abandonment, land banks will be able to own, manage, and finance the development of foreclosed properties.

The Land Bank Act highlights some possible uses for acquired properties. N-PCL § 1609(e) suggests potential uses such as purely public spaces and places, *e.g.,* parks, playgrounds, community areas, affordable housing, retail, commercial and industrial activities, as well as wildlife conservation areas.

The Five New Land Banks

Pursuant to § 1603(g) of the Land Bank Act, the creation of a land bank is conditioned on the approval of ESD.[22] The Land Bank Act authorizes the creation of no more than ten land banks in New York.[23] On May 17, 2012, ESD approved the following five (out of seven) applications it received to create land banks: the Cities of Buffalo, Lackawana, and Tonawanda, with Erie County ("Erie"); the City of Syracuse and Onondaga County ("Syracuse"); the Cities of Schenectady and Amsterdam and Schenectady County ("Schenectady"); Chautauqua County; and the City of Newburgh (collectively, the "Applications").[24] Although each of the Applications emphasizes different needs and aims, they share many common elements. The following sections compare and contrast the problems to be addressed via land banking, the advantages each jurisdiction perceives it will gain from the use of land banks, the means of acquisition and disposition of properties, and the types of properties to be acquired and disposed of.

Problems the Applicants Face

Somewhat surprisingly, the five Applicants do not heavily emphasize the economic downturn and mortgage foreclosure crisis as the main problems to be addressed through the creation of land banks. Rather, the Applications show striking similarities in the long-term challenges they hope to address through the creation of land banks. Most of the successful Applicants cited high vacancy rates as a primary concern to be addressed via land banking[25] and provide detailed statistics as to vacancy rates.[26] Likewise, many jurisdictions identified declining populations and loss of industrial bases as contributing heavily to tax foreclosures and vacant and abandoned properties.[27] The Applicants also focused heavily on urban blight resulting from the presence of large numbers of vacant and abandoned properties.[28] One result of these conditions is that "'[p]otential homeowners will not locate to these neighborhoods."[29]

Another factor identified by several Applicants is that they have the wrong type of housing, either by virtue of age[30] or population density.[31] Several jurisdictions also identified urban sprawl as being a major factor in the increase of vacant and abandoned properties.[32] Applicants also referenced excessive poverty rates as contributing factors to their problems with vacant and abandoned property.[33]

Finally, several Applicants clearly stated that the current system of tax foreclosures was inadequate to address the problem of vacant, abandoned, and tax-delinquent properties, because such auctions attract "speculative investment by out of town investors who purchase properties at the County's foreclosure auctions with the sole purpose of extracting any value remaining in the properties."[34] On the other hand, hard-strapped Applicants cannot simply forgo tax revenues from auctions[35] and allow tax liens to mount, as increasing tax liens deter further development.[36]

Perceived Advantages of Land Banking

The Applications evidence far more diversity in the perceived advantages of land banking, but, nevertheless, several common themes are evident. Several jurisdictions suggested that land banks would give jurisdictions the ability to "collaborat[e] with a wide variety of stakeholders" in attacking the problems of vacant, abandoned, and tax-delinquent property.[37] Relatedly, Applicants see land banking as a means to achieve neighborhood stabilization and revitalization.[38] Revitalization is not just a function of returning properties to productive use. Revitalization through land banking can also result in fewer code violations and "will allow the municipalities to reallocate existing revenues and resources from blight removal to maintenance and development activities."[39]

The jurisdictions also anticipate that land banks will be able to succeed where traditional tax foreclosure processes have failed in restoring properties to tax-paying status, thereby increasing real estate tax revenue.[40] Another advantage of land banking identified by multiple Applicants is that they will provide greater opportunity for planned development over larger parcels.[41]

The Applicants also recognize that traditional redevelopment and tax foreclosure tools will not result in the development of the right kind of housing for their communities.[42] Intriguingly, one of the jurisdictions, Schenectady, cites an *increase* in the demand for housing as a development to be served by land banking.[43] Thus, adjusting the housing stock to the demand for housing—a goal of all Applicants—can mean either reducing the number of units, replacing older housing with newer homes, or even moving toward denser development.

The two successful urban Western New York Applicants—Erie County and Syracuse/Onondaga County—both share several common aims, namely, using land banks to preserve historic structures,[44] while ensuring that development be handled by "responsible" developers, rather than speculators that would merely extract remaining value and then again abandon the properties.[45]

Finally, several Applications highlighted the fact that land banks can make more efficient use of government powers, either by development of "skills, knowledge and best practices through" inter-governmental collaboration[46] or by bringing together and augmenting existing governmental powers.[47]

Acquisition and Disposition of Property by Land Banks

Means of Acquisition

Not surprisingly, most jurisdictions anticipate acquiring properties through the tax foreclosure process[48] or by purchasing tax liens.[49] Several Applicants anticipate acquiring property directly from FGUs.[50] However, most jurisdictions indicated that property would also be acquired by various other means, such as donations and acquisition from developers.[51] The latter path reflects the added flexibility provided by the Land Bank Act.

Properties to Be Acquired

Reflecting the divergent economic conditions and housing mix in each jurisdiction, the Applications each demonstrate different visions of the properties to be acquired. Chautauqua County Land Bank Corp. ("CCLBC") anticipates acquiring small numbers of residential properties, but gradually expanding the number of properties to be acquired, the geographic ambit of acquisitions, and the type of properties to be acquired.[52] In keeping with its relatively modest aims, Chautauqua County anticipates that "[t]he inventory of properties acquired by the CCLBC to be 'banked' for future consideration would be kept to a minimum."[53] A "majority of the…residential properties" to be acquired will be "in the Cities of Jamestown and Dunkirk" and "on or near the Main Streets of our rural communities."[54] In addition to these considerations, the CCLBC will attempt to design its inventory of acquired properties to balance "properties [that] would have the greatest impact when improved or removed" against the need for the CCLBC to generate revenue for itself.[55]

Perhaps because the Capital Region is facing growth as well as decline,[56] Schenectady appears to be taking a diametrically opposite approach. Its Application anticipates that the land bank's "inventory will mirror the available properties: Single Family: 17.5%; Two-Family: 29.5%; Residential (3 or more units): 7%; Vacant Lots: 36%; and Commercial/Mixed Use: 10%."[57] That inventory will consist in no small part of stalled privately owned development projects.[58]

As in Chautauqua County, Newburgh anticipates that its land bank will be acquiring "single family homes, multi-family homes, vacant lots and commercial properties… in targeted areas initially in order to facilitate change on a block by block basis, utilizing best practices from other Land Bank organizations throughout the country."[59] Similarly, Erie County's Application contemplates that the land bank itself will create programs and priorities that will in turn dictate the properties to be acquired to further those programs.[60] However, Erie County's land bank will also focus its attention on identifying '[p]roperties…that ha[ve] marketable value and could provide needed revenue to the land bank and/or required limited capital investment and ongoing costs to the land bank."[61]

Syracuse's Application (along with Erie County's Application) emphasizes the role the land bank will play in acquiring historic properties,[62] but also states that "a significant amount of properties acquired by the land bank will be vacant lots."[63] The land bank also appears to anticipate acquiring occupied rental properties that have the potential to become "lease to own" properties.[64]

Disposition of Properties

Broadly speaking, all Applicants anticipate similar uses of properties on sale by their land banks. The Applicants recognized that many buildings will simply need to be demolished.[65] After demolition, several jurisdictions intend to further the "installation of green infrastructure" such as parks or other green or open spaces.[66] Alternatively, vacant lots or newly demolished lots may be sold to existing neighbors as "side lots."[67] Another, more obvious use of properties sold is rehabilitation and return of the property to owner-occupancy.[68] Several Applicants—most notably, Schenectady and Syracuse—emphasized strategic and long-term planning, in various forms, as a use of property on disposition.

Schenectady envisions the creation of residential, commercial and mixed-use development sites from acquired properties and the reinvigoration of existing private development projects.[69] Similarly, Syracuse envisions rehabilitation of properties in geographically targeted areas where multi-property neighborhood

revitalization plans can be carried out in partnership with both non-profit and for-profit developers.[70] Interestingly, Syracuse also cites obtaining preservation tax credits and prioritized code enforcement as efforts that will coincide with property acquisition and disposition.[71] More generally, Syracuse envisions property disposition as following a period of land assembly, for strategic development.[72] Finally, Erie, Schenectady, and Syracuse envision their land banks as means of creating affordable housing via the disposition of land bank-acquired properties.[73]

"Only time will tell if land banks will be able to successfully assist New York in combating the ever-growing number of fallow properties and the devastating effects of the mortgage foreclosure crisis."

Conclusion

Only time will tell if land banks will be able to successfully assist New York in combating the ever-growing number of fallow properties and the devastating effects of the mortgage foreclosure crisis. The Land Bank Act provides the necessary tools to enable jurisdictions to work together to develop strategic plans to address blight while giving numerous incentives to communities such as the demolition of vacant and distressed properties, preservation and revitalization of historic structures, and the creation of affordable housing. Because land banks are growing in popularity and are viewed as a preferred tool in addressing the foreclosure crisis, jurisdictions that choose to establish land banks will be in a better position to take advantage of federal and state funding opportunities. Based upon a close look at the initial five proposals approved by ESD, the jurisdictions that have chosen to create land banks have set forth aggressive and innovative proposals to combat blight while promoting revitalization. If the five jurisdictions are successful in accomplishing their goals, New York will be a stronger state both economically and socially.

Endnotes

1. N.Y. Not-for-Profit Corp. Law § 1609(e) (McKinney 2012).
2. *See* Frank S. Alexander, Land Bank Authorities (Local Initiatives Support Corp. Aug. 2005), available at http://www.hud.gov/offices/cpd/about/conplan/foreclosure/pdf/lbauthguide.pdf (defining land banks as "public authorities created to efficiently acquire, hold, manage, and develop tax-foreclosed property;" "[a] land bank is a governmental entity that focuses on the conversion of vacant, abandoned, and tax-delinquent properties into productive use); Federal Reserve Bank White Paper, available at http://federalreserve.gov/publications/other-reports/files/housing-white-paper-20120104.pdf, at 14 (defining land banks as "government entities that have the ability to purchase and sell real estate, clear titles, and accept donated properties" for "rehabilitat[ion] as rental or owner-occupied housing, or demolition").
3. Not-for-Profit Corp. § 1601.
4. The St. Louis Land Reutilization Authority was established by legislation in 1971, and has been characterized as the first significant United States land bank. Mo. Rev. Stat. §§ 92.700 - 92-920 (2012); *see* Stuart Pratt, *A Proposal for Land Bank Legislation in North Carolina*, 89 N.C. L. Rev. 568, 575 (2011).
5. *See* Mo. Rev. Stat. §§ 92.700–92.920; Ohio Rev. Code Ann. §§ 5722.01–5722.22 (West 2012); Ky. Rev. Stat. Ann. §§ 65.350–65.375 (West 2012); Ga. Code Ann. §§ 48-4-60–48-4-65 (West 2012); Mich. Comp. Laws §§ 124.751–124.774 (2012); Tex. Loc. Gov't Code Ann. §§ 379E.001–379E.013 (Vernon 2012); Kan. Stat. Ann. §§ 12-5901–12-5911 (2012); Ala. Code §§24-9-1–24-9-9 (2012). Connecticut has passed statutes establishing a fund for community land banks. *See* Conn. Gen. Stat. §§ 8-213-b–8-214-e (2012). Cities in various jurisdictions, including Arkansas and Indiana, seem to have established land banks without state-wide enabling legislation. *See* Little Rock Land Bank Commission, available at http://littlerock.org/citydepartments/housing_programs/landbankcommission; Arkansas Land Bank Commission, available at http://www.arkcity.org/index.aspx?NID=1054; Indianapolis Land Bank, available at http://www.indylandbank.com/about.shtml; Charter of Baltimore City, available at http://www.baltimorecity.gov/Portals/0/Charter%20and%20Codes/ChrtrPLL/01%20-%20Charter.pdf.
6. Assemb. B. 8059, 2008 Gen. Assemb., 1st Sess. (N.Y. 2008); see also Comm. on Local Gov'ts, 2008 Annual Report, Assemb. 231-2008, 1st Sess., at 11 (N.Y. 2008), available at http:// assembly.state.ny.us/comm/LocalGov/2008Annual/ (discussing the background and intent of the legislation).
7. Veto of Gov. David Paterson (Sept. 25, 2008), available at http://image.iarchives.nysed.gov/images/images/146903.pdf.
8. Assemb. B. 700A, 2009 Gen. Assemb., 1st Sess. (N.Y. 2009); Sen. B. 4281-A, 2009 Gen. Assemb., 1st Sess. (N.Y. 2009); Assemb. B. 6118, 2009 Gen. Assemb., 1st Sess. (N.Y. 2009).
9. Ch. 257, § 1, 2011 N.Y. Laws, LEXIS 1.
10. Not-for-Profit Corp. § 1601.
11. *Id.* ("For example, Cornell Cooperative Extension Association of Erie county estimates that the city of Buffalo has thirteen thousand vacant parcels, four thousand vacant structures and an estimated twenty-two thousand two hundred ninety vacant residential units. This condition of vacant and abandoned property represents lost revenue to local governments and large costs ranging from demolition, effects of safety hazards and spreading deterioration of neighborhoods including resulting mortgage foreclosures.").
12. *Id.*
13. *Id.*
14. *Id.*
15. Not-for-Profit Corp. § 1603(a).
16. *Id.* § 1603(b).
17. *Id.* § 1603(e).
18. *Id.* § 201(b).
19. *Id.* § 1610(a).
20. Not-for-Profit Corp. § 1611(a).
21. *Id.* §§ 1608, 1608(c).
22. *Id.* § 1603(g).
23. *Id.*
24. Press Release, *Governor Cuomo Announces Five Municipalities Approved to Create Land Banks* (May 17, 2012), http://www.governor.ny.gov/press/05172012-Five-Municipalities-Approved-Create-Land-Banks.
25. *See* Chautauqua County Application, N.Y. State Land Bank Program, 17–18 (Empire State Development, Mar. 29, 2012) [hereinafter Chautauqua Application] ("As of the 2010 Census, 12,676 (18.9%) of the County's 66,920 housing units were vacant, which is a 2.9% increase since the year 2000." In Jamestown, more than one in ten housing units was vacant. This is a large

vacancy rate (almost double the state average) for a rural region considering the New York State vacancy rate of 9.7%, according to the 2010 Census."); ERIE COUNTY APPLICATION, N.Y. State Land Bank Program, A-5 (Empire State Development, Mar. 30, 2012) [hereinafter ERIE APPLICATION] ("Vacant and abandoned properties are a growing problem in Erie County and the City of Buffalo."); CITY OF SCHENECTADY APPLICATION, N.Y. State Land Bank Program, 6-7 (Empire State Development, Mar. 29, 2012) [hereinafter SCHENECTADY APPLICATION] ("Schenectady has over 860 vacant buildings representing over 1500 units. The municipal inventory is 31 vacant buildings and 108 lots; 767 additional vacant buildings. Amsterdam has 45 vacant buildings and 39 vacant lots in municipal inventory.").

26. *See* CHAUTAUQUA APPLICATION, *supra* note 25; ERIE APPLICATION, *supra* note 25, SCHENECTADY APPLICATION, *supra* note 25; CITY OF SYRACUSE AND COUNTY OF ONONDAGA APPLICATION, N.Y. State Land Bank Program, 4–6 [hereinafter SYRACUSE ONONDAGA APPLICATION].

27. *See* CHAUTAUQUA APPLICATION, *supra* note 25 (showing that the population of Chautauqua County was 147,305 in the 1970s, 134,789 in 2010, which itself represents a 3.5% decline from 2000); *see also* SCHENECTADY APPLICATION, *supra* note 25, at 6 ("[J]urisdictions involved have substantial numbers of vacant and abandoned properties due to long-term urban decline caused by the relocation of large employers… Schenectady has over 860 vacant buildings, representing over 1,500 vacant units, excluding vacant units in partially habited structures."); ERIE APPLICATION, *supra* note 25 (describing "substantial population decline in the City of Buffalo and older, inner-ring suburbs"). However, as discussed below, Schenectady is unusual in that the Capital Region is both losing and gaining employers simultaneously.

28. *See* CHAUTAUQUA APPLICATION, *supra* note 25, at 17 ("13.4% of housing units are in 'fair' (with signs of excess deterioration for its age) or 'poor' (obvious signs of excess deterioration) condition."); *see also* ERIE APPLICATION, *supra* note 25 (properties are unmarketable because of "advanced deterioration and weak market conditions" and the large amounts of unpaid taxes due); CITY OF NEWBURGH APPLICATION, N.Y. State Land Bank Program, 6 (Empire State Development, Mar. 26, 2012) [hereinafter NEWBURGH APPLICATION] ("[a] significant portion of the properties throughout the city are abandoned and derelict," conditions that increase fire risk and depress the values of neighboring properties); SCHENECTADY APPLICATION, *supra* note 25 ("Demolish, identify and remove blighting influences such as condemned, burned and otherwise unsalvageable houses, abandoned cars, trash and debris"); *id.* at 7 ("Houses are packed closely together…[p]overty rates are high, property values are low and public service response is frequent.").

29. SCHENECTADY APPLICATION, *supra* note 25.

30. *See* SCHENECTADY APPLICATION, *supra* note 25, at 17 ("In both the 1990 and 2000 Census, the average age of the housing stock in Chautauqua County was the oldest of any Metropolitan Statistical Area (MSA) in the nation. At the 2010 Census, 47.3% of housing units were built in 1939 or earlier. Only 10.1% of housing units were built since 1990."); *see also* SYRACUSE ONONDAGA APPLICATION, *supra* note 26, at 10–11 (the median year of housing construction in Syracuse is 1939, older in the hardest-hit areas).

31. *See* SCHENECTADY APPLICATION, *supra* note 25, at 7-8 (recommending that 25% of the housing stock acquired be demolished because there are too many two-family houses and too few multiple dwellings).

32. *See* ERIE APPLICATION, *supra* note 25 ("The Buffalo-Niagara region experienced significant suburban sprawl between 1950 and 2010, resulting in substantial population decline in the City of Buffalo and older, inner-ring suburbs…."); *see also* SYRACUSE ONONDAGA APPLICATION, *supra* note 26, at 10 ("The county has experienced one of the highest rates of suburban sprawl in the nation since the 1950s and has suffered significant disinvestment and high rates of property abandonment in the urban core and inner-ring suburbs as a result.").

33. *See* CHAUTAUQUA APPLICATION, *supra* note 25, at 18 (poverty rates that exceed state-wide totals by several percentage points "ha[ve] depressed values of homes in Chautauqua County and limited the potential return on investment for most needed improvements."); *see also* NEWBURGH APPLICATION, *supra* note 28, at 8 ("The demographics of the City illustrate the aforementioned challenges (2010 US Census [B]ureau numbers), 25.8% at or below the poverty line as opposed to 14.2% for New York State, median household income of $36,153 as opposed to $55,603 for New York State, homeownership rate 34.9% as opposed to 55.2% for New York State, and high population density per square mile, 7,588.3 as opposed to 411.2 for New York State."); SYRACUSE ONONDAGA APPLICATION, *supra* note 26, at 5 ("Syracuse has consistently ranked among the worst metropolitan areas in the U.S. for concentrated poverty rates (an indicator that worsened, regionally, by 8.3% between 2000 and 2009)").

34. CHAUTAUQUA APPLICATION, *supra* note 25, at 18; *see also* SYRACUSE ONONDAGA APPLICATION, *supra* note 26, at 2 (sale of properties at tax auctions leads to irresponsible speculation); CHAUTAUQUA APPLICATION, *supra* note 25, at 6 ("The tax foreclosure auction affords foreclosing governmental units (FGUs) little control over the fate of properties, which has led to further deterioration and disinvestment.").

35. The City of Syracuse has in fact discontinued tax foreclosure auctions, thereby reducing speculation at the obvious price of loss of tax revenues. *See* SYRACUSE ONONDAGA APPLICATION, *supra* note 26, at 2.

36. *See* ERIE APPLICATION, *supra* note 25, at A-5–A-6 (interestingly, Erie County makes towns whole for unpaid property taxes on an annual basis, thereby further depleting County-wide resources).

37. CHAUTAUQUA APPLICATION, *supra* note 25, at 14; *see* NEWBURGH APPLICATION, *supra* note 28, at 7 ("NCLB will partner with Habitat for Humanity of Greater Newburgh on a builders blitz to demolish and rebuild two homes as part of a five day builders blitz scheduled for June"); *see also* SCHENECTADY APPLICATION, *supra* note 25, at 12 ("Properties that will require significant investment (greater than 50% of the after rehabilitated Fair Market Value) will be packaged in groups and sold to public, private, and non-profit housing developers."); SYRACUSE ONONDAGA APPLICATION, *supra* note 26, at 2 ("a not-for-profit approach to property redevelopment is needed to positively impact the real estate market in neighborhoods where private development is lacking, but are nevertheless critical to long-term economic growth of this region").

38. *See* ERIE APPLICATION, *supra* note 25, at A-6 (land bank can provide "[n]eighborhood stabilization through the acquisition of destabilizing property for rehabilitation or demolition"); *see also id.* at A-8 (vacant and abandoned properties "will no longer deter people and businesses considering locating and investing in… blighted areas"); NEWBURGH APPLICATION, *supra* note 28, at 6 (the land bank will help "facilitate the transition back to a thriving community"); SYRACUSE ONONDAGA APPLICATION, *supra* note 26, at 3 ("Investments in property maintenance by the land bank will have a positive impact on surrounding property values, discourage widespread neglect, and slow the spread of property abandonment.").

39. ERIE APPLICATION, *supra* note 25, at A-8; *see* SYRACUSE ONONDAGA APPLICATION, *supra* note 26, at 5.

40. *See* ERIE APPLICATION, *supra* note 25, at A-4 (identifying as goal of land bank "[r]eturn property to productive tax-paying status"); NEWBURGH APPLICATION, *supra* note 28, at 6 ("NCLB will seek to restore properties to at least a value of $145,000, therefore, assuming Newburgh's tax rate of $16.00 per $1,000 of assessed value, the direct economic impact is $600,000 in three years.") ("services and supports that have been

cut because of the eroding tax base (see above) need to be restored"); SYRACUSE ONONDAGA APPLICATION, *supra* note 26, at 5 (identifying increased tax collection as a goal of the land bank).

41. *See* ERIE APPLICATION, *supra* note 25, at A-4 (identifying as advantages of land bank the ability to "[s]trategically assemble and bank land for economic development"); SCHENECTADY APPLICATION, *supra* note 25, at 12 ("The Land Bank will assemble large parcels and offer them to private public and non-profit housing developers via an RFP process to attract large-scale community reinvestment projects."); SYRACUSE ONONDAGA APPLICATION, *supra* note 26, at 2 (land bank may in consultation with local planning authorities "assemble large parcels" for later development; land bank can hold properties for longer-term development).

42. *See* CHAUTAUQUA APPLICATION, *supra* note 25, at 13-14 (land bank will "adjust the County's housing supply to meet current demands" and "right-size the available supply with the identified demand"); NEWBURGH APPLICATION, *supra* note 28, at Attachment 5 (land bank can "[t]arget regional growth in urban centers, whose compact, mixed-used development pattern creates an opportunity for growth that is sustainable, cost-effective, energy- and natural-resource conserving, climate-friendly, affordable, and attractive to young workers"); SYRACUSE ONONDAGA APPLICATION, *supra* note 26, at 11 (land bank can unleash potential of older "areas" that "have some of the most historic character in the region and…retain development patterns that include dense residential neighborhoods surrounding a mixed-use or commercial corridor," that "hold vast untapped economic development potential").

43. SCHENECTADY APPLICATION, *supra* note 25, at 8 ("The Capital Region is in a housing growth mode. With the developments at GE, Global Foundries and SUNY's College of Nanoscale Science and Engineering (CNSE) we see the Cities and Capital Region needing to be positioned for safe, decent housing for employees.").

44. *See* ERIE APPLICATION, *supra* note 25, at A-6 (identifying as advantage of land bank its ability to "[a]cquir[e] structures for historic preservation"); SYRACUSE ONONDAGA APPLICATION, *supra* note 26, at 10 (land bank can acquire "high-profile, vacant properties" that are "prime candidates for federal and state historic preservation tax credits").

45. ERIE APPLICATION, *supra* note 25, at A-4 (the land bank will allow for "quicker turnover of vacant and abandoned properties to responsible owners"); SYRACUSE ONONDAGA APPLICATION, *supra* note 26, at 1 (land bank can "[e]nsure that properties are redeveloped in a responsible manner, by qualified developers, for purposes that benefit the surrounding community").

46. ERIE APPLICATION, *supra* note 25, at A-6.

47. SCHENECTADY APPLICATION, *supra* note 25, at 6.

48. *See* CHAUTAUQUA APPLICATION, *supra* note 25, at 7; ERIE APPLICATION, *supra* note 25, at A-9, A-10; NEWBURGH APPLICATION, *supra* note 28, at 17. Interestingly, part of the plan of Chautauqua County is to acquire certain properties before tax auction, and certain other properties post-tax auction. *See* CHAUTAUQUA APPLICATION, *supra* note 25, at 6. In another variation, Erie County anticipates instituting a request for foreclosure process so that FGUs may have some say as to the specific tax-liens to be acquired.

49. SYRACUSE ONONDAGA APPLICATION, *supra* note 26, at 9, 11.

50. *See* NEWBURGH APPLICATION, *supra* note 28, at 7; SCHENECTADY APPLICATION, *supra* note 25, at 7; SYRACUSE ONONDAGA APPLICATION, *supra* note 26, at 9.

51. *See* NEWBURGH APPLICATION, *supra* note 28, at 5 (describing collaboration with community stakeholders, developers, and government agencies in acquisition of property); SCHENECTADY APPLICATION, *supra* note 25, at 8 (describing plans to work with private owners struggling to complete projects); SYRACUSE ONONDAGA APPLICATION, *supra* note 26, at 11 (describing acquisition of property via foundations and via gift).

52. *See* CHAUTAUQUA APPLICATION, *supra* note 25, at 6, 8.

53. *See id.* at 8.

54. *Id.*

55. *Id.*

56. *See* SCHENECTADY APPLICATION, *supra* note 25, at 8 ("The Capital Region is in a housing growth mode...Schenectady and Schoharie Counties are facing issues with numerous homes abandoned.").

57. *Id.*

58. *Id.* ("The City is in discussions now with the owner through mortgage foreclosure of a 50-lot subdivision.").

59. *See* NEWBURGH APPLICATION, *supra* note 28, at 8.

60. *See* ERIE APPLICATION, *supra* note 25, at A-6 ("[T]he list of properties includes various property types with different problems and potential based on what are expected to be specific programs within the land bank.").

61. *Id.*

62. *Id.*

63. *See* SYRACUSE ONONDAGA APPLICATION, *supra* note 26, at 9.

64. *Id.*

65. *See* CHAUTAUQUA APPLICATION, *supra* note 25, at 13; NEWBURGH APPLICATION, *supra* note 28, at 7; City of SCHENECTADY APPLICATION, *supra* note 25, at 8; SYRACUSE ONONDAGA APPLICATION, *supra* note 26, at 10.

66. *See* SYRACUSE ONONDAGA APPLICATION, *supra* note 26, at 5 (referencing "alternative" uses for vacant land); ERIE APPLICATION, *supra* note 25, at A-10; SCHENECTADY APPLICATION, *supra* note 25, at 8.

67. ERIE APPLICATION, *supra* note 25, at A-10.

68. *See* ERIE APPLICATION, *supra* note 25, at A-4, A-10; NEWBURGH APPLICATION, *supra* note 28, at 8; SCHENECTADY APPLICATION, *supra* note 25, at 8; SYRACUSE ONONDAGA APPLICATION, *supra* note 26, at 10.

69. SCHENECTADY APPLICATION, *supra* note 25, at 6.

70. SYRACUSE ONONDAGA APPLICATION, *supra* note 26, at 10.

71. *See* SYRACUSE ONONDAGA APPLICATION, *supra* note 26, at 5, 10; *see* ERIE APPLICATION, *supra* note 25, at A-6 (discussing preservation).

72. SYRACUSE ONONDAGA APPLICATION, *supra* note 26, at 2.

73. *See* ERIE APPLICATION, *supra* note 25, at A-4 ("[i]ncrease homeownership and affordable housing opportunities"); SCHENECTADY APPLICATION, *supra* note 25, at 8 (discussing goal of creating affordable rentals and home ownership); SYRACUSE ONONDAGA APPLICATION, *supra* note 26, at 10 (upon disposition, obtain "low-income housing tax credits").

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Commentary to Owner's Rider to Standard Form of Agreement Between Owner and Contractor (AIA Document A107—2007)

Prepared by the Real Estate Construction Law Committee of the Real Property Law Section of the New York State Bar Association

Introduction

1. The Owner's Rider

Several organizations produce forms of Owner-Contractor agreements. Because the forms drafted by the American Institute of Architects ("AIA") are the forms most commonly used in construction projects in New York, the NYSBA Real Property Law Section ("RPLS") has drafted an owner-oriented form rider (the "Owner's Rider") for use with AIA Form A107—2007 form of construction contract ("AIA Form A107").

The RPLS recommends that an attorney specializing in construction law be involved in the negotiation of agreements for major construction projects and also for small projects where the need exists. Nevertheless, real estate attorneys are often asked by their owner clients (who may include house owners, cooperative corporations, condominiums, and/or apartment owners) to review construction contracts for projects that, although significant for the owner, are not major projects. Because architects and contractors often submit to owners AIA agreements and those agreements are often reviewed by the owner's real estate lawyer, the RPLS saw a need for the development of the Owner's Rider in order to (a) make the review process more efficient and cost effective and (b) close some gaps in AIA form and address certain issues in a manner that more realistically reflects common practice.

2. AIA Forms—In General

AIA has drafted a variety of forms to govern the construction process, including several forms of architect agreements, general contractor and construction manager agreements, and other construction agreements. Forms can be accessed on-line by buying an annual license from AIA to use its forms. The license, however, may be too expensive for a small firm. Individual forms can be purchased at the AIA New York Chapter Center for Architecture. The contact information for the Chapter Center is as follows:

AIA New York Chapter Center
for Architecture
536 LaGuardia Place
New York, NY 10012
212-358-6113
212-696-5022 fax
info@aiany.org
www.aiany.org

With respect to owner/contractor agreements, the AIA has promulgated the following forms (among others):

A105-2007 Standard Form of Agreement between Owner and Contractor for Residential or Small Commercial Project

A107-2007 Abbreviated Owner-Contractor Agreement Form for Construction Projects of Limited Scope—Stipulated Sum

A101-2007 Standard Form of Agreement for Owner and Contractor—Stipulated Sum

A102-2007 Standard Form of Agreement for Owner and Contractor—Cost Plus fee with GMP

A103-2007 Standard Form of Agreement for Owner and Contractor Where the Basis of Payment is Cost Plus fee without GMP

A201-2007 General Conditions of Construction (for use with A101-2007, A102-2007, and A103-2007).

A105 is a bare bones agreement intended for the smallest of projects. The RPLS does not recommend its use except for very small projects and even then the Owner's attorney should consider attaching a rider.

AIA Form A107 is commonly used for construction projects that may range up to several million dollars; and it is AIA Form A107-2007 to which the Owner's Rider is intended to be appended.

A101, 102, and 103 forms are generally used for major projects, although some contractors and architects use those forms for all projects. A201 provides the so-called "General Conditions" for those form agreements. By contrast, AIA Form A107 is self-contained; that is, its General Conditions are included in the form itself.

3. Governing Statute

Article 35-E of the General Business Law (the "Prompt Payment Act") (NY GBL §756 et seq.) applies to construction contracts in which the aggregate cost of the project (including labor, services, materials and equipment) equals or exceeds $150,000. Exceptions include contracts for the alteration of a one-, two- or three-family residential dwelling, for a residential tract development of one hundred or less one- or two-family dwellings, any residential construction project where the aggregate size of the project is 4,500 sf or less, and certain low-income residential projects. The Prompt Payment Act provides, among other things, that:

A. Notices under the Prompt Payment Act must be given by facsimile and reputable overnight courier.

B. If the contract does not specify a billing cycle, payments are to be made on a calendar month cycle.

C. Upon delivery of an invoice and all contractually required documentation, the Owner is required to approve or disapprove all or a portion of the invoice *within 12 business days*. The Owner's approval cannot be unreasonably withheld. If the Owner refuses to approve an invoice or any part thereof, it must give the Contractor a written statement describing the items of the invoice that aren't approved within such 12 business day period. An Owner may refuse to approve an invoice for:

   a. Unsatisfactory or disputed work progress;

   b. Defective construction work or material not remedied;

   c. Disputed work materials;

   d. Failure to comply with other material provisions of the construction contract;

   e. Failure of the Contractor to make timely payments for labor, including collectively bargained fringe benefit contributions, payroll taxes and insurance, equipment and materials; damage to the Owner; or reasonable evidence that the construction contract cannot be completed for the unpaid balance of the contract sum;

   f. Failure of the Architect to certify payment for any of the foregoing reasons (so long as the reasons are specified).

D. The Contractors, in turn, are given 12 business days to approve or disapprove invoices from the Subcontractors.

E. The Owner must pay any interim or final invoice within 30 days after approval of the invoice.

The Prompt Payment Act, by its specific terms, voids certain provisions, including (a) a provision subjecting a construction contract to another state's law, (b) a provision that prohibits a party (e.g., the Contractor) from suspending performance if the other party fails to make prompt payment, (c) a provision prohibiting expedited arbitration where required by 756(b), and (d) payment provisions differing from those set out in 756(b). Other provisions of the Prompt Payment Act should be subject to modification (e.g., the circumstances under which an Owner may withhold payment).

The Owner's Rider is just that—a form. It should not be used unless reviewed by the Owner's attorney and modified as needed. The blanks in the AIA form itself must also be properly completed and refer to all of the plans, specifications, drawings, proposals and other instruments that completely describe the construction project. The provisions of the Owner's Rider generally refer to the corresponding provisions of AIA Form A107 that are intended to be modified or supplemented. Therefore, the provisions of the Owner's Rider are generally ordered in the same sequence as the provisions of AIA Form A107 that are intended to be so modified or supplemented.

The Owner's attorneys should note that the Owner's Rider does not address in any way a most important part of the contract—the description of the work to be performed. If AIA Form A107 does not refer to all of the plans and specifications, or if those plans and specifications do not adequately describe the work to be performed by the Contractor, there will be a large gap in the contract that will not be covered by the Owner's Rider.

Additions to AIA Form A107

1. Add a reference to the Owner's Rider in Section 6.1.6 of AIA Form A107.

2. Make sure AIA Form A107 is properly filled out, including by setting out the retainage in Section 4.1.4 of AIA Form A107. A 10% retainage is customary, but a different percentage may be appropriate in some cases. In large projects and new building construction, it is customary for the Contractor to request that the retainage be reduced after Substantial Completion to an amount equal to a percentage of the estimated cost of performing the final punch list. If such a request is made, the Owner should consult with the Architect as to the reasonableness of the request (given the nature of the project and the reputation of the Contractor), but it is generally recommended that the retainage be reduced to no less than 150% or 200% of the estimated cost of performing the final punch list work.

Commentary to Owner's Rider

1. **Inconsistencies.** The contract, as a whole, is comprised of AIA Form A107, the documents listed in AIA Form A107 (project manual, specifications, drawings, etc.), and the Owner's Rider. Collectively, the agreements are referred to variously as the "Contract" or the "Agreement." Because the documents may conflict with one another (for example, the project manual may contain insurance requirements that differ from the requirements set out in the Owner's Rider), to prevent later questions and avoid ambiguity Owner's Rider Paragraph 1(a) provides that if there is a conflict between the documents, the higher standard or the more restrictive requirement for the benefit of the Owner, controls.

2. **Construction Supervision and Procedures.** Paragraph 4 of the Owner's Rider deals with supervisory and procedural aspects of the construction project that have occasionally proved troublesome to building owners. First, owners should be able to reach the construction foreman at all times and be able to communicate

with the foreman. Accordingly, the Owner's Rider requires the foreman to speak English and requires the Contractor to provide the Owner with the foreman's contact information. If the building in question is Spanish speaking or dominated by another language, the rider provision should be appropriately revised.

In addition, there are several reasons why the Owner should be allowed some control over the personnel that the Contractor uses for the project. First, construction projects are run by people, not inanimate corporate beings. For that reason, the Owner has a vested interest in seeing that the personnel assigned to its project are up to the task and also that they remain with the project throughout its course, for continuity's sake. In addition, if the Owner has dealt with a particular person or group at the construction company prior to contract execution, it may want to require that person or group to supervise the project. Under such circumstances, the desired personnel should be listed in Exhibit 1 to the Owner's Rider. If not, Paragraph 4 of the Owner's Rider should be modified to delete the reference to Section 9.2.5.

It is not uncommon for the Owner, the Architect or the Contractor to call for a site meeting to review progress of the construction. Such meetings are common and, in garden variety construction projects, should generally be conducted without additional fee. Section 9.2.4, as set out in Owner's Rider Paragraph 4, states specifically that there shall be no additional charge for on-site meetings. The Owner's Rider provides for weekly meetings and such additional meetings as are reasonably requested by the Owner or the Architect. In some circumstances it may be appropriate to specify a different frequency or to set out a schedule for meetings (e.g., 1 pm on each Monday)—especially if there is an urgent need for the construction to be completed quickly.

3. **Warranties.** Section 9.4 of AIA Form A107 includes a warranty that the materials used in the Work will be new and that the Work will conform to Contract requirements and be free of defects. Paragraph 7 of the Owner's Rider slightly expands the provision to include an additional warranty that the Work will be free of materials prohibited by law (building on the Contractor's agreement in AIA Form A107 Section 9.6.2 to correct work if the Contractor performs work knowing it to be unlawful) and that the Work will be performed in a good and workmanlike manner (which has been disfavored in recent AIA Forms). Although AIA Form A107 requires the Contractor to perform the work in accordance with Contract requirements and to use its best skill and attention in performing the work (see Sections 9.2.1 and 9.4 of AIA Form A107), the consensus of the drafting committee was that the "good and workmanlike manner" standard was appropriate to assure a reasonable quality of performance.

   Under Sections 15.4.3 and 18.2 of AIA Form A107, contract warranties commence on the date of Substantial Completion (unless otherwise provided in the Architect's Certificate of Substantial Completion); the Contractor agrees to correct work not in accordance with the Contract Documents for a period of one year after Substantial Completion and to perform the corrective work within a reasonable period after notice; and, if the Owner fails to give the Contractor notice during the one-year period and to give the Contractor an opportunity to correct the defects, the Owner waives the right to require the Contractor to correct and to make a claim for breach of warranty (Section 18.2). The warranty limitation is not intended to prevent the Owner from suing for defects in the Work after the expiration of the one-year period (see Section 19.4 of AIA Form A107); and the Owner's Rider makes that clear in Paragraph 7(c), which restates Section 18.5 of AIA Form A107. During the warranty period, however, the Contractor agrees to correct all Work itself to the extent the Work doesn't comply with contract requirements. Of course, if the quality of the Contractor's Work has been generally unacceptable, the Owner may not wish to have the Contractor correct the Work. For that reason, Owner's Rider Paragraph 7(b) gives the Owner the right to perform the corrective work if the Contractor's work has been unsatisfactory. The Owner's Rider also extends the one-year warranty period if corrective work is performed after Substantial Completion, by restarting the warranty period after warranty work is performed (Paragraph 7(c), restating Section 18.5 of AIA Form A107).

   Note that AIA Form A107 is not the only source of warranties. The specifications for the project may include other warranties; and there may be manufacturer warranties, which often cover equipment for longer periods than AIA Form A107 warranty, but are usually limited to replacement of parts, materials or equipment exclusive of labor costs.

   The Committee considered modifying Section 9.4 of AIA Form A107 to have the warranty run from the date of Final Completion rather than Substantial Completion. The thought was not incorporated in the Owner's Rider because the work and installations are essentially finished upon Substantial Completion, except for minor

punch list items, and the Owners often occupy premises and/or use equipment when construction reaches the Substantial Completion stage. Accordingly, Substantial Completion seems the appropriate trigger for the warranty period.

4. **Indemnity (Owner's Rider Paragraph 10); Consequential Damages.** AIA Form A107 Section 9.15.1 includes an indemnity (including against attorneys' fees) in favor of the Owner that essentially covers insurable claims (i.e., claims attributable to bodily injury, sickness, disease, death, and damage to tangible property, other than the Work itself) to the extent the claim arises from the negligent acts or omissions or the Contractor, its Subcontractors or anyone for whose acts they may be liable (which presumably includes employees), even if the indemnified party caused part of the loss. The Contractor's liability is not limited by any statutory limitation of the Contractor's liability (see Section 9.15.2) under workers compensation and similar statutes. What the Section does not cover is (a) losses incurred by the Owner in connection with the Contractor's breach of contract, which might include legal fees and bonding costs incurred in connection with unlawful mechanic's liens and fines and penalties for violations issued against the Building, (b) misconduct by the Contractor Parties, and (c) claims by the Contractor's employees against the Owner where the Contractor was not negligent, but neither was the Owner. Owner's Rider Paragraph 10 expands the indemnity to cover such claims.

   The Contractors engaged in major construction may object to an indemnification that extends beyond the Contractor's insurance coverage. There are several compromises, including (a) limiting the indemnification to the amount of the Contract Sum, and (b) limiting the additional Rider indemnification to specific areas of concern (e.g., mechanic's liens and violations).

   Note that the Owner and the Contractor each waive claims for consequential damages under Section 21.8 of AIA Form A107. The Owner's Rider does not modify that waiver. Accordingly, if the Owner may incur specific consequential damages by reason of the Contractor's default and desires to make the Contractor liable, it should address that issue directly in the Owner's Rider.

5. **Wrongful Filing of Mechanic's Liens (Owner's Rider Paragraph 11).** Section 9 of the New York Lien Law permits a Contractor to file a lien for the agreed amount or value of labor performed and materials installed or manufactured. Section 39 of the Lien Law provides that if the Court finds that the lien amount has been willfully exaggerated, the Court shall declare the lien void and the Contractor may not file another lien covering the claim. Section 39-A further provides that if a Court declares that a lien has been willfully exaggerated, the Owner shall be entitled to recover its legal fees, bonding costs, and an amount equal to the difference between the claimed amount of the lien and the amount permitted by statute. Perhaps because of the seriousness of the consequences, courts are generally reluctant to find that a Contractor has willfully exaggerated the lien amount, making Sections 39 and 39-A of limited utility.

   Consequently, if a dispute develops between an Owner and Contractor, the reality is that the Contractor often files a lien even if it is not entitled to payment and, in addition, often files a lien for an amount that bears no relation to the amount permitted under the Lien Law. The Committee's goal was to find some way, within the limits imposed by the New York Lien Law, to compensate the Owners for costs incurred when the Contractors adopt a "kitchen sink" approach. Accordingly, the Rider:

   a. Prohibits the Contractor from filing a lien once (1) "Final Payment" has been made, or (2) the Contract has been terminated early and all amounts due from the Owner have been paid;

   b. Requires the Contractor to amend an overstated lien to the proper amount within 10 days after receipt of a request from the Owner; and

   c. Provides that a lien shall be deemed willfully exaggerated if the lien amount includes "lost profits" or consequential damages.

   With respect to clauses a. and b., a breach of those provisions (which merely require the Contractor to comply with law) would trigger the general indemnity clause, allowing the Owner to recover its losses, including reasonable attorneys' fees. Section c. is intended to both remind the Contractor that lost profits and consequential damages may not be included in the lien amount and to help the courts make a determination of willful exaggeration where the Contractor includes such damages in the lien amount.

6. **The Contractor's Time to Perform (Owner's Rider Paragraph 13)**. Owner's Rider Paragraph 13 modifies Article 2 of AIA Form A107, which sets out the Contractor's time to perform, and Article 14 of AIA Form A107, which makes time of the essence. The Owner's Rider forces the Contractor to take action when the Owner or the Architect finds that the Contractor has fallen be-

hind schedule, by requiring the Contractor to take such action, including working additional shifts, as is required to complete the Work on time. The Owner may also consider negotiating a per diem charge (so-called "liquidated damages") for late performance or a bonus for early completion; but the Contractor is likely to resist imposition of any liquidated damages charge unless the performance period is so extended, or the liquidated damages charge is so low, as to make the charge almost meaningless. One of the reasons contractors resist liquidated damage clauses is that if the job takes longer than anticipated, the Contractor is already incurring losses from having to staff the project for a longer period than anticipated, so paying liquidated damages may be viewed as adding insult to injury. Liquidated damages may, however, be appropriate in specific situations, especially where failure to make a particular deadline may cause hardship to the Owner. Take note that the time within which the Contractor is required to complete the job may be extended by Change Order for force majeure, which may provide the Contractor with a defense to a liquidated damages claim or a portion thereof.

7. **Applications for Payment; Releases of Lien (Owner's Rider Paragraph 14).** Owner's Rider Paragraph 14 supplements Articles 4 and 15 of AIA Form A107, which govern applications for payment. For a very small job there may simply be one or two payments. For most jobs, however, payments are spread over time. Under AIA Form A107, the Contractor proposes a Schedule of Values, which allocates the Contract Sum to various portions of the Work. See AIA Form A107 Section 15.1.1. When submitted by the Contractor, and if the Architect does not object, the Schedule of Values establishes the payment schedule. If appropriate, one thing for the Owner to consider is incorporating a specific payment schedule into Owner's Rider Paragraph 14(a)(ii).

Paragraph 14 of the Owner's Rider provides that any contract deposit shall be applied against the first payment(s) due under the contract, which is what the Owners typically require. Conversely, the Contractors often ask for the deposit to be applied against their final requisitions for payment, but such an arrangement would, as a practical matter, vitiate the utility of the retainage requirement.

AIA Form A107 requires the Contractor to submit applications for payment to the Architect, who determines whether or not payment is due and is permitted to withhold approval of the payment application under specified conditions (e.g., defective work not remedied). Accordingly, AIA Form A107 effectively makes the Architect the "arbiter" of whether or not payment is due. Owner's Rider Paragraph 14 alters that structure by giving the Owner the right to refuse payment if the Contractor has engaged in one of the enumerated "bad acts" (e.g., defective work, liens filed against building although payment has been made, etc.) and expands the list of "bad acts" (to include, for example, failure to discharge a mechanic's lien filed with respect to work for which payment has been made).

Applications for payment are generally submitted on AIA Form G702.

Owner's Rider Paragraph 14 requires the Contractor to submit with each application for payment a lien waiver in the form included in Exhibit 2 to the Rider. It is intended that Exhibit 2 will consist of progress and final lien waivers for both the Contractor and its Subcontractors. The Committee has posted on the Committee web page (www.nysba.org/construction) suggested forms suitable for stipulated sum and cost-plus contracts. While the lien waivers are the same for the Contractor regardless of the pricing method, the Subcontractor forms differ in that, on a stipulated sum contract, only percentages of completion are shown on the Subcontractor waiver, whereas on a cost-plus contract, the waiver contains full disclosure of all subcontract costs. All lien waivers are effective as of the pending application for payment and are conditioned upon the receipt of payment and clearance of funds. The Lien Law invalidates any unconditional lien waiver executed prior to payment. See N.Y. LIEN LAW §34.

As noted above, the Prompt Payment Act requires the Owner to approve or disapprove a Contractor's invoice within 12 business days after receipt of the invoice and all required contract documentation. Any disapproval must be accompanied by an explanation. Payment of an approved invoice must be made within 30 days of approval. See N.Y. GEN. BUS. LAW § 756-a (McKinney 2009). The Owner's Rider instead provides that payment of any approved invoice will be made within 30 days of the Owner's receipt of the Contractor's Application for Payment (for a small project, it may be appropriate for the Contractor to be paid more quickly). If the Prompt Payment Act applies, the Owner should take care to provide a timely explanation for any disapproved invoice.

With respect to payment for materials, if the Owner does not wish the Contractor to store, or to pay the Contractor for, quantities of materials and equipment at the site (at which point payment

is due for the materials under AIA Form A107 Section 15.1.3), the Owner should delete Section 15.1.3 and instead provide that payment shall be made with respect to materials only when such materials have been actually used in the Work and/or incorporated in the Building.

8. **Final Payment.** The Owner's Rider conditions Final Payment on, among other things, delivery of lien waivers and releases (included in Exhibit 2) to the Owner from each Subcontractor, supplier and materialman, as well as the Contractor.

9. **Waiver of Post-Completion Claims by the Owner.** The Committee considered deleting Section 15.5.3 of AIA Form A107, which provides that upon making final payment, the Owner waives all claims against the Contractor except for (a) claims based on unsettled liens, claims, security interests and encumbrances (which should include mechanic's liens filed after final payment), (b) failure of the Work to comply with the requirements of the Contract Documents, and (c) terms of special warranties. There is a reciprocal provision in Section 15.5.4 protecting the Owner from claims by the Contractor made after acceptance of final payment except for claims previously made in writing and unsettled.

   However, there is a strong preference in the construction industry for closure upon final payment (much as real estate attorneys have a strong preference to have the parties to a sale walk away from a closing without surviving liabilities). Accordingly, the Committee instead expanded the Owner's post-closing rights by adding to the list of non-waived items claims for personal injury, death and property damage, mechanic's lien claims, and violations issued against the Building or the Owner (see Owner's Rider Paragraph 14(c)).

10. **The Owner's Direct Payment of the Subcontractors.** To protect against the possibility that the Contractor may become financially unstable or otherwise fail to pay its Subcontractors, the Owner may wish to consider adding a provision to Owner's Rider Paragraph 14 allowing the Owner, at its election, to issue checks jointly to the Contractor and its Subcontractors; and allowing the Owner to include on the check the endorsement set out below. If included, the provision should further provide that the Contractor and the Subcontractor are conclusively bound by such endorsement if they submit the check for payment.

    Draft Provision.
    The Owner may, in its sole and absolute discretion, issue checks payable to the joint order of the Contractor and any Subcontractor performing portions of the Work for which an Application for Payment is submitted by the Contractor. In addition, without limiting or waiving any rights the Owner may have at law, in equity and hereunder, the Contractor and all the Subcontractors shall be conclusively bound by the following endorsement which may appear on the back of any check or instrument to be issued by or on behalf of the Owner:

    > "EACH ENDORSER HEREBY RELEASES ALL CONSTRUCTION LIENS, STOP NOTICES, AND CLAIMS WITH RESPECT TO _____'S PREMISES LOCATED AT _____, NEW YORK, NEW YORK TO THE EXTENT OF THE FACE AMOUNT OF THIS CHECK. EACH ENDORSER ACKNOWLEDGES PAYMENT OF THE FACE AMOUNT OF THIS CHECK FOR LABOR PERFORMED OR MATERIALS FURNISHED FOR SUCH JOB."

    Failure of such endorsement to so appear on any check or other instrument shall not constitute a limitation of or waiver of the Owner's rights and/or remedies hereunder, nor in any way limit or modify the Contractor's liabilities and obligations hereunder.

    The provision and endorsement were not included in the Owner's Rider because it was felt to be unduly cumbersome and likely to be ignored by both parties.

11. **Termination for Convenience (Owner's Rider Paragraph 20).** The Owner's Rider Paragraph 20 amends AIA Form 107 Section 20.3, which gives the Owner the right to terminate the construction contract for "convenience," to set out more specifically the payment due if the Owner terminates for convenience, by eliminating the reference to profit and instead allowing the Contractor to recover for the Work performed, the retainage allocable to that Work, and the Contractor's demobilization costs. Owners should understand that if a construction contract is terminated for convenience, the Owner essentially waives the right to sue the Contractor for damages it might incur if it has to pay more money to hire another Contractor to finish the project. Owners typically require this provision in case they lose their financing for the project or their applied-for zoning does not materialize. There is an additional, practical reason for having this provision—a Contractor may not be performing up to the Owner's expectations but the

Owner may not want to risk litigating a "for cause" termination. Instead, the Owner can simply terminate for "convenience," pay the Contractor the amounts called for and thereby minimize further proceedings and litigation exposure.

12. **Insurance; Builder's Risk Coverage.**

(a) Owner's Rider Paragraph 19 refers the parties to Exhibit 3 for a description of the insurance required to be carried by the Contractor. The Owner should consult with its insurance agent as to the required insurance, which may vary depending on the nature of the job. The attorney should endeavor to ensure that any insurance requirements set out in the Project Manual (prepared by the Architect) conform to the insurance requirements of the Rider (or vice versa), although Exhibit 3 provides a failsafe in that it provides that the broader requirement controls.

(b) Section 17.3.1 of AIA Form A107 requires the Owner to carry builder's risk insurance. That requirement is an attempt to simplify risk of loss issues by making the Owner responsible for carrying builder's risk insurance, which covers loss that occurs to the construction project during the course of the project. However, builder's risk insurance is expensive and may or may not be appropriate for a particular construction job. Generally, it is appropriate where a new building is under construction, a building addition is being constructed, and/or a "gut" renovation is planned. For ordinary alterations, the Owner's existing property insurance is likely to cover damage to newly installed alterations, although certain kinds of damage (e.g., water damage) may not be covered. Accordingly, Section 17.3.1 is amended and restated, and Sections 17.3.2 and 17.3.4, are deleted; thereby eliminating the requirement that the Owner carry builder's risk insurance. However, the Owner always should discuss with its insurance consultant the adequacy of the building's existing insurance with respect to the proposed construction project, including whether or not builder's risk insurance is appropriate. If builder's risk is appropriate, the Owner needs to determine whether the Owner or the Contractor should obtain the coverage. If the former, the Owner will pay directly for the coverage; if the latter, the Contract Sum is likely to be adjusted to reflect the additional cost to the Contractor to obtain such insurance.

(c) When a casualty destroys materials that are in transit or that have been stored at (but not incorporated in) the Building, multiple issues arise, including the following:

i. The Owner's insurance may (or may not) cover loss of materials in transit or stored at the Building, but such insurance will definitely not cover loss to the materials before they become the Owner's property.

ii. Under the common law, risk of loss passes from the Contractor to the Owner once title passes to the Owner. In this regard, Section 15.1.3 of AIA Form A107 requires the Owner to pay for materials delivered to and suitably stored at the site for subsequent incorporation; and Section 15.1.4 provides that the Contractor warrants that title to materials will pass to the Owner no later than the date of payment. Such provisions do not entirely clarify when title and risk of loss passes, although it seems clear that title and risk of loss pass no later than the date of payment.

iii. The Owner's casualty insurance may not cover certain categories of risk, including some kinds of water damage.

Bearing in mind all of the above, the Owner should consult with its insurance agent as to what insurance should be carried by the Owner and by the Contractor and at what point the Owner's policy kicks in to cover loss.

13. **Indemnification against Hazardous Substances.** The Committee elected to delete Section 16.2.2, which requires the Owner to indemnify the Contractor, the Architect and their employees against claims arising out of performance of the Work in areas in which there are hazardous substances that haven't been rendered harmless. Since construction sites are normally investigated for the presence of known hazardous substances (and, indeed, the Contractor is required to report the presence of any hazardous substances it encounters to the Owner), the Committee was concerned that the Section could be construed to make the Owner liable for (a) claims based on exposure to hazardous substances that were not known to be hazardous at the time the Work was performed or (b) damage arising from Work that causes the release of hazardous substances into the environment (for example, the Contractor breaches a fuel line). The Committee felt that the Owner, which is often the party least likely to have actual knowledge of the environmental risks, should not be required to indemnify. This may be a serious issue for some contractors if their insurance does not cover loss or liability arising from hazardous substances, which is frequently the case. However, the Owner's insurance is also likely to exclude such loss and liability. A possible compromise is to modify

the clause to limit the Owner's liability to damages arising from the presence of hazardous substances of which the Owner has knowledge where the Contractor has complied with its obligations under Section 16.2.

14. **Exculpation.** To eliminate any ambiguity, Owner's Rider Paragraph 23 makes it clear that if work is being performed for a condominium, the unit owners and the members of the board of managers are not personally liable. A similar provision was added confirming that, with respect to cooperatives, board members and shareholders also are not personally liable, although, as to cooperatives, such a provision is not needed because of the Owner's corporate structure.

15. **Miscellaneous Provisions Omitted.** The Owner's Rider does not contain the provisions set out below, although they are normally included in long term agreements (such as leases) and contracts of sale. Such provisions are sometimes included in contracts for the construction of a new building or similar significant construction contracts (for which AIA Form 101 is more likely to be used), but are usually not added to AIA Form A107 contracts.

    (a) Any notice provided for in this Agreement, other than billing, shall be in writing and sent by (i) registered or certified mail, return receipt requested, or (ii) by personal delivery, or (iii) by recognized overnight courier for next business day delivery, and shall be addressed to the Contractor or the Owner at the address indicated at the beginning of this Agreement, and if to the Owner, with an additional copy to _____, Esq., _____, _____, _____, New York _____. Except as expressly otherwise noted in this Agreement, each such notice shall be deemed to have been given (i) if notice is sent by registered or certified mail, 5 business days after notice is sent, (ii) if notice is given by personal delivery, on the date such notice is delivered, provided delivery is between 9 am and 5 pm on a weekday that is not a federal, state or banking holiday, and (iii) if notice is given by overnight courier service, on the date delivery is made or attempted to be made. Any notices may be given by a party's attorneys. Either party may change its address for notices by notice given to the other party in accordance with the provisions of this subparagraph.

    (b) No waiver of any provision of the Contract Documents shall be deemed to be a continuing waiver thereof or a waiver of another provision of any of the Contract Documents. The failure of either party at any time to require performance by the other party of a provision hereunder shall in no way affect the right of that party thereafter to enforce the same in the future or to enforce any of the other provisions in this Agreement; nor shall the waiver by either party of the breach of any provision hereof be taken or held to be a waiver of the provision itself.

    (c) Except as may be otherwise specifically provided in this Agreement, this Agreement may not be orally cancelled, changed, modified or amended, and no cancellation, change, modification or amendment shall be effective or binding, unless in writing and signed by the party(ies) affected thereby.

    (d) Each party hereto shall cooperate and shall take such further actions and shall execute and deliver such further documents as may be reasonably requested by any other party in order to carry out the provisions and purposes of this Agreement.

    (e) This Agreement and the Contract Documents represent the entire agreement between the parties with respect to the subject matter hereof, and all prior agreements relating to the subject matter hereof, written or oral, are nullified and superseded hereby.

    The Owner's counsel can decide whether or not to include such provisions, which are likely to be non-controversial, but which are not typically used in contracts for small projects.

Conclusion

The Owner's Rider is intended to provide a more uniform approach to the review and negotiation of AIA Form A107 construction contracts, and it is the Committee's hope that the Owner's Rider will serve that function, making construction contracts easier and more efficient to negotiate. Naturally, each attorney using the form must review the Owner's Rider, determine if its provisions are appropriate for the project, and make appropriate modifications.

April 2012

New York State Bar Association
Real Property Law Section
Real Estate Construction Law Committee

Kenneth M. Block
Brian G. Lustbader
David Pieterse
Co-Chairs

Nancy A. Connery
Chair,
Contracts Subcommittee

Prepared by the Real Estate Construction Law Committee
of the Real Property Law Section
of the New York State Bar Association

ANY CHANGES TO THE ORIGINAL TEXT OF THIS DOCUMENT
MUST BE INDICATED BY UNDERLINES OR STRIKETHROUGHS

DRAFT 10-1-1

INSTRUCTION: Add a reference to this Rider in Section 6.1.6 of the AIA form.

Instruction: Add a reference to this Owner's Rider in Section 6.1.6 of the AIA Form A107.

OWNER'S RIDER TO STANDARD FORM OF AGREEMENT
BETWEEN OWNER AND CONTRACTOR (AIA DOCUMENT A107-2007)

DATE: _____

OWNER: _____

CONTRACTOR: _____

BUILDING: _____

INDEMNIFIED PARTIES: _____

[*Identify Owner, Architect, Managing Agent, Mortgagee, etc.*] their officers, directors, and employees, and, if the Building is a condominium, the members of the Board of Managers and the persons and entities who own condominium units in the Building

ADDITIONAL INSUREDS: _____

_____

_____

[*Identify Owner, Architect, Managing Agent, etc.*] their officers, directors, and employees, and, if the Building is a condominium, the members of the Board of Managers and the persons and entities who own condominium units in the Building

AMOUNT OF CONTRACT DEPOSIT: _____

CHANGE ORDER PROFIT MARKUP: _____% of the Actual Cost to Contractor

CHANGE ORDER OVERHEAD MARKUP: _____% of the Actual Cost to Contractor

1. **General.**

   (a) If any of the provisions of this Rider conflict or are otherwise inconsistent with the AIA Standard Form of Agreement between Owner and Contractor (the "AIA Form") to which this Rider is attached, the Specifications or other Contract Documents, the more restrictive requirement and the higher standard, for the benefit of Owner, as the case may be, shall prevail and be binding upon Contractor.

   (b) Any capitalized term in this Rider that is not otherwise defined in this Rider shall have the meaning ascribed to it in the AIA Form. The AIA Form and this Rider are hereinafter collectively referred to as this "**Agreement**." "**Including**" means "including but not limited to." "**Managing Agent**" means the then managing agent of the Building. References in this Agreement to defects in the Work shall include defects in materials and equipment incorporated in or installed as part of the Work.

2. **The Work.** Supplementing Section 7.3: The Work includes not only the Work specified in the Agreement, but also all work reasonably inferable from the Plans and Specifications and all related work reasonably necessary to complete the Project and ascertainable from a visual inspection of the Project site.

3. **Representation by Contractor as to Contract Sum; Changes in Contract Sum; Change Orders; Establishing Pricing on Change Orders.**

   (a) Supplementing Section 9.1.1: Execution of this Agreement by Contractor is a representation that the Work can be completed for the Contract Sum. No additional payment shall be due for materials, tools or equipment needed for the proper performance of the Work. Accordingly, the Contract Sum may be increased only by Change Order effected in accordance with the provisions of this Agreement, and no claim may be made by Contractor for compensation in addition to the Contract Sum other than by a Change Order signed in advance by Owner and Contractor setting out the additional cost of a change in the Work or a method for determining such cost. No change in the Work shall be performed by Contractor or binding on Owner unless effected pursuant to a Change Order signed by Owner. If Contractor performs any changes in the Work without prior written authorization from Owner, Contractor shall not be entitled to any change in the Contract Sum or Contract Time and shall not make any claim for unjust enrichment or quantum meruit based on a change in Work that has not been authorized in writing by Owner; notwithstanding any course of dealing between the parties or any implied acceptance of any change by Owner.

   (b) The final price of each change order effected pursuant to Article 13 of the AIA Form, shall be the sum of (i) the actual, out-of-pocket cost thereof (the "**Actual Cost**"), without profit, administrative expense or other "extra," plus (ii) the Change Order Overhead Markup, plus (iii) the Change Order Profit Markup. Contractor agrees that it shall provide Owner with accurate and complete information on all of its actual costs for the change in question.

4. **Supervision and Construction Procedures: Site Meetings.** Section 9.2 is modified to add the following sections:

   9.2.3. Contractor shall provide a full-time English speaking foreman or superintendent who shall be on site at all times during the performance of the Work, and shall provide Owner and Architect with the cell phone number of such foreman or superintendent. Contractor shall furnish to Owner upon request the names of all its employees working at the Project.

   9.2.4. Contractor shall make itself available to meet Owner and/or Architect at least once per week at the Project site and such additional times as may be reasonably requested by Owner, upon Owner and/or Architect's request, in order to review the progress and status of the Work. The cost of attendance at such meetings is included in the Contract Price. Accordingly, there shall be no additional charge for attendance at such meetings.

   9.2.5. Strike if inapplicable: Contractor agrees that the persons listed on Exhibit 1 shall serve in the positions listed thereon for the duration of the Work and that he/she/they shall not be removed from the Project, unless such person becomes unable to perform his or her assigned duties or ceases to be in the employ of Contractor. In the event of such removal, Contractor shall immediately propose by notice to Architect and Owner a candidate to serve in the place of such person, who shall have similar training and experience and who shall first be interviewed by and be reasonably acceptable to Owner and Architect.

   9.2.6. Contractor shall not permit its employees or those of any Subcontractor or sub-subcontractor (or any tier) or those of material suppliers to enter upon or remain in any part of the Building except where their presence is immediately required to perform the Work. Such employees shall not utilize the plumbing systems of the Building except as may be explicitly designated for the use of the construction forces.

5. **Substitutions.** Supplementing Section 9.3.3. Contractor shall personally investigate each proposed substitute material or product and advise Owner if it is not equal to or superior in all respects to the material or product(s) originally specified. Contractor's warranty(ies) under the Contract Documents shall not be impaired or limited by reason of any such substitution.

6. **Labor Harmony.** Section 9.3 is modified to add the following section:

   9.3.4. Contractor shall maintain labor harmony at the Project, and shall be responsible for any delay to the Project resulting from any strike, lockout, picketing, labor disturbance, or other labor dispute. In this connection, Contractor agrees to furnish such security services as are necessary to prevent any delay or damage to the Project. The Contract Sum includes the cost of such security services.

7. **Warranties; Correction of Work.** Modifying Section 9.4 and Article 18:

   (a) Section 9.4 is amended to add the following sections:

   9.4.1. Contractor also warrants that (i) all goods, products, material and equipment to be supplied by Contractor shall be free of substances prohibited by law for use in the Project; (ii) its performance of the Work pursuant to this Agreement shall be accomplished in a good and workmanlike manner and in accordance with all applicable manufacturers' guidelines and instructions (unless otherwise expressly stated in the Specifications), all applicable laws, rules and regulations and applicable industry standards (unless otherwise expressly stated in the Specifications). Any ambiguity in the Contract Documents and any inconsistency between the Contract Documents or between the Contract Documents and such guidelines, instructions, laws, rules, regulations and industry standards, known by or made known to Contractor shall be promptly reported by Contractor to Architect and Owner.

   9.4.2. Contractor acknowledges that the specification of a particular product or use of a particular method or means of construction in the Contract Documents, including through an order issued by Architect pursuant to Section 13.3, shall not relieve Contractor of its warranty obligations under this Agreement.

   (b) Supplementing Sections 18.1 and 18.2: Contractor shall perform its obligations under Sections 18.1 and 18.2 and repair all damage arising therefrom, to the reasonable satisfaction of Owner, no later than thirty (30) days (or, in an emergency, immediately) after notice is given by Owner or Architect to Contractor of the defective Work; subject to reasonable extension of such time if such corrective work cannot, with reasonable diligence, be performed within such 30-day period provided that Contractor promptly commences and diligently pursues such corrective work. If Contractor fails to timely effect such repair, replacement and remedy or if Contractor's performance of the Work is unsatisfactory to Owner, Owner may repair, remedy or replace such defective Work, materials, and equipment; and Contractor shall reimburse Owner for all costs incurred by Owner in connection therewith upon demand.

   (c) Section 18.5 is amended and restated in its entirety to read as follows:

   18.5. If Contractor performs any corrective work pursuant to Section 18.2, the one-year period for correction of Work shall be extended, as to the portion of the Work so corrected, for a period of one year after Substantial Completion of such corrective work. The one-year limitation set out in Section 18.2 does not affect or limit the time within which Owner may initiate proceedings with respect to Contractor's failure to comply with its obligations under this Agreement, including any action for breach of contract or negligence.

8. **Tax Benefits.** Section 9.5 (Taxes) is modified to add the following sections:

   9.5.1. If Owner determines that the Work qualifies for any tax exemption or abatement, Contractor shall cooperate with Owner's efforts to obtain any such tax exemption or abatement, which obligation shall survive Final Completion.

   9.5.2. If Owner determines that the Work qualifies as a Major Capital Improvement ("**MCI**"), Owner shall deliver to Contractor a fully executed MCI certificate and Contractor shall credit Owner for any sales tax savings recognized by Contractor based upon Owner's MCI certificate.

9. **Violations.** Section 9.6 is modified to add the following section:

   9.6.3. If any notice or note of violation is issued against the Building, Contractor or Owner by any public or governmental authority as a result of or in connection with the Work, Contractor shall cause such violation to be cured and discharged of record at Contractor's sole cost and expense within thirty (30) days after Contractor is given or receives notice of such violation (or immediately in an emergency). If Contractor fails to timely cause such violation and notice to be cured and dismissed of record, Owner may effect such cure and dismissal; in which event (a) Contractor shall

promptly reimburse Owner for all costs incurred by Owner in connection therewith, including reasonable attorneys' fees, and (b) without limiting Owner's other remedies, Owner may offset such costs against any payments due Contractor under this Agreement. Payment in an amount sufficient, as determined by Architect, to correct and dismiss of record any such violation, shall be withheld from the payment of the Contract Sum until all such violations are dismissed of record.

10. **Indemnity.** Section 9.15.1 is amended and restated in its entirety to read as follows:

    9.15.1. To the fullest extent permitted by law, Contractor shall defend, indemnify and hold harmless the Indemnified Parties from and against all losses, damages, liabilities, actions, causes of action, claims, demands, fines, penalties, judgments, costs and expenses (including, without limitation, reasonable attorneys' fees, court costs and disbursements) (collectively, the "**Damages**") arising out of (a) the breach of any of the terms, covenants or conditions on Contractor's part to be performed or observed under this Agreement or the Contract Documents; (b) any negligent acts, omissions or misconduct of Contractor, its Subcontractors, suppliers, materialmen and/or any of their employees, agents, servants, or invitees (collectively, the "**Contractor Parties**"), and (c) all injuries to, sickness and death of, any of the Contractor Parties except to the extent such Damages arise out of the negligence, misconduct or breach of this Agreement by Owner. In addition, if Contractor fails to promptly comply with its obligations under this Section with respect to any Indemnified Party, Contractor shall reimburse each Indemnified Party, within twenty (20) days after Contractor is billed therefor, for all reasonable attorneys' fees, costs and disbursements incurred by such Indemnified Party in connection with the enforcement of Contractor's obligations under this Section. This indemnity shall not be construed to negate, abridge or reduce other rights or obligations of indemnity which would otherwise exist; and shall (along with Contractor's obligations) survive Final Completion and final payment.

11. **Wrongful Filing of Lien.** Article 9 is modified to add the following Section:

    9.16. Contractor shall not file any lien against the Building if Contractor has been paid in full all amounts due under this Agreement nor shall Contractor file any lien against the Building that overstates the amount for which Contractor may file a lien pursuant to Section 9 of the New York Lien Law. Contractor shall, within ten (10) days of receipt of request or demand of Owner, correct any lien filing that overstates the amount of Contractor's lien. Without limiting the foregoing, Contractor shall be deemed to have willfully exaggerated the lien amount if Contractor includes in its computation of the lien amount lost profits or consequential damages. If Contractor willfully exaggerates the lien amount, Contractor shall reimburse Owner for its reasonable attorneys' fees incurred to discharge or modify such lien and all costs incurred by Owner to bond such lien (including reasonable attorneys' fees) as set forth in the Lien Law. Nothing contained in this Section (or elsewhere in this Agreement) shall limit Owner's rights and remedies under this Agreement, at law or in equity, by reason of any such overstatement or wrongful filing of a lien.

12. **Subcontractors.** Article 11 is modified to add the following Sections:

    11.4. Before commencing the Work, Contractor shall deliver to Owner a list of all Subcontractors engaged to perform the Work and of those suppliers and materialmen engaged to provide materials for the principal portions of the Work, which list shall include their names, phone and cell numbers, addresses, and e-mail addresses. Contractor also shall deliver to Owner, prior to commencing the Work, an indemnification agreement from each Subcontractor (and signed by each Subcontractor) in form reasonably acceptable to Owner. All Subcontractors and laborers engaged by Contractor who are required by law to be licensed shall be duly licensed by all applicable governmental agencies having or asserting jurisdiction.

    11.5. Contractor shall obtain from each Subcontractor, supplier and materialman, prior to the time it makes a payment to such Subcontractor, supplier or materialman, a waiver of lien and release in the form included in Exhibit 2 (whether or not requested by Owner). Nothing contained in any such waiver of lien and release shall limit any defenses Owner may have to any open claims listed in such waiver of lien and release.

    11.6. If any Subcontractor files a lien against the Building or makes a claim against Owner, Contractor shall, within five (5) days after Owner's request, deliver to Owner a copy of Contractor's contract with Subcontractor. If one or more liens is filed by any Subcontractor(s), supplier or materialman with respect to Work as to which Owner has made a payment to Contractor, Contractor at its own cost and expense shall cause such lien or

liens to be discharged of record, by bonding or otherwise, within thirty (30) days after Owner gives Contractor notice thereof (as of which date TIME SHALL BE OF THE ESSENCE). If Contractor fails to timely discharge such lien(s), Owner may, at its option, discharge such lien(s) by payment (without regard to any defenses Contractor may have or claim), settlement, bonding, or otherwise; and Contractor shall reimburse Owner for all costs incurred by Owner in connection therewith, including any payment(s) made by Owner to discharge or settle such lien(s) and Owner's reasonable attorneys' fees, court costs and disbursements. Owner shall also have the right to set off Contractor's liability to Owner pursuant to this Section against amounts owed by Owner to Contractor, but Owner's rights against Contractor under this Section shall not be limited in any way by any such set-off right.

11.7. Owner may communicate directly with Subcontractors, suppliers, and materialmen for the purpose of verifying amounts due and payable, or paid, for work performed and/or materials supplied by such Subcontractors, suppliers and materialmen. Within five (5) days after Owner's request, Contractor shall provide Owner with evidence of payments made to Subcontractors, suppliers, and materialmen.

11.8. Promptly upon Owner's request, Contractor shall assign to Owner all of Contractor's right, title and interest in and to the contracts between Contractor and its Subcontractors, which assignment agreement shall be in a form reasonably satisfactory to Owner, shall adequately identify each such contract, and shall provide that Owner shall not exercise its rights as assignee unless and until this Agreement has been terminated by reason of Contractor's default.

13. **Untimely Performance; Contractor's Sole Remedy for Delay.** Article 14 is modified to add the following Sections:

14.6. If the Work is not progressing in a timely manner because of delays caused by Contractor or any Subcontractor or material supplier, Contractor shall, at its own cost and expense, take such action as is required to Substantially Complete the Work within the agreed time period, including by working additional shifts, causing its Subcontractors to work additional shifts, and taking other measures to Substantially Complete within the agreed time period. Nothing contained in this Section (or elsewhere in this Agreement) shall limit Owner's rights and remedies under this Agreement, at law or in equity by reason of Contractor's delay.

14.7. Contractor shall give Owner prompt written notice of (a) any delay in the commencement, performance or completion of the Work caused by Owner that might give rise to a claim by Contractor against Owner and (b) any events that Contractor claims will justify an extension of the Contract Time pursuant to Section 14.5, setting forth in reasonable detail the reasons for and the estimated length of such delay. Contractor shall immediately take all measures that may be required to minimize the extent of any delay. Contractor's sole remedy for any claim based on any delay in the commencement, performance or completion of the Work caused by Owner, hindrance in the performance of the Work caused by Owner, loss of productivity caused by Owner, or other similar claim (collectively referred to as "**Delay Claim**"), whether or not foreseeable, shall be (i) an extension of the time in which to complete the Work and (ii) payment to Contractor of a reasonable sum to compensate it for increased Project expenses actually incurred and directly attributable to the Delay, but not for any consequential damages, extended general conditions, lost opportunity costs, impact damages, or similar damages.

14. **Contract Deposit; Applications for Payment; Payments to Subcontractors and Suppliers; Limitation on Actions.** Supplementing Articles 15 and 4:

(a) (i) If this Rider provides for payment of a Contract Deposit, the Contract Deposit shall be applied against Contractor's first Application(s) for Payment until fully applied.

(ii) [If appropriate, include a specific payment schedule. Otherwise, Section 15.1.1 will govern the schedule of payments.]

(b) Supplementing Section 15.1 (Applications for Payment):

i. Each Application for Payment submitted by Contractor shall include a properly completed, executed and acknowledged waiver of lien and release in the form included in Exhibit 2 from Contractor and each Subcontractor that is unconditional with respect to all prior work and services for which Contractor previously applied for and received payment and conditional as to the work for which the Application for Payment is submitted.

ii. Within thirty (30) days of Owner's receipt of Contractor's Application for Payment and Architect's Certificate for Payment, Owner shall pay the amount certified by Architect as due (less any Retainage provided in Section 4.1.4). Notwithstanding the foregoing, Owner may with-

hold payment (1) for any of the reasons specified in Section 15.2.3, clauses .1-.7 inclusive, or (2) if any mechanic's or other lien or liens has(have) been filed in connection with the Work and not discharged by bonding or otherwise (unless such lien arises because of Owner's failure to make a required payment); or (3) for failure of Contractor to comply with material provisions of this Agreement, including by misrepresenting the percentage of the Work completed or by billing for materials, supplies and/or equipment that has not been installed or incorporated in the Project, stored at the Project site, or stored at an off-Project site storage location(s) approved in writing by Owner; or (4) to the extent required to recoup all or any part of a prior payment made pursuant to a Certificate for Payment that has been nullified by Architect.

iii. Section 4.1.3 is deleted.

(c) Section 15.5.3 is modified to add the following sub-clauses at the end thereof:

.4 claims by third parties against Owner, including claims by employees of the parties, for bodily injury, death or injury to property.

.5 mechanic's liens.

.6 any notice of violation issued against the Building or Owner, by any public or governmental authority as a result of or in connection with the Work.

(d) No action or proceeding shall be commenced or maintained against Owner with respect to any claim not waived pursuant to Section 15.5.4, unless such action or proceeding is commenced against Owner within one (1) year of the date of Final Payment (or, if earlier, the date this Agreement is terminated).

15. **Substantial Completion; Retainage; Punch List.** Modifying Section 15.4:

(a) Supplementing Section 15.4.1: "Substantial Completion" of the Work shall occur only when all of the following conditions, in addition to the condition set forth in Section 15.4.1, have been met: (i) all of the Work has been fully and properly performed in strict accordance with the Contract Documents, with the exception of minor "punch list" items (as determined by Architect), (ii) all required inspections have been either waived or performed and all required sign offs (including but not limited to electrical and plumbing sign-offs) have been obtained and submitted to the New York City Department of Buildings and/or other governmental agency or department having jurisdiction, (iii) if a certificate of occupancy is being amended or a certificate of occupancy or letter of completion is being issued in connection with the Work, all inspections required to obtain same have been satisfactorily completed (with no objections made or violations issued) and evidence of satisfactory inspection delivered to Owner and all items of the Work required to obtain same have been satisfactorily performed, as determined by Architect.

(b) The Retainage withheld by Owner shall, upon Substantial Completion pursuant to Section 15.4.4, be released except for an amount equal to 200% of the estimated cost (as reasonably determined by Architect and subject to approval by Owner) to complete those items (the punch list items) to be performed by Contractor (which determination shall take into account reasonably estimated additional costs incurred to engage a new contractor to perform such work if Contractor fails to perform its obligations, and cost of labor, services and materials).

(c) The following Section 15.4.5 is added to Section 15.4:

15.4.5. Contractor shall perform all items on the punch list within thirty (30) days after Contractor's receipt of such list, unless Architect has provided for a different time period pursuant to Section 15.4.3; provided, however, that if any item is incapable of completion within the aforesaid thirty (30) day period due to no fault of Contractor, Contractor shall notify Architect thereof and use all diligent efforts to complete work on such items as soon as possible but in no event later than sixty (60) days after the punch list is received by Contractor. Failure to include an item on the punch list shall not alter Contractor's responsibility to complete all Work in accordance with the Contract Documents, Contractor's responsibility for defective Work, or Contractor's warranty obligations.

16. **Final Completion and Final Payment.** Supplementing Section 15.5:

Final Payment shall not be due until all of the following conditions have been met, in addition to those conditions and requirements set out in Sections 15.5.1 and 15.5.2: (i) Contractor has provided (or assigned) to Owner fully executed and valid warranties and guaranties, in form and content satisfactory to Architect, for all products and materials supplied by Contractor, (ii) Contractor has delivered to Owner all operating and service manuals and instructions for the equipment, fixtures, and materials installed as part of the Work, (iii) Contractor has delivered to Owner a final lien waiver and release, in form annexed hereto as Exhibit 2(b) for itself and

from each Subcontractor, supplier, and materialman, and (iv) all liens filed against the Building by reason of Contractor's wrongful filing of a lien and/or Contractor's failure to pay Subcontractors, suppliers, and materialmen have been discharged by bonding or otherwise, and (v) Contractor has delivered to Owner three (3) complete sets of "as built" plans.

17. **Site Safety; Hazardous Materials.**

(a) Section 16.1 is amended to add the following clauses .4-.6:

.4 Subcontractors' employees, agents, servants, and invitees;

.5 the Building and the property of the occupants of the Building;

.6 the Building's occupants and their guests; and the Building's workers, agents, contractors, and employees.

(b) Section 16.2.2 is deleted.

18. **Risk of Loss to, and Protection of, Contractor's Materials.** Article 16 is modified to add the following paragraph:

Contractor is responsible for protecting and insuring its own tools and equipment and all materials stored on-site or off-site, from theft and other loss; and, with respect to materials stored on-site, if Contractor has any special requirements with respect thereto, Contractor shall so advise Owner and cooperate with Owner to provide a safe and secure location for those items that must be stored at the Building. Owner shall not be responsible for loss or theft of or damage to any of Contractor's property or to any materials stored at the Building, except, subject to Section 17.3.3, to the extent such loss, theft or damage was caused by the negligence of Owner.

19. **Insurance.**

(a) Supplementing Article 17: Contractor shall provide the insurance described in Exhibit 3 to this Rider, and shall cause all Subcontractors to provide the insurance described in such Exhibit.

(b) Prior to the commencement of any of the Work, Contractor shall provide Owner with copies of the insurance policies and certificates and such other documents and instruments which Owner may reasonably request. If Contractor shall fail or refuse to obtain and maintain all of the foregoing insurance coverage, then, at the sole option of Owner, Owner shall have the absolute right to terminate this Agreement or to obtain and pay for such coverage and deduct the amount of the premiums therefor from the Contract Sum.

(c) Section 17.3.1 is amended and restated in its entirety to read as follows:

17.3.1 Owner agrees to maintain, with a company or companies lawfully authorized to do business in New York, its usual "special form" property damage or equivalent insurance policy.

(d) Sections 17.3.2 and 17.3.4 are deleted.

20. **Termination.** Article 20 is modified as follows:

(a) Termination by Contractor. Contractor may terminate the Contract pursuant to Sec. 20.1 only if Owner fails to cure such default within seven (7) days after Owner is given notice thereof.

(b) Termination by Owner for Cause. Section 20.2.1 is supplemented by adding the following clauses .5 and .6:

.5 Subject to Section 14.5 and to any delays caused by Owner, failure to timely perform the Work and any part of the Work, and/or failure to achieve Substantial Completion and Final Completion, within the time periods provided in the Contract Documents; or

.6 Failure to timely discharge any lien that Contractor is required to discharge under this Agreement.

(c) No Architect Certification of Default Required. Section 20.2.2 is modified to delete the requirement for a certification by Architect.

(d) Termination by Owner for Convenience. Section 20.3 is hereby amended and restated in its entirety to read as follows:

20.3 Owner may, at any time, terminate this Agreement for Owner's convenience and without cause. If Owner so terminates this Agreement, Contractor's compensation shall be limited to: (a) payment for Work executed in compliance with the Contract Documents, as determined by Architect, which payment shall be calculated in accordance with the schedule of values previously submitted and approved pursuant to Section 15.1.1 or Paragraph 14(a)(ii) above, as the case may be, including any retainage allocable to the Work so executed (to the extent not previously paid to Contractor); and (b) out-of-pocket demobilization costs incurred by reason of such termination, including cancellation charges applicable

to leased equipment and labor charges to dismantle and remove equipment.

21. **Disputes.** Article 21 is modified as follows:

    (a) Section 21.1 is deleted. Mediation shall be required only if both parties consent thereto in writing.

    (b) If a claim or dispute should arise between the parties, Contractor shall nonetheless continue to work in accordance with the Project Schedule and Owner shall continue to make payment for undisputed portions of the Work pending resolution of said claim or dispute.

22. **Building Requirements.** Contractor shall comply with (a) the Rules and Regulations annexed hereto as Exhibit 4 and (b) Owner's Construction Rules and Guidelines. Contractor acknowledges that it has received and reviewed Owner's Construction Rules and Guidelines.

23. **Exculpation.** If Owner is a Condominium (including its Board of Managers), no officer, agent (or employee thereof), or employee of such Condominium, no member of the Condominium's board of managers, and no owner of a Condominium unit shall have any personal liability arising from or in connection with this Agreement. If Owner is a cooperative corporation, no director, officer, employee, or agent of the cooperative corporation (or employee thereof), and no propriety lessee or shareholder of the cooperative corporation, shall have any personal liability arising from or in connection with this Agreement.

24. **Miscellaneous.**

    (a) **Unenforceable Provisions.** If any provision of this Agreement is found to be void or unenforceable by a court of competent jurisdiction, the remaining provisions of this Agreement shall nevertheless be binding upon the parties with the same effect as though the void or unenforceable part had been severed and deleted.

    (b) **No Modification of Architect Agreement.** Nothing in this Agreement shall be deemed to modify the agreement between Owner and Architect.

    (c) **No Kickbacks.** Contractor warrants and represents that Contractor has not paid or received, and will not pay or receive any consideration, monetary or otherwise, in exchange for the execution of this Agreement, other than the Contract Sum.

    (d) **Counterparts.** This Agreement may be executed in counterparts, each of which shall be deemed an original and all of which together shall constitute one and the same instrument. Signed copies of this Agreement may be faxed and e-mailed with the same force and effect as if the originally executed Agreement had been delivered.

OWNER:

_____

By _____
Name:
Title:

CONTRACTOR:

_____

By _____
Name:
Title:

Exhibit 1

LIST OF PERSONNEL WORKING ON OR SUPERVISING THE PROJECT AND THEIR POSITIONS

Name	Position	Cell Phone Number

Exhibit 2

FORM OF PROGRESS WAIVER OF LIEN AND RELEASE

FORM OF FINAL WAIVER OF LIEN AND RELEASE

Exhibit 3

INSURANCE REQUIREMENTS

NOTE: THIS EXHIBIT SHOULD BE REVIEWED BY OWNER'S AND CONTRACTOR'S INSURANCE CONSULTANTS, AND A DETERMINATION MADE AS TO WHETHER THE COVERAGES AND ENDORSEMENTS PROVIDED ARE ADEQUATE AND WHETHER ADDITIONAL COVERAGES, SUCH AS BUILDER'S RISK, ARE APPROPRIATE

Supplementing Section 17.1: Contractor shall provide and maintain at Contractor's own expense, until completion of Work, the following insurance, to the extent the following requirements exceed the requirements of the other Contract Documents:

i. Worker's Compensation and Employer's Liability Insurance, in such amounts and scope as is required under the laws of the State of New York;

ii. Commercial General Liability Insurance (including coverage for commercial general liability, personal injury and death, completed operations, broad form property damage coverage with "XCU" exclusion (if any) deleted, products liability, and contractual liability) with a combined single limit for bodily injury and property damage liability of not less than $1,000,000 per occurrence and $2,000,000 in the aggregate, together with Excess/Umbrella Liability Insurance providing excess coverage in an amount of not less than Five Million Dollars ($5,000,000) per occurrence and in the aggregate, which shall contain the same coverage, including contractual liability, as the base policy;

iii. Property Damage Insurance with a limit in an amount of not less than One Million Dollars ($1,000,000) to cover Contractor's tools and equipment; and

iv. Comprehensive Automobile Liability to cover owned, long term leased, hired and non-owned automobiles (including medical payments and uninsured motorists coverage) with a combined single limit of not less than One Million Dollars ($1,000,000) (for bodily injury and One Million Dollars ($1,000,000) per occurrence for property damage).

All such insurance policies shall be written on an occurrence basis. The limit of liability may be satisfied by one or more policies, to include excess or umbrella policies, so long as the policies, viewed as a whole, provide "first dollar" coverage without any gaps or self-insured retained amounts. The foregoing insurance shall be effected under valid and enforceable policies issued by a financially responsible insurance company or companies, each having at least an A, IX rating under A. M. Best and licensed in the State of New York and reasonably acceptable to Owner.

Contractor's Commercial General Liability insurance policy (including the excess policy) shall be duly endorsed to name Owner as certificate holder and to include as additional insureds the **Additional Insureds** and other parties designated by Owner except that the worker's compensation certificate shall name the foregoing parties only as certificate holders. All insurance policies shall provide for a waiver of the right of subrogation. Contractor's policies will be on a non-contributory basis and shall be primary for any and all losses arising out of or in connection with the performance of the Work.

If customarily available, each certificate shall contain an endorsement that the insurance may not be changed, terminated or cancelled without ten (10) day's prior written notice thereof to Owner.

EXHIBIT 4

RULES AND REGULATIONS

1. To the extent Owner's Construction Rules and Regulations for the Building (however denominated) impose greater obligations on Contractor than these Rules and Regulations, Owner's Construction Rules and Regulations shall prevail.

2. Contractor acknowledges that the Building is a first-class residential apartment building. Contractor shall take all steps reasonably necessary to ensure that its performance of the Work does not unreasonably interfere with the use and enjoyment of the Building and its amenities by the Building residents; and that access to the Building, its apartments, and any commercial units is not impeded or obstructed.

3. Contractor shall not erect, or permit the installation of, any sign on or about on the Building (including any sidewalk bridge) without the prior written consent of Owner, except for temporary safety signage and signage required by law.

4. Contractor shall follow the directions of Owner and Managing Agent as to ingress and egress to and from the Building and access to the Project site. If the Building has a freight elevator, only the building freight elevator shall be used for transporting construction materials, workmen, tools and equipment. Prior arrangements for freight elevator use shall be made with the Building superintendent by Contractor. If the freight elevator is manually operated, Contractor's freight elevator use during construction shall be subject to the availability of the freight elevator operator and shall be coordinated, at the Building superintendent's discretion, with the needs of residents. No material or equipment shall be carried under or on top of elevators. No material that exceeds the elevator's capacity may be carried in the elevator. If the Building has no freight elevator, but does have a passenger elevator, Contractor's use of the passenger elevator shall be subject to the direction and control of Owner and the Building's superintendent. Contractor shall provide adequate protection for any elevator used by Contractor and/or its Subcontractors to prevent damage to the elevator.

5. Contractor shall (i) take all precautions necessary and desirable to prevent dirt and dust from entering other parts of the Building during the progress of the Work, including residential and commercial units; (ii) protect any air conditioning unit(s) and window(s) that may be affected by performance of the Work and, if affected by the Work, thoroughly clean them at the completion of the Work, and repair or replace any damaged units and windows, as appropriate; (iii) not cause any damage (or permit its employees, Subcontractors, sub-Subcontractors to cause any damage) to the apartments and commercial units in the Building, adjacent building(s) and improvement(s), sidewalks and curbs, trees and/or cars parked on the street. To the extent required to control dust and debris, Contractor shall install dust-proof partitions (plastic, paper and/or tape) during the performance of the Work. Contractor shall cause Work areas to be in broom-clean condition each night.

6. Debris and rubbish shall be placed in covered containers or sealed bags before being taken out of the Building. Contractor shall remove from the Building all such containers and bags, rubbish, rubble, debris, equipment, emptied packing cartons and other materials as often as is necessary to prevent the accumulation thereof at the Project Site and to ensure that no fire hazard or obstruction is created. Contractor shall comply with all directives of the Building's superintendent and Managing Agent with respect to keeping the Building clean from dust, dirt, rubbish and debris resulting in whole or in part from its operations and with respect to the protection of persons and property (provided that the foregoing does not release Contractor from its responsibilities under Article 16). Contractors shall keep containers in the construction area until ready to be removed, and coordinate garbage removal with the carter. No containers are to be kept on the street. The street and sidewalk must be swept clean after debris removal is effected

7. Except as permitted by Owner: (i) no work shall be performed on Saturdays, Sundays or holidays; and (ii) work shall be performed only Mondays through Fridays and then only between the hours of 8 a.m. and 5 p.m. Any work which creates unusual noise shall not be performed until after 10 a.m. Mondays through Fridays.

8. Workers shall not loiter around the outside of the Building, hallways, stairways or any other part of the Building used by the Building's residents. Alcohol beverages of any kind are not permitted in the Building. Workers shall not smoke anywhere inside the Building, on the roof of the Building, on the sidewalks or alleyways adjacent to the Building or anywhere else around the Building.

9. USE OF POWER TOOLS THAT WILL CAUSE SIGNIFICANT VIBRATION, SUCH AS ELECTRIC HAMMERS AND JACKHAMMERS, IS NOT PERMITTED, except to the extent authorized in writing by the Architect.

Bergman on Mortgage Foreclosures: The Bugaboo of Fiduciary Duty

By Bruce J. Bergman

Included in the omnipresent efforts of borrowers—and others—to stave off mortgage foreclosure is the charge of fiduciary duty breached; in the vernacular: "the lender owed me a special duty and so had no right to (you fill in the variety of protest)." But overwhelmingly it is not so. The general rule is that the legal relationship between a lender and borrower is one of debtor and creditor, not a fiduciary relationship.[1] This applies as well to the role of lender and guarantor.[2]

As always, there can be nuance to the formulation and any number of fact patterns illuminate the point. For an expanded review, attention is invited to 1 *Bergman on New York Mortgage Foreclosures* §1.01[1][a], LexisNexis Matthew Bender (rev. 2011). What particularly catches our interest, though, is a recent case[3] which arises out of the turmoil of a home equity theft scenario and tried to ensnare an innocent lender. The desperation of these times suggests that the issue may not be as obscure as a quick glance might indicate.

There, the plaintiff (an 82-year-old widow no less) said she was scammed in 2005 by her granddaughter Smith who obtained a deed to her house by fraud and forgery. Of course as soon as Smith grabbed the title she secured a $175,000 mortgage from Eastern. It will be no surprise that Smith defaulted on that mortgage (naturally $175,000 richer in the process) which precipitated a mortgage foreclosure action by Eastern. But Smith was not yet done. In 2007 she obtained a $270,000 mortgage from Zoumas to satisfy the Eastern mortgage (and apparently supply additional funds).

Although Eastern quietly went on its way (the foreclosure was concluded and it was paid) its exposure was not over. The plaintiff sued Smith, Eastern and Zoumas to quiet title (she wanted her title back) and for actual and punitive damages. As to Eastern in particular—our focus as the lender—Smith alleged that in 2006 Eastern was notified of the fraud but nonetheless allowed its loan to be satisfied in 2007. Zoumas joined the fray and charged fraud and negligence upon Eastern's part, pursuing indemnification and contribution.

Eastern the lender escapes liability. (It beat plaintiff Smith for lack of service within 120 days, but that was an accident of the case and not the point of this exploration.)

Regarding the claim of Zoumas, the new lender who satisfied the mortgage with its loan, indemnification and contribution which might have been available was barred because no breach of duty from Eastern to them could be shown[4]—precisely the important principle.

Buttressing that holding was the conclusion that Eastern owed no duty of care to the new lenders—and there was no evidence of affirmative misrepresentations.[5] The final relevant conclusion was that Eastern had no fiduciary duty or confidential relationship with the new lender and had no duty to disclose material information.

So the no fiduciary relationship between lender and borrower does indeed extend to others.

Endnotes

1. See, *inter alia*, *Debroshi v. Bank of America,* 65 A.D.3d 882, 886 N.Y.S.2d 106 (1st Dept. 2009).
2. *Niazi v. JP Morgan Chase Bank*, 66 A.D.3d 438, 886 N.Y.S.2d 404 (1st Dept. 2009).
3. *Selden v. Smith*, 76 A.D.3d 623, 907 N.Y.S. 2d 36 (2d Dept. 2010).
4. *Selden v. Smith*, *supra* at note 3, citing *Raquet v. Braun*, 90 N.Y.2d 177, 659 N.Y.S.2d 237, 681 N.E.2d 404; *Ruddy v. Lexington Ins. Co.*, 40 A.D.3d 733, 734, 835 N.Y.S.2d 440.
5. *Selden v. Smith*, *supra* at note 3, citing, *inter alia, Industrial Risk Insurers v. Ernst*, 224 A.D.2d 389, 390, 638 N.Y.S.2d 109.

Mr. Bergman, author of the three-volume treatise, *Bergman on New York Mortgage Foreclosures*, LexisNexis Matthew Bender, is a member of Berkman, Henoch, Peterson, Peddy & Fenchel in Garden City. He is a fellow of the American College of Mortgage Attorneys and a member of the American College of Real Estate Lawyers and the USFN. His biography appears in Who's Who in American Law and he is listed in Best Lawyers in America and New York Super Lawyers.

Student Case Comment: *Baygold Associates, Inc. v. Congregation Yetev Lev of Monsey, Inc.*: Clarifying the *J.N.A. Realty* Test

By Brett Bustamante

On May 3, 2012 the Court of Appeals held, in *Baygold Associates, Inc. v. Congregation Yetev Lev of Monsey, Inc.,* that the out-of-possession tenant was not entitled to equitable relief for failure to properly exercise its option to renew.[1] This ruling clarifies the *J.N.A. Realty* test which provides that "equity will intervene to relieve a commercial tenant's failure to timely exercise an option to renew a lease where (1) such failure was the result of 'inadvertence,' 'negligence' or 'honest mistake;' (2) the nonrenewal would result in a 'forfeiture' by the tenant; and (3) the landlord would not be prejudiced by the tenant's failure to send, or its delay in sending, the renewal notice."[2]

In 1976, Plaintiff Baygold Associates Inc. ("Baygold"), operating a nursing home, contracted with Monsey Park Hotel ("MPH") for a ten-year lease with the option to renew for an additional four ten-year terms.[3] Under this agreement, Baygold was required to provide "written notice… 'by certified mail with return receipt requested' no later than 270 days prior to the expiration of each term."[4]

Baygold then properly subleased the property to its affiliate, Monsey Park Home for Adults ("Monsey Park").[5] Monsey Park operated a nursing home there from 1976 to 1985 making approximately one million dollars in improvements to the property.[6] In 1985, Monsey Park subleased the property to Israel Orzel, a nonaffiliate.[7] Orzel paid rent and taxes directly to the MPH, as well as substantial yearly rent payments to Baygold under the sublease agreement.[8] When it came time to renew in 2007, it was disputed whether Baygold failed to properly renew by neglecting to send the renewal notice by certified mail, resulting in termination of the lease.[9]

Baygold brought suit against MPH seeking a declaratory judgment.[10] The Supreme Court held that the plaintiff failed to comply with the terms of the lease agreement for renewal and failed to establish excusable default under the *J.N.A Realty* test.[11] Specifically, testimony by Plaintiff's attorney lacked evidence of any mistake, but rather indicated that he complied with the terms.[12] The Appellate Division agreed with the Supreme Court's analysis. Additionally, the Appellate Division held Baygold was unable to prove a "forfeiture" under the second prong of the *J.N.A. Realty* test.[13] This would require improvements of "substantial character" in good faith and with the intent to renew the lease, and proof that tenant would sustain a substantial loss if the lease was not renewed.[14]

The Court of Appeals assumed that there was excusable default, and shifted attention to the second prong of the *J.N.A. Realty* test, whether there was indeed a "forfeiture."[15] The issue became whether Baygold made improvements of a "substantial character."[16] Baygold cited improvements made from 1972 to 1985 while it was a tenant-in-possession, but the majority found these improvements too attenuated,[17] the crucial factor being that it was not a tenant-in-possession at the time of the failure to renew.[18] The court noted that: "The forfeiture rule was crafted to protect tenants in possession who make improvements of a 'substantial character' with an eye toward renewing a lease, not to protect the revenue stream of an out-of-possession tenant like Baygold."[19]

In addition, the court found improvements made by Orzel under the sublease could not be deemed a "substantial loss" by Baygold since it had already reaped the benefit of its expenditures.

In the dissent, Judge Smith argued that the majority drew an arbitrary distinction between tenants and subtenants that resulted in a windfall of improvements for the benefit of the landlord.[20] Based on the *Baygold Associates* decision attorneys will want to advise long-term tenants to take greater care in complying with renewal provisions.

Endnotes

1. 19 N.Y.3d 223, 970 N.E.2d 829, 947 N.Y.S.2d 794, 2012 N.Y. Slip Op. 03472 (2012).
2. *Baygold Associates, Inc.,* 19 N.Y.3d 223, 225 (*citing J.N.A. Realty Corp. v. CrossBay Chelsea*, 42 N.Y.2d 392, 366 N.E.2d 1313, 397 N.Y.S.2d 958 (1977)).
3. *Id.*
4. *Id.*
5. *Id.*
6. *Id.*
7. *Baygold Associates, Inc.,* 19 N.Y.3d 223, 226.
8. *Id.*
9. *Id.*
10. *Id.*
11. *Id.* at 227.
12. *Id.*
13. *Baygold Associates, Inc.,* 19 N.Y.3d 223, 227.
14. *Id.*
15. *Id.*
16. *Id.*
17. *Id.*
18. *Id.*
19. *Baygold Associates, Inc.,* 19 N.Y.3d 223, 228.
20. *Id.* (J. Smith, dissenting).

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For ease of publication, articles should be submitted via e-mail to any one of the Co-Editors, or if e-mail is not available, on a disk or CD, preferably in Microsoft Word or WordPerfect (pdfs are NOT acceptable). Accepted articles fall generally in the range of 7-18 typewritten, double-spaced pages. Please use endnotes in lieu of footnotes. The Co-Editors request that all submissions for consideration to be published in this *Journal* use gender-neutral terms where appropriate or, alternatively, the masculine and feminine forms may both be used. Please contact the Co-Editors regarding further requirements for the submission of articles.

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