KNOW YOUR LEASE

By Thad Armstrong

PART 3

Questions to Ask

This is the third in a series of articles following my recent *NBIZ* article titled *10 Questions You Need to Ask about Your Lease*. Each of the questions touched upon an important issue facing tenants when negotiating a commercial lease agreement. The following article will focus on the fifth, sixth, and seventh of the original 10 questions, giving you a better understanding of the critical issues controlling your and your landlord's rights and obligations under your lease agreement.

What if My Roof Leaks? Or, What if Building Services Go Out?

The lease should clearly allocate responsibility between the landlord and the tenant in two respects: (1) maintenance; and (2) building services (e.g., utilities, air conditioning, and elevator service). With regard to maintenance in most multitenant buildings, the tenant should expect to be responsible for nonstructural interior items; responsibility for structural items, building mechanical systems, and common areas should be allocated to the landlord. With regard to building services, the lease should clearly describe the services to be provided to the tenant and at what cost.

Buyer Beware

Even with these clear allocations of responsibility, most commercial leases contain a so-called "as is" clause, and many leases contain a so-called "independent covenants" clause. An "as is" clause means that the tenant agrees to take possession of and occupy the premises in their present condition—whatever that condition may be. An "independent covenants" clause means that the tenant's obligation to pay rent is not dependent on the landlord's obligation to maintain the building or to provide building services. In other words, let the buyer beware. Tenants with good bargaining positions should negotiate for special rights if the landlord fails to maintain the building or if essential building services are interrupted.

Tenant's Remedies

These special rights typically come in the form of the remedy of "self-help" or an abatement of rent. But tenants should not expect to be given these rights unless the premises are actually unusable for the tenant's business purposes. The remedy of self-help allows the tenant to do what the landlord failed to do, and to receive reimbursement for doing so. In the case of a leaky roof, for instance, the tenant would have the right under the lease to have the roof repaired at the landlord's expense. The remedy of abatement allows the tenant not to pay rent under certain circumstances. If, for instance, the building's air conditioning stops functioning in the heat of the summer and the tenant can't reasonably occupy the premises, the rent would abate until the air conditioning is restored.

What Happens if I Don't Pay My Rent?

Leases typically give the landlord the following remedies after the tenant's default: the right to lock the doors; the right to permanently evict the tenant; the right to terminate the lease; and the right to file a lawsuit against the tenant to recover the landlord's economic losses.

Tenant's Default & Landlord's Remedies

If the landlord chooses to lock the doors, Texas law requires the landlord to post a specific notice and to give the tenant a new key to the premises when the tenant pays the delinquent rent. This is called the tenant's "right of re-entry." But the right of re-entry can be

lost if the lease states otherwise. The lease will control.

The legal process by which a landlord is entitled to evict a tenant is called "forcible entry and detainer" and is a judicial process involving certain notices followed by a lawsuit. The legal process of forcible entry and detainer is beyond the scope of these articles. In Texas, nine times out of ten, the lease contract itself will control over the general law. Therefore, rather than submit landlords to the uncertainty, time, and costs of a judicial process, most commercial leases allow landlords to exercise these remedies as a matter of contract without judicial process. If the landlord chooses to evict the tenant without terminating the lease, the tenant's right to possess the premises will be permanently terminated, and the tenant will have no right of re-entry.

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The lease, however, will remain in place as a contract between the landlord and the tenant. This means that the tenant will still be required to pay rent each and every month, even though the tenant has no right to occupy the premises. The landlord, on the other hand, should be attempting to re-let the premises during this time. Any money received by the landlord under the new lease will be credited, net of the costs of re-letting, to the first tenant's rent obligation.

If the landlord chooses to terminate the lease, both the tenant's right of possession and the lease as a contract will be terminated. Because the lease itself is terminated, the parties' obligations under it will not continue. The tenant's obligation to continue paying rent each month will stop; however, most commercial leases will require the tenant to pay a lump-sum settlement. This settlement amount should be calculated along the following lines: the amount of delinquent rent owed at the time of termination PLUS the amount that would have been owed for the remainder of the term (discounted to present value) MINUS the amount of rent the landlord could reasonably expect to receive for the premises upon re-letting (i.e., the market value of the premises) (also discounted to present value) PLUS the amount of the landlord's costs and expenses resulting from the tenant's default. Leases run the gamut on how this settlement amount is determined, but the foregoing will serve as a simple guide for what should be expected.

These remedies can be harsh, and most leases allow the landlord to take these steps without first giving the tenant notice of the default and the opportunity to cure it. The tenant should negotiate a clause into the lease requiring the landlord to give written notice of a default and a period of time in which to cure it before the landlord is entitled to exercise remedies against the tenant. The tenant should also pay careful attention to the amount it will owe the landlord

after a default. The landlord should be allowed to recover the landlord's lost rent and direct damages, as generally described above, but many leases overreach and permit the landlord to recover from the tenant other damages that are out of the tenant's control (e.g., an above-market improvement allowance given to re-let the premises).

What Am I Liable for Under My Personal Guaranty?

The answer to this question is: probably everything. Landlords rightly expect to be paid the rent that the landlord bargained for. If the tenant defaults, landlords also rightly expect to be repaid the costs and expenses they incur in dealing with the tenant's default and in enforcing the lease. Most guarantors understand this but are still interested in drawing some parameters around personal liability.

What Is Covered by the Guaranty?

Most personal guaranties cover both "payment and performance." This means that the guarantor is guaranteeing not only the tenant's obligation to pay rent, but also the tenant's obligation to perform each and every other obligation under the lease (e.g., maintenance and repair of the premises). Personal guarantors expect to be on the hook for money, but many do not expect to be called upon to perform other contractual obligations of the tenant. Sophisticated guarantors will attempt to remove the guaranty of performance from the guaranty, leaving only a guaranty of payment. Specific legal drafting is required to accomplish this, and guarantors should seek the advice of an attorney to make sure their intentions are properly captured in the document.

Limitations on Liability

To further soften the blow of personal liability, the guarantor should attempt to limit the guaranty in two respects: time and amount. With regard to time, the guarantor may be able to limit the guaranty by causing it to expire automatically after a specific period of time. With regard to amount, the guarantor may be able to limit the guaranty to a specific amount of money. Many guarantees contain a hybrid of these two limitations, commonly referred to as a "burn-off" clause. A burn-off clause in a guaranty reduces the guarantor's liability over time until the guarantor's liability equals zero. If a guaranty is limited in any respect, and there are more than one guarantor, it is critical that any clause referring to the guarantor's "joint and several" liability be removed and expressly negated. Otherwise, the guarantor may find him or herself on the hook for his or her co-guarantors' obligations. Again, specific legal drafting is required to accomplish this, and guarantors should seek the advice of an attorney to make sure their intentions are properly captured in the document.N

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