

PHASE FIVE: NEGOTIATING LEASES FOR THE RETAIL CENTER

Brian P. Henry, Esq.
FREEMAN, COTTON & NORRIS, P .C.
33 Bloomfield Hills Parkway, Suite 100
Bloomfield Hills, Michigan 48304-2945
(248) 642-2255
Fax (248) 642-2255
e-mail: bhenry@fcnlaw.com

OUTLINE

PREAMBLE

- I. THE DO'S AND DON'TS OF LETTERS OF INTENT**
- II. ISSUES TO BE ADDRESSED DURING ANY LEASE NEGOTIATION**
- III. EXPANSION AND CONTRACTION OPTIONS**
- IV. MAKING SENSE OF CLAUSES PROVIDING THE RIGHT TO REBUILD AFTER DAMAGE OR DESTRUCTION**
- V. USE CLAUSES AND THE ENFORCEMENT OF RESTRICTIVE COVENANTS**
- VI. DEFINING COSTS IN COMMON AREA MAINTENANCE PROVISIONS**
- VII. WORK LETTERS AND CONSTRUCTION ISSUES**
- VIII. LENDER'S CONCERNS AND TENANT'S FEARS**
- IX. CASE LAW RELATED TO BREACH**
- X. LIST OF FORMS**

LIST OF APPENDIXES

Appendix A: Landlord Form Lease Agreement

Appendix B: Sample Provisions

PREAMBLE

Lease. “Any agreement which gives rise to a relationship of landlord and tenant (real property) or lessor and lessee (real or personal property)... Contract for exclusive possession of lands or tenements for determinate period. Conveyance of interest in real property for specified period or at will.”

Black’s Law Dictionary (5th Ed. 1979)

Lease agreements are negotiated from many different forms. This section will not cover all the possible clauses that one would negotiate as an attorney responsible for negotiating the leases for the Retail Center.

I. The Do’s and Don’ts of Letters of Intent.

A. Why use Letters of Intent? (“LOI”)

A Letter of Intent is customarily used to reduce to writing, a preliminary understanding of parties in connection with a lease (or other business) negotiation. A Letter of Intent may or may not be binding upon the parties, depending upon the intent of the parties. Letters of Intent are a minefield for litigation. Many times, the parties proceed to court because they misunderstand the purpose of the writings associated with the negotiation of a lease.

1. Generally, the LOI take less time to draft than a typical lease.
2. The LOI enable the parties to focus on the essential terms of a deal.
3. The LOI allow the parties to list the terms which are acceptable and those which still must be negotiated.
4. The LOI, even if not intended to be binding, indicates that the parties are serious about making a deal.
5. The LOI provides direction and focus for the lawyer drafting the lease.
6. The LOI can establish deadlines by which certain items must be completed (i.e., transfer of a license, submission of plans and specs for approval, space plan, layout plans, etc.).
7. The LOI can force a party to spend enough money so that the party is committed to the transaction.
8. The LOI can clarify the position of the Landlord and Tenant if multiple parties have been involved in the negotiations.

9. The LOI can establish “drop dead” events which should prevent the other party from “stringing out” the negotiations (i.e., provide an option to renew or option to purchase with fixed price or rate).

B. What are the risks of a Letter of Intent?

1. Is there a duty, to negotiate the lease in good faith after the letter has been signed?
2. May a party reopen an issue addressed by the Letter of Intent?
3. May a party change an issue addressed by the Letter of Intent under the guise of refining it?
4. May a party later raise or add an issue which the other party believes materially changes the Letter of Intent (i.e., an option to extend or an option to renew)?
5. Can the parties distinguish or restrict the terms of the Letter of Intent to binding and non-binding terms?
6. The Letter of Intent may not clearly reflect the intent of the parties regarding binding and non-binding issues.
7. When can a party walk away from the deal? "
8. Can a dispute over a Letter of Intent be submitted to binding arbitration?
9. The Tenant may use the Letter of Intent to shop for a better lease rate.

C. Sample Clause used for Non-binding LOI. “The foregoing provisions of this letter shall not be deemed an offer to lease, an agreement to negotiate, or a lease or other agreement. This letter does not contain all the necessary material terms which will be the agreement between the parties. This letter is not intended to be legally binding nor is it intended to confer any rights of usage or occupancy. The terms of this letter are subject to withdrawal and modification, at any time, by either party, without cause. Until the parties execute and deliver a formal lease agreement, neither party shall have any obligation to the other. No reliance, performance, change, or loss of position or other action or expectation now or hereafter made shall be deemed to create any obligation or agreement of any type.”

D. Case Law.

1. Background. As a rule, preliminary negotiations do not constitute a contract and an agreement to enter into a contract is of no effect unless all of the essential terms and conditions of the contract are understood and accepted by the parties. A simple statement of intention is not an offer that may be turned into an agreement by acceptance. 17 C.J.S. Contracts §49 (1963).

2. Opdyke Investment Co. v Norris Grain Co. 413 Mich. 354 (1982). This is the seminal case in Michigan on letters of intent. The case provides that a contract to make a subsequent contract is not per se unenforceable. The court reversed a grant of summary judgment which held a letter of intent to be a non-binding obligation, stating that a contract to make a contract “may be just as valid as any other contract”. 413 Mich. at 359. The court also discussed application of the Statute of Frauds in determining the enforceability of a letter of intent. The Statute of Frauds is not strictly construed to require the parties to reduce to writing, a complete list of all terms. “Some note or memorandum having substantial probative value in establishing the contract must exist; but its sufficiency in attaining the purpose of the statute depends in each case upon the setting in which it is found”. 413 Mich. at 368 (quoting Goslin v Goslin, 369 Mich 372, 376 (1963)).

3. Jim-Bob, Inc. v Nehling, 178 Mich App 71 (1989). Landlord and Tenant were negotiating a new lease. The parties used a prior lease as a draft document by “marking up” the old lease with new terms and crossing out others. The Landlord sold the building and wanted to evict the Tenant, arguing that no “final” lease had been negotiated. The Court of Appeals held that since the parties had discussed the entire lease, page by page, and reached agreement on most essential issues, the lease was binding.

4. Cases to Review from Other Jurisdictions:

(a) Phoenix Mutual Life Company v Shady Grove Plaza Limited Partnership, 734 F. Supp. 1181 (D. Md. 1990);

(b) Bercoon, Weiner, Glick and Brook v Manufacturers Hanover Trust, 818 F. Supp. 1152 (N.D. Ill. 1993);

(c) A/S Apothekernes Laboratorium for Specialpraeparater v I.M.C. Chemical Group, Inc. 873 F.2d 155 (7th Cir. 1989);

(d) Teachers Insurance and Annuity Association of America v Tribune Company, 670 F. Supp 491 (S.D.N.Y.1987);

(e) Channel Home Centers, Division of Grace Retail Corporation v Grossman, 795 F.2d 291 (3rd Cir. 1986);

(f) Feldman v Allegheny International, Inc., 850 F.2d 1217 (7th Cir. 1988).

II. Issues to be Addressed During Any Lease Negotiation.

A. LEASE REVIEW CHECKLIST.

Re: Tenant Concerns/Retail Leases

1. Charges
2. Term

3. Fixed Minimum Rent
4. Percentage Rent
5. "Gross Sales" Defined
6. Taxes
7. Leased and Occupied/Leasable Floor Area for Tenant's Proportionate Share
8. Books of Account and Audit
9. The Premises
10. Parking
11. Repairs and Maintenance
 - a. Capital Improvements
12. Landlord's Repairs
13. Right to Relocate
14. Conduct of Business
15. Common Areas
16. Mandatory Refurbishing
17. Surrender
18. Indemnification
19. Subrogation
20. Insurance
21. Utilities
22. Subordination and Attornment
23. Assignment and Subletting
24. Promotion and Advertising
25. Merchants Association
26. Damage and Destruction
27. Eminent Domain/Condemnation
28. Bankruptcy
29. Default
30. Security Deposit\Letter of Credit
31. Use
32. Miscellaneous
33. Arbitration
34. Late Charge
35. Alterations and Improvements by Tenant

- 36. Quiet Enjoyment
- 37. Landlord's Lien
- 38. Rules and Regulations
- 39. Future Expansion
- 40. Landlord's Work
- 41. Authorization to Enter Into Lease
 - a. Board of Directors Authorization

B. Highlighted Topics and Suggestions for Tenants.

1. Charges

- always ask that any numbers be written out; (i.e., twenty-five (25))
- all pass through charges should be definite; if not, get the Landlord to provide written estimates of the pass through charges
- ask the Landlord for copies of billings from the previous year attempt to negotiate a cap on the pass through charges

2. Term

- the Tenant wants a guaranteed commencement date; the Tenant should ask for a penalty if the premises are not delivered on time (i.e., rent credits)
- set deadlines to establish a reasonable period to submit architectural drawings, obtain necessary building permits and complete leasehold improvements
- negotiate work letters whenever possible
- after the commencement date, obtain a letter from the Landlord confirming the commencement and termination date
- Tenant will want options to renew the lease term

3. Fixed Minimum Rent

- sample clause for protection of Tenant if a major Tenant departs from a retail center:

“A material inducement to Lessee to enter into this Lease is the presence and full operation of the _____ stores identified on Exhibit “_____” as “_____”, “_____”, and “_____”. If any of these _____ Stores (or stores of comparable quality in merchandising and reputation) fails to continuously operate during the term of the Lease, Tenant's business and ability to pay rent as well as its ability to meet other obligations under the Lease will be substantially impaired. Therefore, if any of the Stores closes for business for sixty (60)

consecutive days, then Minimum Annual Rent and Percentage Rent shall abate and in lieu thereof, Tenant shall pay (i) an amount equal to six percent (6 %) of Tenant's Gross Sales for each calendar month (or partial calendar month at the beginning and end of such period, as the case may be), payable monthly, in arrears, on or before the 15th day of the month immediately succeeding each and every calendar month and (ii) all additional rent which shall be due and payable in advance on or before the first day of each month unless expressly stated otherwise elsewhere in the Lease. As provided above, the contingency payment shall be referred to as "in lieu rent" and shall continue until a substitute Store of comparable quality in merchandising and reputation opens for business. In the event that any of the remaining Stores close for business for sixty (60) consecutive days, Tenant shall have the option to cancel this Lease. The option to cancel may be exercised by giving notice of cancellation in writing to Landlord within sixty (60) days after the option to cancel becomes available to Tenant."

4. Percentage Rent

- percentage rent can add considerably to the Tenant's cost of doing business
- payment should normally be made 30 days after the end of the lease year
- the denominator for calculating partial lease years should be 365 no yearly Percentage Rental Adjustments
- any overage paid by Tenant should be credited against "any" future installment of rent due or refunded
- Landlord and Tenant must agree how to resolve disputes over percentage rent

5. "Gross Sales" Defined

(a) Bad Debt and Employee Discount Deductions

Landlord usually will not allow deductions for uncollectible accounts. However, Landlords should encourage credit sales which in turn result in increased Percentage Rent payable to Landlord. Therefore, Landlord should permit a deduction from Gross Sales for uncollected accounts not to exceed three percent (3 %) of annual Gross Sales. Further, Landlords usually do not permit an exclusion or deduction from Gross Sales for employee discounts. However, these discounts generate employee goodwill, which, in turn, can result in increased sales in Percentage Rent payable to Landlord. Therefore, Landlord should also permit an exclusion or deduction from Gross Sales for employee discounts in an amount not to exceed three percent (3%) of annual Gross Sales.

(b) Payment of Percentage Rent

Sample clause for payment of percentage rent:

“Percentage Rent for each Lease Year and Partial Lease Year shall become due and payable on the fifteenth (15th) day of the month immediately following the month during which said Adjusted Gross Sales exceeds the percentage breakpoint for such Lease Year or Partial Lease Year, as the case may be, and thereafter shall be paid monthly on all additional Adjusted Gross Sales made during the remainder of such Lease Year or Partial Lease Year, as the case may be.”

Tenant must establish the percentage breakpoint at a figure which will allow the Tenant to establish itself financially in the shopping center. The breakpoint must be high enough to allow Tenant to cover initial capital expenses of operation.

(c) Certification of Financial Statements

Sample clause:

“Tenant shall submit to Landlord at the address specified for notices to Landlord, on or before the thirtieth (30th) day following the end of each Lease Year and Partial Lease Year, a written statement of Adjusted Gross Sales showing Tenant’s Gross Sales, itemized deductions and exclusions for the preceding Lease Year or Partial Lease Year, signed by an officer of Tenant, and certified under oath to be complete and correct.”

Landlord may want more than a certified statement from the Tenant regarding gross sales. Landlord may request the right to audit gross sales or may request independent third party verification.

(d) Payment of Additional Percentage Rent upon Audit

Small tenants do not maintain large cash reserves. Therefore, small tenants should have thirty (30) days from the date of notice in which to make such payment.

Sample clause for tenants regarding payment of additional percentage rent showing “carve outs” from the definition of “Gross Sales”:

“Provided that Tenant keeps proper evidence thereof, Gross Sales shall not, however, include (i) any sums collected and paid out for any retail sales tax or retail excise tax imposed by any governmental authority and paid directly by Tenant to that governmental authority and separately stated, (ii) any exchange of goods or merchandise between the stores or warehouses of Tenant where such exchange of goods and merchandises made solely for the convenient operation of the business of Tenant and not for the purpose of consummating a sale which has theretofore been made at, in, on, about or from the Premises, nor for the purpose of depriving Landlord of the benefits of a sale which otherwise would be made

at, in, on, about or from the Premises, (iii) the amount of returns to shippers or manufacturers, (iv) the amount of any cash or credit refund, limited to the sales price, made upon any sale where the merchandise sold, or some part thereof, is thereafter returned by the Purchaser and accepted by Tenant, (v) sales of fixtures which are not a part of Tenant's stock-in-trade, (vi) sales to employees of the Premises at a discount of at least fifteen percent (15 %), but not in excess of two percent (2 %) of Gross Sales per Lease Year, (vii) to the extent that the amount thereof was previously included in Gross Sales, bad debts, not exceeding two percent (2 %) of Gross Sales per Lease Year, (viii) sales of gifts certificates. Each sale upon installment, credit or layaway shall be treated as a sale when Tenant shall receive any payment from its customer and, subject to the limitations set forth above."

6. Taxes

- if not negotiated properly, language regarding taxes can significantly add to the Tenant's costs of operation in a facility
- Tenant should pay taxes attributable to common areas and leasehold only
- proportionate share: denominator: gross leasable floor area; Tenant should exclude inheritance taxes, gift taxes, transfer taxes, franchise taxes, excise taxes, net income taxes, profit taxes and capital levies
- Tenant wants the right to audit Landlord's tax statements
- Tenant wants the right to contest taxes
- Tenant wants the right to pay assessments in installments
- Tenant should request a gross cap on increases over term of lease

7. Leased and Occupied/Leasable Floor Area for Tenant's Proportionate Share

(a) The definition of "Leased Space" for the shopping center can add significantly to Tenant's costs. When calculating Tenant's proportionate share of costs, the Landlord will use a ratio. The ratio will use the square footage of Tenant's premises as the numerator. The denominator will often be the Leased Floor Area of the shopping center or the building.

(b) The Tenant will want to change the denominator for Tenant's proportionate share to "Leasable Floor Area" rather than "Leased Floor Area". If Leased Floor Area is used as the denominator, Tenant's proportionate share will increase and Tenant will subsidize the cost to maintain vacant space in the shopping center or the building. Tenant does not want to be responsible for general economic conditions or for poor management. As an alternative, Landlord should agree that the denominator shall not be less than ninety percent (90 %) of the Leasable Floor Area of the Shopping Center.

8. Books of Account and Audit

- Tenant want to assure confidentiality

- Tenant wants the right to independent verification

9. The Premises

- Be sure to attach the exhibits showing all space Tenant intends to lease
- The exhibits should show expansion and contracting options
- Tenant wants date certain for Landlord to review and return plans

10. Parking

- Designated spaces may be important to Tenant
- Landlord should provide tenant with copies of the rules and regulations for parking
- Landlord should provide written notice of defaults

11. Repairs and Maintenance

- Tenant should be only responsible for defects it causes
- Tenant does not want to be responsible for capital improvements

12. Capital Improvements

- Sample clause:

“Notwithstanding anything herein to the contrary, if Tenant is responsible for an expense or cost which would be deemed a capital improvement or capital expenditure under generally accepted accounting principles, Tenant shall only be responsible for a portion of said costs or expenditure which shall be determined by the following formula:

$$\frac{\text{Amount of Capital Cost or Expenditure}}{\text{Useful life of Improvement}} \times \text{Remainder of Lease Term}$$

If Tenant exercises an option to renew, the numerator shall be adjusted accordingly to take into account the renewal term. If Tenant exercises its option to purchase the property, Tenant shall be responsible for the entire cost of said repair. Each party shall pay its prorata share of the expense of the capital improvement or expenditure at the time the work is undertaken.”

13. Landlord's Repairs

- Landlord should always complete repairs during non-business hours and after reasonable notice to Tenant
- Landlord will not block entrance to Tenant's space during repairs

- Tenant will want language that Landlord will minimize the interruption to Tenant's business

III. **Expansion and Contraction Options.**

A. **Contraction Option.**

- 1) **Definition.** An option for the Tenant to give back part of its space to the Landlord before the end of the term and receive the appropriate reduction in rent and other obligations. Sometimes, the Landlord may provide a cancellation option in which the Tenant gives back the entire space. Normally, the contraction option is used by a Tenant who leases a significant amount of space and later determines that all of the space is not necessary. The contraction option allows the Tenant to save money and allows the landlord to release the space. The cancellation option is better suited to a smaller Tenant.
- 2) **Purpose.** Sometimes, if a Tenant loses a major customer, it will not need as much space. During periods of economic down-turns, contraction options were common. Landlords do not like contraction options nor do lenders, but sometimes they are necessary in order to entice the Tenant to sign a lease during uncertain economic times.

B. **Contraction Checklist.**

- 1) May the Tenant exercise a number of different options to reduce space?
- 2) What type of notice must be given by the Tenant and how much in advance of exercising the contraction option?
- 3) Is the Tenant forced to provide the notice during a specific period (i.e. anniversary date), or within a window?
- 4) Is the space specifically identified in an exhibit to the lease or some other writing?
- 5) Must the Tenant return the space in a specified order?
- 6) Are there any specific areas within which the Tenant cannot contract?
- 7) What is the effective date of the contraction?

C. **Expansion Option.**

Definition. An expansion option is an option that the Tenant has to increase the size of the premises at some time after the original lease commencement date. Sometimes the Tenant has the fixed option to add space. Other times, the Tenant has a right of first

refusal to lease certain space on the same conditions that another prospective Tenant has been offered. Finally, the Tenant is allowed the opportunity to lease additional space when the space becomes available but before the Landlord puts it on the market.

D. Checklist.

- 1) Does the Tenant have one or more options to expand?
- 2) How much advance notice must be given?
- 3) Does the Tenant exercise all prior expansion options to obtain the right to exercise subsequent options?
- 4) Does the Landlord have flexibility to deliver the space within a square foot range?
- 5) Is the option assignable?
- 6) May the Tenant exercise the option if it is in default?
- 7) Must the Landlord provide reasons for rejection of the expansion options?
- 8) Are there any preconditions to exercising the option?

E. Sample Language.

- 1) **Contraction Option.** So long as Tenant is not in default hereunder, Landlord hereby grants to Tenant the right to terminate this lease for the _____ square feet marked on Exhibit _____, effective as of any day chosen by Tenant during the sixth (6th) or seventh (7th) years of the Term hereof, provided (i) Tenant gives Landlord written notice of the exercise of this contraction option and of the effective date of termination not less than one hundred eighty (180) days prior to the effective date of such termination, and (ii) simultaneously with the giving of such notice, Tenant pays to Landlord liquidated damages for the contraction of this lease in the amount of \$_____. Landlord and Tenant shall execute an amendment to the lease to incorporate the following terms: _____.
- 2) **Expansion Option.** During the Term, so long as Tenant is not in default hereunder, Tenant shall have the continuing option to lease all or part of the space located on the _____ floor of the Building which is not then leased to The _____ Group, and affiliated entity of The _____ Group or other tenants, by giving thirty (30) days written notice to Landlord of Tenant's desire to lease such space. Such space to be leased by Tenant (the "Option Space") shall be included within the Premises and leased to Tenant pursuant to the provisions of this lease and this lease shall be amended accordingly. The amendment shall include the following terms:
_____.

IV. Making Sense of Clauses Providing the Right to Rebuild after Damage or Destruction.

A. Concerns of Landlord and Tenant

- 1) What happens to the rental space?
- 2) What happens to the lease space?
- 3) What happens to the lease?

B. Two Sample Clauses.

1) (First Clause) Damage or Destruction to Building

(a) In the event the Premises or the Building are damaged by fire or other insured casualty and the insurance proceeds have been made available therefor by the holder or holders of any mortgages or deeds of trust covering the Building, the damage shall be repaired by and at the expense of Landlord to the extent of such insurance proceeds available therefore, provided such repairs and restoration can, in Landlord's reasonable opinion, be made within _____ days after the occurrence of such damage without the payment of overtime or other premiums, and until such repairs and restoration are completed the rent shall be abated in proportion to the part of the Premises which is unusable by Tenant in the conduct of its business (but there shall be no abatement of rent by reason of any portion of the Premises being unusable for a period equal to three (3) days or less). Landlord agrees to notify Tenant within thirty (30) days after such casualty if it estimates that it will be unable to repair and restore the Premises within said _____ day period. Such notice shall set forth the approximate length of time Landlord estimates will be required to complete such repairs and restoration. Notwithstanding anything to the contrary contained herein, if Landlord cannot or estimates it cannot make such repairs and restoration within said _____ day period, then Tenant may, by written notice to Landlord, cancel this Lease as of the date of the occurrence of such damage, provided such notice is given Landlord within thirty (30) days after Landlord notifies Tenant of the estimated time for completion of such repairs and restoration. Except as provided in this Section _____, there shall be no abatement of rent and no liability of Landlord by reason of any injury to or interference with Tenant's business or property arising from the making of any such repairs, alterations or improvements in or to fixtures, appurtenances and equipment. Tenant understands that Landlord will not carry insurance of any kind on Tenant's furniture and furnishings or on any fixtures or equipment removable by Tenant under the provisions of this Lease, and that Landlord shall not be required to repair any injury or damage by fire or other cause, or to make any repairs or replacements of improvements installed in the Premises by or for Tenant.

(b) In case the Building throughout shall be so injured or damaged, whether by fire or otherwise (though the Premises may not be affected, or if affected, can be repaired

within said _____ days) that Landlord, within sixty (60) days after the happening of such injury, shall decide not to reconstruct or rebuild the Building, then notwithstanding anything contained herein to the contrary, upon notice in writing to that effect given by Landlord to Tenant within said sixty (60) days, Tenant shall pay the rent, properly apportioned up to date of such occurrence and Landlord shall return the security deposit required by paragraph _____, and this Lease shall terminate from the date of delivery of said written notice, and both parties hereto shall be freed and discharged from all further obligations hereunder.

2) (Second Clause) Destruction of Premises.

(a) In the event of damage to the Premises, rent and all occupancy charges shall abate wholly or proportionately, as the case may be, during any period of untenantability. In the event of damage to the Premises by fire or other insured casualty or cause rendering the Premises partially untenantable, Tenant shall diligently restore same. In the event of damage by fire or other casualty or cause rendering the Premises substantially untenantable and requiring essentially a rebuilding of the Premises or in the event of an uninsured casualty, Tenant may elect to either terminate this Lease or to rebuild and restore the same; provided, however, that in the event that said destruction shall occur anytime after the _____ year of the original term of this Lease or after the third (3rd) year of any renewal term and cannot be repaired within 120 days, either Landlord or Tenant can terminate this Lease in which case Tenant shall assign to Landlord the right to collect any insurance proceeds payable on account of such casualty, and this Lease shall terminate automatically as of the date of casualty. This Lease shall be extended by any period of untenantability.

(b) In the event the Premises shall be partially or totally destroyed by fire or other casualty insured under the insurance carried by Landlord so as to become partially or totally untenantable, then, to the extent that insurance proceeds are available, the damage to the Premises shall be promptly repaired (unless Landlord shall elect not to rebuild as hereinafter provided), and the Basic Rent and Additional Rent shall be abated in proportion to the area of the Premises rendered untenantable. Payment of full rental so abated shall commence from the 30th day following the date that Landlord advises Tenant that the Premises are tenantable, unless Tenant opens at an earlier time in the damaged area or remains open in such area following destruction or damage, in which event there shall be no abatement or any such abatement shall terminate as of the date of Tenant's earlier re-opening. The obligation of Landlord hereunder shall be limited to reconstructing the Premises to the extent insurance proceeds are available, in accordance with the initial plans and specifications for the original construction of the Premises. In no event shall Landlord be required to repair or replace Tenant's merchandise, trade fixtures, furnishings or equipment, or alterations or additions constructed or installed by or for Tenant.

(c) Subject to Section _____, if (i) more than seventy-five (75 %) percent of the Door area of the Premises shall be damaged or destroyed by fire or other casualty, or (ii) during the last eighteen (18) months of the term hereof more than twenty-five (25 %) percent of the Door area of the Premises shall be damaged or destroyed by fire or

other casualty, or (iii) all or any part of the Premises are damaged or destroyed at any time by the occurrence of any risk not insured under the insurance carried by Landlord, then Landlord, at its sole option, may terminate this Lease by giving written notice to Tenant of Landlord's election so to terminate, such notice to be given within ninety (90) days after the occurrence of such damage or destruction.

C. Lender's Concerns.

- 1) Lenders want the right to use insurance proceeds.
- 2) Rental interruption insurance must be purchased by the Landlord.
- 3) Business interruption insurance must be purchased by the Tenant.
- 4) Lenders are concerned when there is a short-fall in insurance proceeds. If insurance proceeds are inadequate to rebuild the premises, the lender will want assurance that proceeds are available from the Landlord or Tenant to rebuild the premises in accordance with the original plans and specifications.
- 5) In a multi-tenant development, the Landlord wants all damage clauses to be identical.
- 6) Any obligation of Landlord to restore the premises after damage or destruction will be limited by the terms of the mortgage. The lender will want to hold the proceeds and disburse as restoration proceeds to lender's satisfaction.

IV. Use Clauses and the Enforcement of Restrictive Covenants.

A. Definition. An exclusive clause gives the Tenant the exclusive privilege to carry on a particular business on the Landlord's property.

B. Sample Cause.

"Tenant shall have the exclusive right (except for existing grocery and drug stores and any replacement grocery and drug store) to sell cards, related items, gifts, office supplies and office furniture, and to operate a copy center. Any unauthorized use shall be a breach of the lease."

C. Complaint/Causes of Action.

- 1) Breach of lease
- 2) Intentional interference with contract (Broker)
- 3) Intentional interference with advantageous business relationship (Customers)

- 4) Conspiracy

D. Relief.

- 1) Injunction
- 2) Lost profits
- 3) Incidental and consequential damages

E. Cases.

- 1) Handy Andy Home Improvement Centers v American National Bank and Trust Company, 177 Ill. App., 3d 647; 532 NE2d 537 (1988)
- 2) NIB Foods v Mally, 70 Mich. App. 553 (1976)
- 3) Bobenal Investment v Giant Super Market, 79 Mich. App. 18 (1977)

V. Defining Costs in Common Area Maintenance Provisions.

A. Two Sample Clauses.

1. First Clause:

The operation and maintenance of the Common Area and related facilities shall include but shall not be limited to the following: improving, updating, expanding, operating, equipping, lighting, repairing, replacing, and maintenance of the Common Area, illumination and maintenance of exterior Building signs (excluding Lessee signs), parking lot lighting and exterior Building lighting (and electricity therefore), parking lot cleaning, exterior window cleaning, snow removal, parking lot striping, parking lot repairs and replacements, landscaping maintenance and replacements, lawn sprinkler system and water therefore, all roof repairs and replacements, eaves troughs, down spouts, gutters, trash removal service, repairing, repainting and washing of exterior Building walls, and all other costs and expenses of repairing, replacing and maintaining the exterior areas of the Building and Site. All of the foregoing, together with a management fee of 4 % of the yearly minimum net rental hereunder, shall be included in and shall be deemed to be common area costs ("Common Area Costs") to be borne prorata by Lessee in the manner hereinafter stated.

2. Second Clause:

(a) Upon demand, Tenant shall pay to Landlord, as additional rent during the term hereof, Tenant's proportionate share of Operating Costs, as hereinafter defined, calculated on the basis of the ratio set forth in Paragraph _____

As used in the Lease, the term "Operating Costs" shall mean any and all expenses, costs and disbursements of any kind and nature whatsoever incurred by Landlord in connection with the ownership, management, maintenance, operation and repair of the Property or the Building which Landlord shall pay or become obligated to pay in respect of a calendar year (regardless of when such Operating Costs were incurred). Operating Costs shall include, without limitation, the costs of maintenance, repairs, and replacements to the Building including roof, walls, downspouts, gutters, painting, and sprinkler systems; the costs of maintaining and repairing parking lots, sidewalks, exterior lighting, parking structures and easements; costs of landscaping maintenance, trash removal, and repairing, maintaining and washing the exterior building walls; property management fees in the amount of 3 % of the annual minimum net rental, salaries, fringe benefits and related costs payable to employees of Landlord whose duties are connected with the Property; insurance costs, all heating and air conditioning costs, electricity, sewer and water and other utility costs not separately metered to Tenants, landscape maintenance, trash and snow removal, taxes, as defined in Paragraph _____, and costs and expenses incurred by Landlord in protesting any assessments, levies or the tax rate, provided, however, that Operating Costs shall not include the following: (i) costs of alterations of any tenant's premises; (ii) costs of curing construction defects; (iii) depreciation; (iv) interest and principal payments on mortgages, and other debt costs; (v) real estate brokers' leasing commissions or compensation; (vi) any cost or expenditure (or portion thereof) for which Landlord is reimbursed, whether by insurance proceeds or otherwise; and (vii) cost of any service furnished to any other occupant of the Building which Landlord does not provide to Tenant hereunder. Notwithstanding anything contained herein to the contrary, depreciation of any structural repair or replacement shall be reasonably determined by Landlord. In addition, interest on the undepreciated cost of any such improvement, structural repair or replacement (at the prevailing construction loan rate available to Landlord on the date the cost of such improvement was incurred) shall also be included in Operating Costs.

Promptly after the commencement of this Lease and during December of each year or as soon thereafter as practicable, Landlord shall give Tenant written notice of its estimate of amounts payable under Paragraph _____ for the ensuing calendar year. On or before the first day of each month thereafter, Tenant shall pay to Landlord as additional rent one/twelfth (1/12th) of such estimated amounts, provided that if such notice is not given in December, Tenant shall continue to pay on the basis of the prior year's estimate until the first day of the month after the month in which such notice is given. If at any time it appears to Landlord that the amounts payable under Paragraph _____ for the then current calendar year will vary from its estimate by more than five percent (5 %), Landlord may, by written notice to Tenant, revise its estimate for such year, and subsequent payments by Tenant for such year shall be based upon such revised estimate.

Within ninety (90) days after the close of each calendar year or as soon thereafter as practicable, Landlord shall deliver to Tenant a summary of the total Operating Costs for the previous calendar year and Tenant's proportionate share thereof. If such summary shows an amount due from Tenant that is less than the estimated payments previously paid by Tenant, it shall be accompanied by a refund of the excess to Tenant. If such summary shows an amount due from Tenant that is more than the estimated payments previously paid by Tenant, Tenant shall pay the deficiency to Landlord, as additional rent, within thirty (30) days after delivery of the summary.

(b) Tenant or its representatives shall have the right to examine Landlord's books and records of Operating Costs during normal business hours within twenty (20) days following the furnishing of the summary to Tenant. Unless Tenant takes written exception to any item within thirty (30) days following the furnishing of the summary to Tenant (which item shall be paid in any event), such summary shall be considered as final and accepted by Tenant.

(c) If Landlord selects the accrual accounting method rather than the cash accounting method for operating expense purposes, Operating Costs shall be deemed to have been paid when such expenses have accrued.

(d) For purposes hereof the Premises total _____ square feet. The Building totals _____ square feet. Tenant's "proportionate share" of _____ % is arrived at by dividing _____ into _____.

(e) Landlord agrees to pay before they become delinquent all taxes, installments of special assessments and governmental charges of any kind and nature whatsoever (herein collectively referred to as "taxes") lawfully due and payable with respect to the Building and the Property.

(f) If at any time during the term of this Lease, the present method of taxation shall be changed so that in lieu of the whole or any part of any taxes, assessments or governmental charges levied, assessed or imposed on real estate and the improvements thereon, there shall be levied, assessed or imposed on Landlord a capital levy or other tax directly on the rents received therefrom and/or a franchise tax, assessment, levy or charge measured by or based, in whole or in part, upon such rents for the present or any future building or buildings on the Property, then all such taxes, assessments, levies or charges, or the part thereof so measured or based, shall be deemed to be included within the term "taxes" for the purposes hereof.

B. Watch Definitions.

C. Watch Management Fees.

VI. Work Letters and Construction Issues.

A. Elements.

- 1) The lease
- 2) The construction contract/design space planning documents
- 3) Financing Document

B. Goals of Landlord and Tenant.

- 1) Control the quality of construction.

- 2) Control the time for completion of the work
- 3) Assure lien-free completion of the work.
- 4) Control over the cost of the improvements
- 5) Maintain proper insurance coverage
- 6) Establish the procedure and control for change orders
- 7) Decide who pays and who builds the improvements

C. Compliance with Law Issues.

Landlords and Tenants contemplating work letters need to assess the American's with Disabilities Act of 1990 and the regulations promulgated thereunder. Landlords and Tenants must be aware that:

- 1) All new construction must be readily accessible and usable by persons with disabilities.
- 2) With respect to alterations of existing facilities, the ADA requires immediate and continuing accessibility and barrier removal obligations in places of public accommodation.
- 3) As to places of public accommodation, the Landlord and Tenant may allocate obligations relating to accessibility.
- 4) If the Landlord voluntarily alters the common areas within a building and operates the common area, the area that is subject to Landlord's alterations will have to be made accessible under ADA.

VII. Lender's Concerns and Tenant's Fears.

A. Lender's Concerns.

1. The income stream from leases in real estate developments such as office buildings or shopping centers provides the flow of cash necessary for the Landlord to repay its mortgage.
2. The leases give value to the property. The income stream from the leases must be sufficient for the lender to underwrite the loan.
3. Criteria for the evaluation of a leased project:

- (a) amount of fixed rent
 - (b) character and credit ratings of Tenants and Landlord
 - (c) duration of leases
 - (d) size of loan in relation to the value of the land and improvements
 - (e) interest rate and general conditions in the money market
 - (f) suitability of the improvements for other uses
 - (g) options to renew and rental rights to contract
 - (h) Tenant mix and exclusive use clauses
4. In order to assist the Lender:
- (a) for a multi-tenant project, the landlord should use a printed lease form to simplify the process of review by the lender.
 - (b) the Landlord should always attach the form of lender's estoppel certificate which will be used by the lender.

B. Tenant's Fears

1. The lender wants the Tenant to pay rent "without any deduction or setoff" whatsoever.
2. The lender wants the Tenant to open for business on a certain date and thereafter to continuously operate the business in the leased premises and to pay rent for the entire term.
3. The lender wants the amount of total rent due under the lease to be stated specifically so that, in the event of the Tenant's default, the Landlord may accelerate the balance so that the Tenant will be liable for the outstanding balance of the rent term.
4. In shopping center leases, the lender will want to ensure a proper mix of Tenants and avoid any conflicts with "exclusive use" clauses. As a result, each lease should be limited as to the type of business and/or the type of merchandise sold. Any references to words of limitation, such as "only" and "for no other purpose" must be clear that they are merely descriptive and are not intended to be exclusive clauses.
5. The lease form should prohibit alteration of the premises by Tenant without Landlord's prior consent.

6. In some shopping center leases, lenders require the lease to require the Tenant to join a merchant association. Such an association may be deemed essential to the successful promotion of the project.
7. The lease should contain a “lender modification” clause which obligates the tenant to make any reasonable or non-substantive modifications or amendments to the lease which are required by the lender.
8. If possible, the Landlord should obtain approval of the form of lease from its lender in advance.

VIII. Case Law Related to Breach.

A. Case Law

1. Upon abandonment by tenant, a landlord is required to use reasonable efforts to mitigate. Jefferson Development Company v Heritage Cleaners, 109 Mich App 606 (1981)
2. Landlord is required to use reasonable diligence to relet the property upon abandonment. Froling v Bischoff, 73 Mich App. 496 (1977) See also: Winshall v Ampco Auto Parts, Inc., 417 F. Supp 334 (E.D. Mich 1976)
3. The recovery available to the Landlord who filed a breach of contract action based upon an acceleration clause in a lease of a specially constructed billboard is discussed in Walker & Co. v Harrison, 347 Mich 630 (1957)

IX. List of Forms.

- A)** Landlord Form Lease Agreement - a Retail Development (Appendix “A”)
- B)** Sample provisions setting forth contingencies that if not fulfilled will permit the termination of the lease (Appendix “B”)

NOTE: These forms are not intended to be a substitute for an attorney’s judgment and knowledge of the law. These forms should only be used after determining a client’s needs and the latest developments in federal and state law.