



COMMERCIAL LEASE LAW insider

Practical Tools for Owners, Managers, Attorneys, and Other Real Estate Professionals

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Set Limits on Retail Tenant’s Right to Terminate When Anchor Departs

Don’t let an anchor’s departure spark a mass exodus that turns your center into a ghost town.

Even before the pandemic, shopping center tenants were insisting on the right to terminate their lease in the event the anchor tenant leaves. Giving in to these demands may be unavoidable when tenants are a part of a national

chain or otherwise enjoy negotiating leverage. But you should also impose reasonable restrictions so that an anchor’s departure doesn’t cause a mass exodus that turns your shopping center into a ghost town. Here’s a look at the restrictions you



need, along with a [Model Lease Clause: Limit Retail Tenant's Right to Terminate If Anchor Tenant Leaves](#) that you can use to implement them.

Be Selective About Which Tenants to Give Termination Rights

The loss of an anchor tenant and its power to draw traffic to the center hurts all tenants. But that doesn't mean all tenants should get termination rights. In addition to lacking negotiating leverage, smaller retail tenants are typically less dependent on customers that an anchor attracts.

In general, you should grant termination rights to mid-sized retailers, especially if they're part of a national chain—not just because of their leverage but their greater dependence on an anchor's drawing power. After all, mid-sized tenants need the boost that anchors provide to help cover overhead, which includes not only rent, but also franchise fees and the costs of conforming store space, signs, and advertising to franchise standards.

Set 4 Limits On Tenants' Termination Rights

When you do grant tenants the right to terminate after the loss of an anchor, be sure to limit those rights as much as possible. There are four key limits you should seek:

1. No Termination If Anchor Is Replaced

Give yourself a period of time to avoid triggering the tenant's termination right by securing an equivalent replacement for the anchor. This is vital to the extent that the more mid-sized tenants who vacate the shopping center, the harder it will be to line up a replacement anchor. Whether tenants agree to this will largely depend on how much time you give yourself to find the replacement.

How much time *should* you get? Attorneys suggest asking for one year. Although that may sound like a long time, it's also fairly realistic given the current state of the retail business. "Asking for 12 months to find an anchor tenant, negotiate a lease, finance the needed improvements,

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IF YOU HAVE TWO ANCHOR TENANTS, TERMINATION RIGHTS SHOULDN'T TRIGGER UNLESS BOTH LEAVE.

complete the construction, and get the tenant to move in and open is hardly unreasonable in this soft retail market,” notes one attorney.

In the not unlikely event that tenants object to giving you that much time, you could counter by trading additional time for rent breaks. One possibility would be to agree to reduce the tenant’s rent by the same percentage as the losses the tenant incurs due to the anchor’s departure. If possible, provide that rent concessions kick in only after the replacement window ends.

2. No Termination Unless Tenant Can Show Business Loss

Loss of an anchor tenant isn’t always catastrophic, especially when there are multiple anchors or a strong tenant mix to offset the losses. So, restrict tenants who get termination rights from using them unless and until they demonstrate the financial losses they actually incur as a result of the anchor’s departure. Financial losses may also be the result of a weak economy or the normal ups and downs of the business. Accordingly, tenants should be able to show two things to establish a causal link between their losses and the anchor’s departure:

Losses are substantial: Make tenants demonstrate not simply that they’ve lost business but a *substantial percentage* of business, meaning at least 10 percent. Losses smaller than that are just as likely to be due to general economic conditions and would have occurred with or without the anchor, according to one leasing attorney in the retail industry.

Losses occurred over a substantial period: Tenants should also be able to prove that they incurred their losses over a *substantial period of time*. Losses over a short period may be attributable to seasonal ups and downs, such as the normal drop in sales that occurs in the months after Christmas. That’s why you should try to negotiate a sample of at least one year, or nine months at the very minimum.

3. Tenant Must Give Notice of Intent to Terminate

Require the tenant to give you written notice of its intent to exercise its termination rights, with termination to become effective no earlier than three months after you receive the notice. The longer the notice period, the more time you have to:

- Ensure the tenant’s space remains occupied;
- Find a replacement for the tenant; and
- Find a replacement for the anchor that may make the tenant willing to stay.

Leasing strategy:

Our [Model Lease Clause](#) includes what’s called a “second-chance” provision stating that the landlord’s election to terminate is cancelled if a replacement anchor tenant opens for business before the end of the termination notice period.

Example: The lease gives the tenant the right to terminate if the shopping center’s anchor leaves and the landlord doesn’t find a replacement anchor within one year. A year after the anchor moves out, the tenant sends the landlord written notice of its intention to exercise its termination rights, effective three months from the landlord’s receipt of the notice. Two months later, a replacement anchor opens up in the shopping center. The tenant’s termination election is cancelled.

Caveat: Don’t be surprised if tenants push back on second-chance rights.

4. No Termination Unless Both Anchors Leave

If there are two anchor tenants in your shopping center, termination rights shouldn’t trigger unless both of them leave, subject to the same time, replacement, notice, and other restrictions that apply to the loss of one anchor. Take the same approach when there are more than two anchors, but be prepared to compromise, for example, by agreeing to termination if two of three anchors leave. ♦

**MODEL
LEASE
CLAUSE**

Limit Retail Tenant's Right to Terminate If Anchor Tenant Leaves

While losing an anchor tenant is tough enough, it's especially devastating if it triggers a mass exodus of other tenants in the shopping center. That's why you shouldn't let tenants have the right to terminate when an anchor leaves unless they have the bargaining leverage to command it. In that case, your strategy should be to impose reasonable limitations on the exercise of those termination rights. The Model Lease Clause below incorporates the kinds of limitations you need to protect yourself. Talk to your attorney about adapting it for your own specific needs and circumstances.

RIGHT TO TERMINATE

In the event that [*insert name of anchor tenant*] surrenders possession of its space at the Shopping Center and Landlord does not replace such tenant with an equivalent substitute tenant within twelve (12) months and as a result Tenant suffers at least a ten (10) percent loss of business during such 12-month period:

- a. **Rent Reduction.** Fixed Annual Rent shall be reduced by the percentage reduction in loss of business for such 12-month period for the period commencing on the first day following the end of such 12-month period until the date that an equivalent substitute tenant opens for business.
- b. **Right to Terminate.** After three (3) months after the end of such 12-month period if an equivalent substitute tenant has not opened for business, Tenant may terminate this Lease upon three (3) months' written notice to Landlord and such termination shall be effective on the last day of such three-month notice period.
- c. **Voiding of Right to Terminate.** If prior to the end of such three-month notice period an equivalent substitute tenant opens for business, Tenant's right of termination shall be null and void and this Lease shall continue as if no notice of termination had been given.

**BEYOND THE
BOILERPLATE**

'Best Efforts' vs. 'Commercially Reasonable Efforts':

What the Difference Is and Why It Matters

Chances are, your standard lease form includes one or more provisions requiring the tenant to exercise some kind of “efforts” to achieve a desired but uncertain result or outcome. The most likely possibilities: “best efforts”; “commercially reasonable efforts”; or “reasonable efforts.” While these phrases sound interchangeable, they have potentially significant variances in meaning that may prove decisive when the desired outcome doesn’t come to pass and the question becomes whether the tenant’s effort to make it happen were adequate. Here’s what you need to know to ensure the “efforts” clauses in your own lease give you adequate protection.

What’s at Stake

Some lease obligations are contingent on conditions that tenants can affect but not completely control. For example, tenants may need to obtain a liquor license to open a restaurant. Third-party agreements and/or zoning, environmental, and other approvals may also be required for certain kinds of contemplated uses. “Efforts”

clauses are important because they balance the legal risks in the event the tenant is unable to achieve the outcome. As long as the tenant exerts the efforts required, its failure to achieve the desired result doesn’t constitute a breach.

When disputes arise, the question often becomes whether the tenant’s efforts were up to the standard specified in the lease. In most courts, the answer to that question turns on the specific kind of efforts the lease required.

Caveat: It’s important to recognize that the following analysis is based on general rules and that principles may vary. Thus, courts in a few states (including Massachusetts) treat “best efforts” and “commercially reasonable efforts” the same as requiring the exercise of good faith; by contrast, in many other states (including California), the differences are sharp, with “best efforts” falling somewhere above “commercially reasonable” but below fiduciary responsibility. And in still other states (including New York), the courts are divided on the issue.



THE EFFORTS CLAUSE SHOULD SET FORTH OBJECTIVE CRITERIA FOR JUDGING PERFORMANCE.

Best Efforts

“Best efforts” is the most stringent standard because it requires the tenant to pursue *all reasonable methods* to satisfy the lease obligation in accordance with what a person in the same industry would be expected to do under similar circumstances and conditions. Thus, for example, one unsuccessful attempt to obtain a cannabis license over the course of six months won’t do it if typically takes dispensaries at least 12 months and two applications to get a license. Pursuing “all reasonable efforts” might even require a third attempt.

However, there are also limits. A promise to use “best efforts” isn’t a guarantee and doesn’t require the tenant to take every conceivable action to accomplish the result. Nor is the tenant expected to incur ruinous costs or disregard its own reasonable interests. Key factors in evaluating the adequacy of a tenant’s efforts include:

- The tenant’s financial status, experience, and capabilities—well-financed tenants are generally expected to do more than thinly funded startups;
- The costs of the tenant’s performance compared to the financial benefits it stands to gain;
- Industry standards and practices;
- The landlord’s and tenant’s practices with respect to other similar leases; and
- Promises made during negotiations.

Commercially Reasonable Efforts

“Commercially reasonable efforts” requires a tenant to exercise the efforts that a reasonable business entity would have made under similar circumstances. “Commercially reasonable” is only slightly less stringent than “best efforts” to the extent it doesn’t require “all reasonable actions.”

In construing “commercially reasonable efforts,” courts won’t engage in Monday morning quarterbacking or hindsight speculation about what the tenant should have done differently. Instead, they’ll

look at the tenant’s efforts as a whole, judging them not on their personal opinions but by objective industry standards, practices, and customs. The other factors listed above that are used to evaluate “best efforts” also come into play in assessing “commercially reasonable efforts.”

Reasonable Efforts

A promise to use “reasonable efforts” generally requires a tenant do what it can and what’s reasonable in the circumstances. As with the other efforts standards, reasonable is a relative term based on the context, purpose, and value of the subject lease.

How to Protect Yourself

The biggest problem with efforts’ clauses is their uncertainty with regard to what’s required. The best way to protect yourself is to avoid using the clause and instead expressly require the tenant to achieve the desired outcome. This takes the question of whether the tenant used sufficient efforts out of play and focuses solely on whether the result was achieved.

But for that same reason, tenants are unlikely to accept this solution. **Compromise:** Include an efforts clause but set forth objective criteria for judging performance. There are two basic ways to do that.

Solution 1: Deal-Specific Efforts Clauses

The first approach is to spell out your exact expectations of what the tenant must do to achieve the desired result by:

- Specifying the activities and efforts in which the tenant must engage;
- Citing specific industry standards or benchmarks for gauging the tenant’s efforts;
- Including a time frame or set of deadlines for the tenant to perform certain obligations; and
- Setting a minimum—or maximum—amount the tenant will be required to spend to exercise the required efforts.

Practical Pointer: Include “among other things,” “including but not limited to,” or similar language to indicate that the listed provisions aren’t exhaustive and thereby imply that the tenant may have to take additional steps to exercise the required degree of effort.

Solution 2: Clearly Define ‘Efforts’ Required

A more scalable approach that can work for a general lease form is to provide a detailed, principled definition of the kind of “efforts” required and limitations that apply. Here’s an example for “Reasonable Efforts”:

MODEL LEASE LANGUAGE

“Reasonable Efforts” means, with respect to a given goal, the efforts that a reasonable person in the position of Tenant would use to achieve that goal as expeditiously as possible, but which does not include:

- a. Incurring any expenses not expressly contemplated by this Lease including:
 - (i) out-of-pocket costs incurred in gathering information and making filings with any governmental authority;
 - (ii) fees and expenses of advisors and consultants;
 - (iii) taxes, fees, and penalties charged by any governmental authority;
 - (iv) fees and penalties charged by any other person; and
 - (v) extraordinary employee costs;
 - b. Taking any actions that would, individually or in the aggregate, cause Tenant to incur costs, or suffer any other detriment, out of reasonable proportion to the benefits to the Tenant under this Lease;
 - c. Taking any actions that would, individually or in the aggregate, cause a material adverse change in the Tenant;
 - d. Changing the Tenant’s fundamental business model;
 - e. Taking any action that would violate any law or order to which the Tenant is subject;
 - f. Taking any action that would imperil the Tenant’s existence or solvency; or
 - g. Initiating any litigation or arbitration.
-

**NEGOTIATING
TIPS**

Limit Holdover Rent Cuts to Short Holdovers

Getting tenants to leave their space when the lease ends can be a difficult and costly proposition. For one thing, you may have to initiate an eviction suit to get the tenant out. And if you've already re-rented the space, holdovers expose you to the risk of being sued by the new tenant for failing to deliver the space on time. All of this makes the holdover rent rate a crucial issue in typical lease negotiations. If a tenant is in a strong bargaining position, you may have to give in on rates. But here's a strategy for compromising on rates without sacrificing financial protections against holdovers that last an extended period.

What's at Stake

Landlords seek meaningful disincentives to prevent tenants from holding over. By contrast, tenants want flexibility to remain in the space temporarily at a reasonable rate if they can't vacate on time, for example, because their new space isn't yet ready or the moving company goes on strike.

Typical dynamic: The landlord proposes a 200 percent premium holdover rent in the lease first draft. The tenant counters with a much lower rate, like 125 percent. The horse trading ensues, and the sides end up meeting somewhere in the middle.

How to Structure Compromise

But there should be more to the compromise than simply the holdover rate, cautions a veteran New York City leasing attorney. The landlord should also ensure that the rate compromise is memorialized in an agreement that includes certain built-in safety nets and guardrails to protect its interests. To achieve this objective, the attorney recommends adding the following lease language (based on a scenario where the landlord has agreed to discount its standard 200 percent holdover rate to 150 percent):

MODEL LEASE LANGUAGE

Holdover Rent. If any holdover period exceeds thirty (30) days, then the aforementioned one hundred fifty percent (150%) rate shall be deemed automatically increased to two hundred percent (200%), and shall apply to the full duration of the entire holdover period beginning with the very first (1st) day on which the holdover originally commenced immediately following the expiration or earlier termination of the Lease.

This provision grants the tenant a measure of short-term relief while ensuring that the concessionary 150 percent rate (and holdover itself) doesn't last forever. If the holdover period becomes prolonged, the 200 percent holdover rate springs back to life. Moreover, the 200 percent rate gets grandfathered so that it applies not just to the extended period (30 days in our example) but also retroactively to the very first day of the holdover period. In effect, it unwinds the 150 percent discounted rate for the first 30 days and replaces it with the 200 percent rate, as if the discount had never been granted at all.

Bottom Line

The compromise is fair to both sides. It gives tenants limited flexibility to hold over for a pre-determined—and short—grace period, as well as a powerful financial incentive to end the holdover before that initial grace period expires. “Based on the experience of my own clients, this arrangement is a win-win solution to the holdover problem,” the New York City attorney attests. ◆

**RECENT
COURT
RULINGS****Tenant Who Didn't Thoroughly Inspect
Defective Building Can't Claim Fraud**

What Happened: A Texas landlord leased a standalone building to a tenant for use as a restaurant. Even though the building needed a lot of work, the tenant accepted it “as is” without warranty of suitability for its intended restaurant use. The gamble came up snake eyes when the tenant discovered physical defects in the building while performing the construction work. The tenant stopped paying rent and claimed fraud when the landlord sued. The case went to trial, with the landlord winning a directed verdict of \$180,000 for the unpaid rent and \$181,000 more in attorneys’ fees.

Ruling: The Texas appeals court rejected the tenant’s appeal and upheld the verdict.

Reasoning: The landlord didn’t commit fraud by failing to disclose the building’s structural defects. The lease included clear language indicating that the tenant assumed the obligation “to satisfy itself that the leased premises may be used [as intended] by independently investigating” without warranties from the landlord. Moreover, it could have discovered the problems before signing the lease since the landlord provided the keys to the building. But the tenant didn’t avail itself of the opportunity to make the kind of thorough inspection you’d expect a reasonably prudent businessperson to make before leasing a property for five years.

- *Uribe v. Briar-Ridge, LLC*, 2021 Tex. App. LEXIS 9351, 2021 WL 5365104

**Defaulting Tenant's Closure Doesn't
Justify Landlord's Changing the Locks**

What Happened: After warning that its business was struggling, a restaurant tenant paid only half the rent on June 1. Two weeks later, it closed the restaurant. When its demands for full rent went unheeded, the landlord changed the locks and re-entered the premises on June 24. Both sides accused the other of lease violations.

Ruling: The Iowa court ruled for the tenant, and the appeals court upheld the decision.

Reasoning: The tenant breached first on June 1 by not paying full rent, the court acknowledged. However, it wasn’t a

material breach justifying the landlord’s right to re-enter, the court continued, citing provisions in the lease that gave the tenant the right to cure in such contingencies. So, the landlord committed the first *material* breach by changing the locks without giving the tenant the opportunity to cure. The court also rejected the landlord’s reliance on the clause allowing for re-entry in the “event of an emergency,” since the clause didn’t define what kind of “emergency” justified re-entry.

- *Dolly Invs., LLC v. MMG Sioux City, LLC*, 2021 Iowa App. LEXIS 1040

Construction Lien Is Enforceable Against Landlord that Contracted for the Work

What Happened: A landlord and tenant hired a contractor to construct improvements on a leased movie theater. The subcontractor that installed the drywalls recorded a lien for the work and sought to foreclose when it didn't get paid. The landlord asked the court to dismiss the claim under a state law prohibiting enforcement of liens against owners of property who record a lease banning such claims. The trial court sided with the landlord.

Ruling: The Florida appeals court reversed, finding that the subcontractor could foreclose.

Reasoning: The state law ban on foreclosure didn't apply in this case because the landlord and tenant both contracted for the work, with the contract naming each party as "Owner" of the property. Having personally contracted for the improvements, the landlord was on the hook to pay for them, and the trial court was wrong to bar the subcontractor's foreclosure action.

- **K.D. Constr. of Fla., Inc. v. MDM Retail, Ltd., 2021 Fla. App. LEXIS 15235, 2021 WL 5617447**