A Common Law Conveyance or a Contract for Services: **What is a Lease Anyway?**

The amount of office, retail, and industrial space annually available for lease in the United States is measured in millions and millions of square feet. During the life cycle of that space, a variety of landlords and tenants, both large and small, will sign leases ranging from a matter of months to 99 years or more. Some will be confronting the commercial leasing process for the first time, while others will be re-confronting the process after a lengthy hiatus of five to ten years or more. Many of the leases will be reviewed and signed with little or no professional help, while others will engage numerous professionals to assist them. The results will be mixed for both groups.

The landlord is usually ahead in the knowledge accumulating area since its ownership of an office building or shopping center will have given it multiple experiences and a great deal of familiarity with the form that it has developed for its use. Tenants, on the other hand, are usually not in the real estate business and are forced to re-enter the market and review and negotiate a so-called standard lease form once every five to ten years when it is time to renew their lease. Their accumulation of leasing knowledge is spotty at best.

It is difficult to determine what *should* be contained in a commercial lease. The real estate professional must look at this question in detail and develop a basic framework in which the questions of "shoulds" and "musts" may be reviewed. The need for such a discussion is highlighted by the fact that if you pick up a handful of leases from around the country they will all be different. It is true that most of them deal with many of the same topics, some of them in very similar fashion. Yet some leases may be a few pages while others go on at great length. Large building owners, developers, and management firms that are equally sophisticated and have spent large sums of money for their lawyers to develop their standard lease forms will produce documents of varying lengths and specificity. It is difficult to say, on the basis of any objective criteria, whether there is a good, better, or best in a group of lease documents. Longer is not necessarily better, and shorter is not always adequate.

Fortunately, leasing has been around for hundreds of years, and the industry is filled with sophisticated participants, including owners, landlords, developers, managers, brokers, office users, regional and national retail chains, and a wide variety of industrial users. As a result of their dealings with each other over the years, certain issues have come to be recognized in the commercial leasing industry as the ones that *should* be addressed in some form in each leasing arrangement. It must be noted that there is no one standard list of topics that is correct and that there is no one standard way of treating any particular topic included in the list. Nevertheless, the bulk of most commercial leasing forms will address most of the same topics and some will do it successfully and others will not.

The Common Law Background. Since there are a number of differences among the standard forms on the one hand, and an absence of safe harbors on the other, how can you tell when a lease is a good one, a fair one, or one of the so-called "killer" leases? From the legal point of view, it is very important to understand that an enforceable lease needs to contain only four basic pieces of information: (1) an identification of the parties; (2) a description of the property; (3) the period or term; and (4) the price or rent. These four items when properly identified constitute a lease, which at common law is a conveyance of an interest in real estate.

> **Practice Tip** It is also important that the four basic requirements be handled in a way that complies with applicable law. For example, in most jurisdictions the statute of frauds will require that the four basic items be in writing if the lease is for a period of more than one year. Some jurisdictions will permit the lease to be signed by one party only, while another may require a notary or witness. In all jurisdictions, the parties need to make sure that the mechanics of memorializing the four basic legal ingredients are complied with.

The four legal ingredients are necessary to affect a conveyance of an interest in real property. If a lease contains nothing else, all other issues will be resolved by applicable statutes or the common law. Part of that resolution, of course, may be to find that an entire series of issues will not be applicable at all. Thus, a lease, which does not specify typical landlord services, will be resolved by the common law, which provides that no such services are required.

Many parties to leasing transactions are surprised to find that their contract or lease may not be the controlling document on every issue and that they may, in fact, be subject to rights and obligations not expressed in the standard form. For example, all of the normal issues of subleasing, repair obligations, subordination, use, and so forth will be resolved under the common law if not otherwise set out in the lease. It is only necessary to

include these topics when the parties want to clarify a particular point or change the results obtained under the common law. Once the four ingredients necessary to affect a conveyance are identified, the common law becomes the "default lease" to address all of the other issues, which have not been fully addressed in the written lease. To the extent that the parties have not overridden an aspect of the common law, they may well find the lease to be inconsistent with what they thought they were obtaining.

> **Example** For example, the common law favored the alienability of property and if restrictions on that alienability are not fully set out, they may be ineffective. Almost all landlords include restrictions on assignments and subleasing in their standard documents. The topics are usually treated together. However, sloppy drafting in a provision labeled "assignment and subletting" that ultimately focuses only on subletting, will permit the tenant to make the more sweeping choice of assigning its interest in the lease.

> **Practice Tip** When the parties begin their negotiation and exchange of information, it is important that the letter of intent (LOI) or the lease draft being exchanged contain suitable disclaimers which indicate that the LOI is non-binding or, in the case of the lease, the boilerplate should include a provision that there is no lease until both the landlord and tenant have signed and delivered final copies. In the absence of such provision, each exchange of an LOI or a draft lease will constitute a contractual offer, which the other party is free to accept at any time. If important provisions have not been addressed in the LOI or the draft leases, the common law will then control those issues.

A quick snapshot of the historical evolution of the lease is helpful to understand the common law "default lease". Most states have a statute or enabling act, which adopts the common law of England. Some of the acts define the common law as the law that existed in England during a certain period of time, which is usually sometime during the 16th to the l8th centuries, while others will just make reference to the common law without trying it down to a specific date. The constitutions or enabling acts generally provide that the common law will be the law of that state except as modified by statute or subsequent court decisions. Unless modified, a lease will consist of a body of rights and obligations that existed 200 to 300 years ago. This can raise some interesting situations if not properly handled, since the common law did not envision 21st-century leasing practices nor 80-story skyscrapers, large multiple-use buildings, and shopping centers containing hundreds of different leasehold estates.

The development of the common law was and continues to be an evolutionary process; and in the case of leasing, the evolution changed the original agrarian tenant rights from contracts to an interest in real property. By the l8th century, the common law lease had evolved into a real property transaction that conveyed rights in real property. The lease transaction assumed that the property had been conveyed or "sold," although the conveyance or sale was limited to a term of years. The lease has, until recently, been construed under the rules governing real property. Those rules assumed that the landlord had completely conveyed his interests in the land for a specific period and that all obligations concerning the land were transferred to and assumed by the tenant. For example, at common law the tenant continued to be liable for the agreed-upon rent payments even if the building was destroyed or became unusable. In fact, the common law required the tenant to rebuild or restore the building prior to the end of his term so he could reconvey it to his landlord and not be liable for waste.

While this result, and numerous others like it, may have been workable in 18th-century England, it is a little awkward at the beginning of the 21st century. Leases now contain provisions that change most of the common law rules since their application today could be a disaster. For example, leases now routinely require the landlord to carry insurance on its buildings, and outline the respective duties regarding restoration and liability in the event of a casualty. This departure from the common law reflects a basic business understanding that many of the common law solutions will not work or are otherwise unacceptable in current practice. Nevertheless, the landlord and tenant must carefully review these provisions to make sure that the old common law issues have in fact been successfully revised or modified in the lease.

A number of rights and obligations grew out of the real property conveyance view of the lease; some were beneficial to the tenant, and some to the landlord. For example, the landlord, having parted with the property and given exclusive use to the tenant, generally had no duties or obligations to keep the building or property in good repair. Similarly, the landlord had no obligation to provide the tenant with the vast majority of the services that are found in modern commercial leases. These duties passed to the tenant with the conveyance.

On the other hand, the common law gave the tenant some rights with which modern-day landlords are not willing to part, at least not without a serious negotiation. For example, the right to sublease the property or assign the lease passed to the tenant at common law. The common law favored the alienation of real property, and gave the tenants broad rights in this area. Modern leases contain pages of elaborate mechanisms to permit landlords to prohibit subleases and assignments, take profits from subleases and assignments, or, in many cases, recapture the property.

While many rights and responsibilities pass to the tenant at common law, the obligation to comply with laws generally remains with the landlord. This is based on the fact that those obligations were generated outside of the landlord/tenant arrangement and, when laws, ordinances, or statutes are passed, they are generally directed toward the "owner" of the property. While the land may have been "sold" to the tenant for a term of years, the landlord was still deemed to be the "owner" for limited purposes and subject to the obligations of most statutory enactments. Many modern landlords attempt to pass the costs of such compliance on to their tenants, through elaborate provisions which require the tenant to repair certain items while the landlord may agree to handle major structural repairs. Tenants have generally been able to prevent the landlord from shifting the responsibility for some types of compliance costs, and usually can avoid paying for costs involved with structural changes unless the allocation is abundantly clear. Landlords have also found in some cases that while they thought they had contractually passed certain responsibilities on to tenants, the failure to adequately draft the contractual description of the responsibility left them responsible for a number of significant obligations. Asbestos removal, compliance with fire codes, and similar responsibilities are examples of areas where, if the lease did not address them thoroughly, the landlord may not have successfully escaped its common law obligations. In the process of contractually altering the common law lease and shifting selected responsibilities back and forth, the parties have ended up in strange positions from time to time, because their efforts were ambiguous or incomplete.

A number of examples can be given for most provisions contained in the so-called standard form lease. Because of the great disparity between the common law and modern business practices, the lease must contain rules to sort out the rights and duties of the landlord and tenant. Many of the typical approaches to topics like subleasing, repair and restoration, subordination, and so on, are really contractual agreements that modify the common law. An understanding of the common law and the contractual provisions contained in the lease are necessary to permit the parties to intelligently allocate their respective risks during the term of the lease.

The Move Toward Commercial Reasonableness. To make things more complicated, portions of leases are now being reviewed more and more under general principles applicable to contracts, as opposed to principles applicable to real property conveyances. A case in point involves the question of whether a landlord has any duty to assist a defaulting tenant in subleasing its space. Under the common law of real property, the answer was a pretty clear no. However, most jurisdictions now review this obligation in terms of contractual duties, which are determined by principles of commercial reasonableness. Decisions in a number of states, as well as a number of statutory enactments, now provide that the landlord has an affirmative duty to help mitigate or, at a minimum, cannot arbitrarily prevent the tenant from mitigating its damages by subleasing. Even in those situations where a landlord may pass on the responsibility for the costs of such compliance, it will still end up as the party who is charged with the responsibility of getting it done. These results are evidence of a leaning toward the interpretation of a number of lease provisions under the contractual concept of "commercial reasonableness" as opposed to the more strict common law of real property.

The duty of the tenant at common law to continue to pay rent even though the building was destroyed was a product of the real property transaction, which held that all provisions in a lease were *independent* of each other. A default by one party did not permit another party to withhold performance. However, the contractual view of a lease document tends to view lease provisions and obligations of the parties as *dependent*. Performance by one is a necessary condition to enforce performance by the other. However, the shift in this paradigm of construction is not accompanied by rules with a lot of sharp edges, and it is important that the parties understand which edges are sharp and which are fuzzy. Current decisional law suggests that if the parties clearly allocate their expectations in a given situation, the courts will enforce the parties' agreement even if the results are sometimes rather strange.

The modern lease has now evolved into a combination of a conveyance of an interest in real property and a collection of contractual agreements regarding services and the allocation of certain defined risks between the landlord and tenant. The question of what risks should be dealt with by the parties and how those risks should be allocated are business questions. Of course, before those decisions can be made, it is important to understand what happens in a given situation if they choose not to deal with an issue.

Aside from the occasional statute, it can be very difficult to pin down the "black letter law" applicable to a

commercial lease. Decisional law is generally good for the specific facts on which the holding is based, and is not necessarily binding on future decisions where the facts may be somewhat altered. The landlord's and tenant's obligations to repair the leased premises during the term are a good example. Basically, the common law placed no obligation on the landlord to repair the tenant space during the term of the lease. However, the tenant's duty to repair was a limited one. He was only required to make the ordinary repairs necessary to prevent a waste of the landlord's asset. Modem commercial landlords have expanded that duty in most standard form leases, to require the tenant to undertake a full range of repairs and replacements during the term of the lease. However, the courts have reviewed this type of contractual agreement in light of the common law, and have traditionally held that the tenant's duty must be generally read to exclude any requirements to make "structural" or "substantial" repairs.

Thus, even in the efforts to shift or enhance the common law position, the parties must draft such shifts or modifications very carefully, to make sure that the agreement is not lost in the interpretive process. Just to make things interesting, the states occasionally will pass a statute that alters the common law rule that the legislature found unacceptable and the parties must then focus on making sure that both the common law default rule and the statutory rule is modified if desired. For example, Arizona is one of the few jurisdictions that has passed a statute that provides that if a leased facility is destroyed by fire or casualty and is not rebuilt within a certain period of time, the tenant may terminate the lease. Here, a statute reverses the duties found under common law, which are generally unacceptable from the landlord's point of view anyway. Thus, a landlord confronting this issue must override both the statutory provisions and modify the common law provisions to arrive at a repair duty that is consistent with the standards found in most modern leases.

The common law is decisional law and inherently lacks clarity. The best approach for both landlords and tenants is to identify and allocate their respective risks as thoroughly as possible, so that their written lease agreement becomes the governing document which the courts will interpret largely under the rules of contract law, instead of reaching back to the common law for interpretation. While common law research can be entertaining, it is often time-consuming, and many different nuances can be supported in most situations.

Case law in the landlord/tenant area is extensive, and statutory provisions are the exception. Many of the old common law rules have evolved into a "majority" rule or "minority" rule, which can be found in multiple volumes of the *Restatement of Property*. In short, a lease agreement must ultimately be reviewed closely with the applicable law, both decisional and statutory, that may be extant in a particular location where the lease is to be enforced.

The Addition of Goods, Services, and Restrictions. The 21st-century commercial lease has come a long way from the common law conveyance. Many of the lease provisions are now concerned with restrictions and conditions of use. No longer does the landlord stand back and reenter the picture only upon the expiration of the tenant's exclusive use of the property. Now, landlords retain and routinely use the provisions scattered throughout the commercial lease, which permit them to enter upon the premises and make inspections, improvements and changes, and which provide a basis for the landlord to monitor the tenant's use of the space and to ensure that it is in compliance with all of the restrictions placed in the lease.

Modern lease restrictions routinely range from those which govern the tenant's *manner* of conducting its business in the building or facility on the one hand, to the duties of the tenant with respect to the repair, maintenance, and upkeep of the premises on the other hand. All aspects of the tenant's use of the premises are usually touched upon in a variety of clauses contained in most commercial leases.

Some of the chief departures from the common law conveyance are those provisions in all forms of the commercial lease where the landlord agrees to provide one or more services to the tenant and its space. The gross lease, found most often in multi-tenant office facilities, usually contains the greatest number of landlord provided services. At the other end of the spectrum, the landlord of a small retail facility with a so-called "net" lease will provide fewer services directly to the tenants. Yet, in all its forms, the commercial lease has gone far beyond the common law conveyance in terms of the landlord's ongoing obligations to provide some level of service, repair, and maintenance of the facility.

Almost all commercial leases include provisions outlining a variety of specific services that are routinely provided to tenants under their leases. These services are added to the commercial lease as contractual agreements in addition to the conveyance and it is this contractual agreement to provide goods and services which helps turn the common law conveyance of an interest in real estate into the modern commercial lease. The more rigid, less flexible rules of real property are now married to the more flexible rules of commercial reasonableness. Many aspects of the lease now become a two-way street, with rights and duties on both sides of the transaction. The difference between the common law lease and the modern commercial lease shows up very clearly in those arrangements concerning the rights to receive payment in exchange for the duty to

supply a service.

The common law lease treated rent as an independent covenant, and no matter what happened to the property throughout the term of its lease, the tenant was required to pay its rent to the landlord without deduction, setoff, or abatement of any kind. A good portion of the rent in modern leases covers the cost of facilities and services provided by the landlord to the tenant. Oftentimes, some aspect of the facilities may be unusable or the services may be interrupted, and the immediate question will focus on the duty of the tenant to continue paying rent. The commercial view of business contracts favors the dependency of related covenants, where performance defaults by one party may excuse performance by another and where all parties are under various requirements to mitigate their damages.

The presence of both the leasing conveyance and the contractual obligations to supply services and perform certain duties naturally leads to many interesting situations. The agreement to provide services and perform duties exists only through the contractual agreements put in the standard form lease by the landlord and tenant. These agreements will not be found in the default provisions of the common law. However, if those contractual agreements do not fully address the topic, the question will then come up as to whether that problem is to be addressed as a real property problem or a commercial contract problem. Will the common law rules for construing real property agreements be utilized, or will the court impose the modern rules of commercial reasonableness? The answer is not always clear.

> **Practice Tip** Almost every standard form lease will provide that the rent is to be paid to the landlord "...without setoff, abatement or deduction of any kind." Yet, throughout the lease, a tenant may be given and will certainly attempt to negotiate setoffs and abatements under a variety of situations. Even the most landlord-oriented forms include in their fire and casualty provision the abatement of the tenant's rent following a fire or other insured casualty. The tenant is generally left to its own initiative to pick those provisions throughout the lease where an impairment will affect its ability to conduct business and to use those locations to insert offsets, abatements, self-help, etc. Nevertheless, the main rent provisions usually remain unamended and in conflict with the specific provisions. While the tenant would probably prevail under the ordinary rules of construction, it is just easier to modify the rent language to include that there may not be any such offsets or abatements "...except as otherwise specifically provided in this lease." As noted above, what is not excluded will in fact be included under the common law and probably in a manner envisioned by none of the parties. This type of arrangement obviously does not qualify as a knowing allocation of risk by the parties.

The traditional example of the attempts by modern-day landlords to restrict assignments and subleases by the tenant is *apropos*. The common law permitted the tenant to alienate the property as he chose during his lease. That practice is not acceptable from a business point of view to modern-day landlords, and so leases frequently contain many restrictions on the tenant's right to assign and sublet. There are numerous cases where the landlord focused on prohibiting either an assignment or a sublease, but not both. While it may have been obvious that the landlord just made a mistake and did not carry through on his parallel references, the courts have traditionally held that if you want to restrict both, you must name both, and a prohibition on subleasing will not be implied to also be a prohibition on assignment, and vice versa. Here, the incomplete contractual efforts to handle an issue may default to the common law, which may take a narrow and rigid view of that particular topic.

On the other hand, the landlord and tenant may contract for HVAC services to be supplied at "comfortable levels" or "normal levels," and even though there is a failure to provide any meaningful standards based on that type of language; courts may make an attempt to find what is reasonable. It is a contractual agreement, and the courts will draw from prevailing industry standards and practices to determine what those levels may be. Here, the failure to adequately document the temperature will generally not default to the common law for the purpose of determining what standards will be imposed. However, as in all contracts for the exchange of services, there is no real substitute for specificity.

The Standard Form Lease. A lot of the literature associated with commercial leases make, references to the "standard form lease" and the "standard lease form." The terms seem to be used interchangeably and are equally meaningless. **Briefly stated, there is no standard form lease!**

The concept is a device used by landlords to lure tenants into believing that the vague, overly-broad, very limited lease put in front of them is in fact a standard form instrument commonly in use in the industry, and that

there is no reason for them to be alarmed. Many pre-printed leases will actually be emblazoned on the front cover as "standard form" leases. The ridiculousness of this approach can be demonstrated very clearly if one takes a dozen or so "standard form" leases, throws them on the table, and invites comparison. Some will be a few pages long, others 20, 30 or 40 pages, and some will approach 100 pages. Issues will be addressed in a different order and in a different manner. Some rent adjustment clauses, for example, will be only a paragraph, while others will reach five pages.

A simple Google search on the Internet for commercial leases will produce a number of websites with preprinted leases in which the parties can fill in their name, address and rental amount and be presented with a fairly short form of commercial lease. These fall into the "one size fits all" approach and will be exemplified by what is not addressed as opposed to what has been included. These pre-printed, one size fits all leases make no attempt to use the commercial lease as a thoughtful process by both landlords and tenants to knowingly allocate their respective risks. Neither do these forms attempt to adequately grapple with the common law "default lease" and ensure that the provisions included in the pre-printed forms produce the right result. Both landlords and tenants utilizing this approach can certainly anticipate one or more unanticipated challenges during the term of those leases.

Basically, the term "standard lease form" or "standard form lease" merely means that the owner, developer, or landlord for a particular facility has prepared and printed a form of lease that it intends to use as its starting place in its lease negotiations in that particular building or center; no more, no less.

In some areas of the law, long documents have become commonplace, and their "standard form" approach has become accepted. Residential mortgages are a good example. These are extensive long-term agreements which are somewhat standard, and which are routinely signed and accepted by parties without much negotiation and without substantial change. In fact, a lot of people on both sides of the table probably do not even read those documents. These instruments tend to be heavily regulated under federal laws, such as the Fannie Mae legislation, and related state and federal legislation governing residential mortgages. However, the same oversight and regulation is not involved in the commercial leasing area. It is one area of the law where oversight or control by legislative bodies or administrative agencies is almost nonexistent. The lease form, at best, is a contractual agreement by the landlord and tenant on how they are going to supplement, modify, or add to the common law and, in general, the parties are fairly free to negotiate whatever provisions they feel are important with respect to any part of their relationship, which is likely to extend for a number of years.

> **Practice Tip** Notwithstanding this general freedom to contract, the parties must always be alert to specific ordinances, laws, or statutes in their jurisdiction which may place a limit on their contracting rights. Generally, the parties are free to waive any rights or duties provided by statute, unless the particular statute has been adopted for "public policy" purposes, in which case those restrictions may not be contractually waived by the parties. Similarly, each jurisdiction has its rules on the mechanics of how the contract should be signed up and memorialized. Once a lease is fully negotiated and memorialized, the parties need to make sure that its execution and delivery complies with any mechanical or procedural requirements in that jurisdiction.

The so-called standard form lease is not just found on the landlord's side of the table. Regional and national retail tenants are notorious for their own versions of the standard form lease. Retailing chains and franchises frequently develope their own "standard form lease", which they submit to the landlord as the only approach that is acceptable to them. These leases are almost uniformly bad. To the landlord's vague, broad, overbearing approach to leasing, many of these tenants bring with them a lack of development and real estate management experience. These leases are well known for their failure to address numerous issues routinely handled in most owner-generated leases. Their approach to defining operating costs and common area charge pass-throughs may have little or no relationship to how such arrangements are routinely structured in facilities across the country. The battle to return that "standard form lease" to an arms-length mutual, intelligent allocation of risk between the landlord and tenant can be long, expensive, and tedious.

Both landlords and tenants are advised to think twice before developing a standard lease form that is too one-sided, since it may well color a prospective landlord's or tenant's view of the other and its method of doing business. Experience teaches that landlords and tenants who get too aggressive in the basic lease document will arouse the suspicions of the other, who will respond by either terminating negotiations or by becoming much more aggressive themselves in negotiating all of the terms and conditions of the lease. The basic element of "good faith," which is important in all transactions, will begin to erode very quickly in this situation.

Finally comes the major office tenant or retail anchor tenant. These tenants, while sometimes agreeing to start with the landlord's standard form lease, will essentially end up negotiating a "scratch" lease, which means that many of the provisions will have been freshly negotiated from the beginning. These tenants tend to be represented by experienced and knowledgeable real estate professionals, and their personnel are generally well-informed, and are prepared to review and negotiate issues with precise goals in mind. Of all the leases that are negotiated, these can end up being among the very best. These parties routinely understand and attempt to allocate, in a rational way, a variety of risks that may be encountered on both sides. This is not meant to imply that these parties do not have very diverse views on the amount of rent, operating covenants, rights to go dark, and similar business issues. While they may or may not make a deal based on the resolution of certain fundamental economic terms of the lease, it seems to be rare for deals to fall apart because they cannot allocate insurance risks or agree on repair and maintenance standards.

Legal Issues. Much of the content of the standard form lease focuses on business issues. Most jurisdictions have passed very little legislation which restricts or impacts the ability of landlords and tenants in the commercial arena to contract for and shape their own rights and remedies. As always, there are a few wrinkles, and the laws of the applicable jurisdiction where a lease is being negotiated must be thoroughly reviewed before concluding an agreement. For example, a few jurisdictions have passed statutes, which limit the ability of a landlord to require a tenant to waive rights against the negligence of the landlord. This, of course, can cause problems with straightforward business arrangements outlining an agreed-upon and responsible allocation of risk through insurance. Most jurisdictions will require leases for a duration of more than one year to be in writing, and will have a variety of rules on whether that writing may be amended orally or whether any amendment must also be in writing.

Similarly, some legislation exists in jurisdictions concerning specific issues such as the duty to rebuild following a fire or other casualty and the duty to remove toxic and hazardous substances. But, by and large, the landlord and tenant are relatively free to approach each substantive topic of the lease as a business issue, to outline their respective rights and obligations, and to provide for remedies in the event of default on either side. It is obviously important that the parties fully comply with the minimal rules that may have been adopted by statute.

As noted earlier, the casebooks, newsletters, treatises, and handbooks on commercial leasing contain extensive case decisions, which have sorted out and decided the rights and duties of both landlords and tenants. An ongoing review of those materials can be helpful to understand some of the recurring problems in the landlord/tenant relationship, how the parties attempted to handle them, and how the courts decided that the parties did or did not handle a particular problem.

In many situations, as noted above, the common law lease will become the default lease, and in the event the written lease document does not provide complete guidance, the courts must look to the common law to see what should happen in that situation. Therefore, a general feeling for the common law is important, in order to have a sense of where the lease document is going. Many items did not exist at common law, including the landlord's duty to provide services. Therefore, the failure to specify the services required to be supplied by the landlord can result in the court looking to the common law, where the landlord has no obligations and, therefore, the tenant has no rights to receive such services.

On the other hand, where the landlord and tenant have attempted to provide, although in an unclear manner, some level of services, the courts will often look at those efforts from a commercial point of view and attempt to interpret them. The following story outlines an unusual collection of unfortunate events that illustrate the differences between common law rights and duties and modern leasing practices.

A Common Law Lease in Modern Times. Tom Landlord developed a wonderful-looking office building in Phoenix, Arizona containing approximately 150,000 square feet. Tom, unfortunately, chose to do this during the late 1980's when the real estate industry, not only in that community, but across much of the country, was heading into a serious recession and Tom was fairly anxious to achieve his lease up, meet his pro forma, and keep his lender from being any more jittery than most lenders were during that period.

As a favor to an old friend, Tom agreed to participate in a seminar to discuss commercial leasing, development, and financing of office facilities. There, he met Reg Tenant, who was also one of the panel participants. Reg worked for a large corporation headquartered in Pennsylvania with offices scattered around the country, and he mentioned to Tom that his corporation, Big Corp., was considering an expansion into the Southwest. Offices had already been established in California and Dallas. The Phoenix location looked to be an important link in the Western market.

After the end of the first day of the seminar, Reg and Tom had a chance to visit, and Tom invited Reg to look at his building, specifically 10,000 square feet of that building, located on the fourth floor and available for lease. Tom had immediately seen the possibility of using the seminar

as a basis to strike a deal. Reg was quite surprised at the quality of the space being offered by Tom, which had been built out partly as a model of what was possible in his building, and partly as a flashy developer's office which showed all the outward signs of financial success. Significant tenant improvements were contained in every room of the 10,000 square feet, including extensive mill work, Berber carpets, wet bars in the conference rooms, recessed low voltage lighting throughout for art work, and extensive marble work on a variety of floors, walls, and counters. Reg even likened the restroom facilities to those he was using at The Phoenician resort that weekend.

The week following the seminar, Tom wrote to Reg and threw out what he thought was a teaser:

Dear Reg,

I really enjoyed the opportunity to visit with you in Phoenix last week. If you decide to open an office in Phoenix, I will give you a special deal: the 10,000 square feet of space you visited on the 4th floor for five years at $6.00 per square foot. Lease must start by June 1, 1990. I look forward to hearing from you.

Very truly yours,
Tom Landlord

Meanwhile, Reg had returned to the east coast and was informed that his board of directors had decided to acquire space in Phoenix for the purpose of opening a branch office. The board instructed Reg to locate a facility in the range of 6,000 to 8,000 square feet. Based on their pro formas, they anticipated paying up to $20.00 a square foot, and Reg was instructed to see what was available in that category and report back to the board. While Tom Landlord's space was much larger than anything required by his company, the rent quoted by Tom was such that the overall price would be far below that authorized by the company.

Reg responded to Tom's correspondence promptly:

Dear Tom,

I too enjoyed the chance to visit with you and trade war stories, and especially the opportunity to look at your wonderful facility. We appreciated your generous offer of a week ago and we have decided to open a branch office in Phoenix. We accept your offer without reservation. We will begin our five-year term on May 1, 1990 in accordance with the terms of your offer. We look forward to seeing you in Phoenix.

With very best wishes,
Big Corp. of Arizona, Inc.
Reg Tenant

Tom is seeing some light at the end of the tunnel and is excited about the chance to get his leasing up and moving again, and responds:

Dear Reg,

I am delighted that you are coming and know that this will be the beginning of a wonderful friendship. Our leasing agent, Grabit & Run, will follow up with particulars. I am looking forward to seeing you soon.

Cordially,
Tom Landlord

Several weeks later, Jerry Broker, a leasing broker with Grabit & Run who had the exclusive leasing rights for Tom's building, sent the standard package of the landlord's lease up materials, including its standard form lease, to Reg.

Dear Mr. Tenant,

Mr. Tom Landlord has informed me of Big Corp.'s agreement to take space in Brand New Building and I have enclosed five copies each of Mr. Landlord's standard form office lease with the exhibits, rules and regulations, parking limits, cleaning specifications, estoppel certificates, and the statement for the first month's rent. Please sign where indicated on page 42 and initial the rules and regulations at page 56. Please send four completely executed copies to my attention, along with your payment. We are looking forward to your arrival and welcome you to the building.

Sincerely,
Jerry Broker

The enclosed statement itemized Reg Tenant's charges, and appeared as follows:

Rent for May, 1990 ($6.00 per square

foot) $5,000.00

Taxes and Operating Costs Pass-Through (estimated at $6.25 per square foot) 5,208.33

Above building standard build out ($25.00 per square foot) 250,000.00

Directory and signage throughout building 1,000.00

Anticipated service elevator charges for move-in 750.00

Access decoder cards and door keys 1,200.00

Electric meter hook-up 950.00

Since Reg Tenant was not born yesterday, the enclosed did not surprise him. Reg Tenant responded to Tom Landlord directly, and explained that he really did not see any need to deal with Jerry from Grabit & Run since they had concluded their deal:

Dear Tom,

I just received the building lease form and related exhibits from Jerry. I enjoyed the opportunity to look at them and it looks like you are doing a great job especially with the tax and operating cost pass-throughs. I must say I am glad that we accepted the special deal that you extended to me and that I am not required to actually get in and negotiate the "killer" lease clauses that are contained in your standard form. I had thought that those existed only in New York City but it is obvious that you are not far behind in your ability to write a vague, overreaching, and very expensive form of agreement. I am looking forward to seeing you soon. With continued anticipation, I remain,

Very truly yours,
Reg Tenant

Upon receipt, Tom Landlord experienced a mixture of anger, frustration, and, upon reflecting on the lectures about the "phantom lease" at the seminar, a growing fear that he had made a serious mistake. Instead of immediately responding to Reg, Tom decided to talk with his counsel, and sent him copies of his correspondence with Reg. Tom Landlord's counsel informed him that he appeared to have entered into a binding lease with Big Corp. of Arizona, Inc. The parties were well defined, the specific space to be leased was identified within a particular building, the term of the lease was set out with particularity, and the rent was absolutely certain. Counsel informed Tom Landlord that he had leased his prize space for five years at $6.00 a foot.

Tom Landlord, of course, was flabbergasted. What about all the normal stuff that goes in the lease? What about clauses on subordination, default provisions, fire and casualty, repair obligations, rent escalation and pass-throughs, CPI clauses, and on and on? After all, Tom exclaimed, his counsel had prepared, at considerable expense, a 42-page form lease with 12 additional pages of rules and regulations and other exhibits. How could that be replaced with one short letter?

Counsel informed Tom Landlord that while those topics were typically covered in most forms of the commercial lease, there was no need to set those items out if the parties chose not to. Basically, Tom Landlord had offered to give exclusive use of a defined piece of property to Reg Tenant for five years at an agreed-upon rent. The letters constituted a "writing" under the statute of frauds and, at that point, the parties had entered into a common law conveyance of an interest in real estate. Nothing further was required to enter into a legally enforceable lease agreement.

As noted above, landlords and tenants can make a lease based on a one-paragraph letter without the need to negotiate a 100-page lease. Likewise, landlords and tenants can enter into a variety of leases which, for lack of thoroughness, mistake, or intentional omission, may have one or more substantive items which are not governed by the lease and which, if not otherwise satisfactory to the landlord and tenant, may present a problem. The following is an extension of the Tom and Reg story, and reflects some of the problems that occurred after Reg moved into his very nice space.

Reg Tenant began to move into the space on May 1, 1990. Summer came early to Phoenix that year, and within a matter of weeks, the heat, dry as it was, was beginning to be oppressive, and Reg began sending notices to Tom Landlord about the lack of HVAC services for his first-class space. The building, being new, was constructed of block and glass with hermetically sealed windows. While some air seemed to circulate throughout the space, none of it was chilled. Upon receipt of Reg's complaint, Tom responded to Reg as follows:

Dear Reg,

I am sorry that you misunderstood the situation with air-conditioning. As you know, you declined to enter into our normal standard form lease, which addresses this type of issue. We were particularly proud of our willingness as a landlord to actually state minimum temperatures and humidity levels which we would provide in your premises since we know what an important amenity that can be in a lease in Phoenix, Arizona, especially in the summertime. However, since you decided not to reach any agreements with us on the supply of services, our counsel has informed us that we are under no legal obligation to supply you with cooled air. Whatever liabilities you believe we may have to supply re-circulated air under various building codes, we are informed are satisfied with the current level of airflow. Assuming that you are interested in acquiring cooled air, we have enclosed our list of charges for cooled air and related services which we would be happy to discuss with you. Since you chose not to accept our package deal, you may find that some of these costs are a little higher than other tenants of the building are experiencing because of their willingness to assume the responsibilities of the standard form lease. We have also enclosed our statement for charges associated with your use of the elevators.

Very truly yours,
Tom Landlord

Reg Tenant understood immediately that while he had picked Tom Landlord's pocket on the basic rent structure, Tom had just picked his pocket on the services issue. Reg met with his counsel, who confirmed that the common law conveyance was a two-edged sword, and that while Reg got certain benefits from the lack of a modern written lease, Tom got some also. Here, counsel explained, the landlord under the basic conveyance had no duty to supply conditioned air, cleaning services, and electricity, and that if Reg desired those amenities, he would have to arrange for them. Basically, Reg's choices were to acquire the services from the landlord at the best price and under the best terms he could negotiate, or to attempt to put in some supplementary air-conditioning units to handle the cooling of his own space and to obtain his own electricity.

On the other hand, Reg's counsel informed him that the elevator fees and charges were not appropriate, since the elevators were obviously appurtenant to his lease and must be included, without charge, unless otherwise expressly addressed. Reg responded to Tom, and informed him that he had reviewed his charges for conditioned air and elevator usage and that he was unable to accept Tom's offer. He did advise Tom of the fact that a failure of elevator service would be deemed a material violation of the lease and, in the event he was constructively evicted, his damages would include the difference between his current rent and the rent necessary to achieve a comparable lease in the vicinity. With respect to the air-conditioning problems, he informed Tom that he was going to install supplementary air-conditioning within the space.

Tom Landlord followed his counsel's advice and did not attempt to cut off elevator service, although he made an attempt to stop the construction in Reg Tenant's premises that was necessary to set up the supplementary heating and air-conditioning system. In that situation, Reg Tenant informed Tom Landlord that he was intending to make those modifications and changes, that none of them were structural, that they would not endanger the integrity of the building, and that upon termination of his lease, he would remove all of this equipment and return the premises in exactly the condition that he received them, less ordinary wear and tear. Again, the failure to obtain a standard form lease, which addressed those types of issues, left the tenant free to exercise those rights that normally were an incident of the common law conveyance of an interest in real estate.

At this point, Tom's development experience was running into serious trouble. In addition to vacancies in the building, the return on Reg Tenant's 10,000 square feet of space had severely affected Tom Landlord's ability to meet his mortgage payments. Tom's mortgage had been funded once he had shared Reg Tenant's original acceptance letter with his lender, and the lender, on the credit of Big Corp., decided to go forward with its loan to Tom Landlord. However, it had expected that the pre-approved landlord's standard form lease, which contained the normal subordination and attornment provisions together with the tenant's covenant to pay for its share of taxes and other operating expenses, would be utilized.

Larry Lender was forced to foreclose and take over Tom Landlord's building, and in the process sought to evict Big Corp. However, it soon became apparent that Big Corp.'s lease was entered into *prior* to the lender's loan, and therefore was not subordinate to the lender's lien. Since no subordination agreements had been obtained or exchanged, Big Corp of Arizona, Inc. was permitted to continue its occupancy, and the lender who had now stepped into title

was powerless to prevent it.

This led the Larry Lender to take a much more pragmatic view of the building, and he decided that the upscale design and marketing approach that had been utilized by Tom Landlord did not work. He began to look around for any type of tenant that could be attracted and that would produce some return on the development. Four marginal tenants were brought in, the value of the tenant improvements was significantly reduced, and the general amenities provided to the building were similarly reduced. Big Corp of Arizona, Inc. made several efforts to challenge the new landlord on its change in services, upkeep of the lobby, substitution of plastic plants for the original landscaping, and so on. In each case, Big Corp of Arizona, Inc. realized that without the standard form lease to tie these items together, it had no real stake in what was happening in the balance of the building.

Finally, Big Corp of Arizona, Inc. realized that no matter how high-class its space was, the building was becoming unsuitable as a regional headquarters location for a national company. Reg had also confirmed with counsel that his options to require the landlord to handle items such as landscaping, lobbies, etc. were slim to none, and that almost any arguments would be uncertain, time-consuming, and quite expensive, since he did not have a lease where the landlord agreed to maintain a "first-class building."

At that point, Big Corp of Arizona, Inc. gave up and advertised for subleasing. Obviously, the rock-bottom rent gave it a terrific advantage in the market, with a way to not only get out of the space but make a profit as well. Since a standard form lease had not been signed, the landlord had none of the traditional rights that landlords attempt to get these days, including provisions giving them all profits that a tenant may realize on its subleases. Even though it would undoubtedly be required to go to market prices in any other location, part of the profit from a sublease on that facility would defer that cost. Big Corp of Arizona, Inc.'s ad for rent was so successful that it had numerous subtenants to pick and choose from, and ultimately decided on an escort service who felt that the high-class amenities would help them establish a very competitive image for their type of services. Reading rooms and video rentals were also offered to the public. The new landlord was horrified, and immediately attempted to prevent the sublease. However, since no restraints on alienation had been obtained and the lease had no restrictions on use, the sublease could not be stopped.

Shortly after taking occupancy under the sublease, a fire broke out in the premises which was caused by the negligent use of too many candles in the group therapy room, and the landlord soon presented Big Corp. with a restoration and repair bill of a little over a million dollars. Since no standard form lease had been entered into, the question of allocating that risk did not come up, and when Big Corp of Arizona, Inc. attempted to contact its subtenant to review their insurance policies, he found that they had gone out of business and were no longer available.

Big Corp.'s counsel informed it that there were three years left on the lease, and that it would be required to continue to make the monthly payments of rent and, upon the expiration of the lease, return the premises to the landlord in the same condition in which it had received them. At this point, Reg advised his board to consider filing bankruptcy for the wholly owned subsidiary that had been formed solely for the purpose of signing the Arizona lease. Reg pointed out that, since it was a new business, the subsidiary had almost no assets and limited accounts receivable, and he recommended that the board consider the possible liquidation as a rational way to make a final allocation of risk on this particular business arrangement. Upon re-inspection, Larry Lender saw that both it and Tom Landlord had not realized that Reg's acceptance of his offer was on the letterhead of "Big Corp. of Arizona, Inc." In their initial excitement, both Larry and Tom had missed the nuance and did not know who their tenant was.

After filing for bankruptcy and handling the adverse news publicity attendant to the filing, Reg was sharing a glass of wine with an old lawyer friend of his, who asked him why they had not simply terminated the lease, which they were permitted to do under Arizona law if the landlord refused to restore the building following a fire or casualty. Reg was shocked to hear that he had that option, and realized that his counsel had pretty much viewed his lease as a pure common law arrangement and were providing him with advice on that basis. Since their headquarters were back east, and they were not familiar with Arizona law, they missed the fact that Arizona was one of those few states which had actually decided to change this particular aspect of the common law with respect to commercial leases, and had enacted a statute extending such rights to the tenant.

The above is obviously a somewhat exaggerated illustration of what can happen if some topics are not covered or dealt with, but worse has happened. As indicated, the commercial lease in most of its varieties would change many of the results produced under the common law. Many of these changes have been necessary to fit with modern business practices. The tenant's duty to repair the building in the event of fire and casualty is a good example. While that may have made some sense several hundred years ago where the tenant occupied a small home on a farm, it does not fit with the concept of multi-tenanted high-rise buildings or large retail malls. Tenants will no longer accept that responsibility and landlords want to keep control of their buildings and malls

in all respects.

On the other hand, a number of changes have been made to protect the landlord's point of view. For example, the rent pass-through and escalation provisions are contractual, and a failure to include adequate or detailed provisions would leave the landlord with no fall back other than to accept whatever amount of rent was clearly stated in the lease. Landlords, with their growing concern over tenant mixes in the retail area, and a sense of control and competitiveness in the office area, have added provisions to restrain the alienability of the property by the tenant. These are heavily negotiated in many cases, and have become a very important ingredient in the modern commercial lease. Without such provisions, landlords are almost powerless to stop or interfere with the assignment and subleasing of space by tenants.

As the story illustrates, the problem of defining a lease is a difficult one to get your arms around. The legal aspect is easy to answer. It is Reg's letter which identifies the parties, the property, the term, and the rent. However, very few leases are done like that any more and the modern lease begins to change, add to, modify, and amend many of the common law principles illustrated above.

At this point it is extremely important to remember that the lease is not only what the parties may expressly agree to add to their written common law conveyance, but is also what is not included in the lease. For example, if the lease does not outline services, there are none. If the lease does not restrict alienability, there is no such restriction. If the lease does not allocate restoration responsibilities for fire or other casualty, it will remain with the tenant unless changed by statute. If the space becomes unusable, rent will not abate unless otherwise provided, and so on.

Therefore, landlords and tenants alike need to evaluate the standard lease form that is put on the table, not only in terms of the expressed agreements that they have all addressed and agreed upon, but in terms of the "hidden" agreements or those that will be provided by the common law if the parties have failed to address the issue. The bottom line is that a failure to modify, amend or delete portions of the common law default lease can expose a modern leasing agreement to interpretations that just do not work.

What is a lease anyway? It can be a complete clearly stated allocation of risk by the respective parties. It can memorialize the essential business terms of the transaction and it can provide substantial guidance through all the years of the lease term. Or, as noted above, portions of the lease may be what the law fills in to the surprise of one or both parties and it can be a poorly articulated arrangement where neither party "pulled the string" very much and they are left just to become another one of the parties filling up an already full calendar in the local superior court. In short, a lease will be whatever the parties decide to make it.