

In the Spotlight

Beware of Lease Disputes In a Declining Market

By Jack Garson

We have just experienced a rising, perhaps frothy, commercial real estate market for the past half decade, resulting in ever-increasing rental rates throughout much of the country. More recently, we have suffered increased gas prices that tax the budgets of all retail customers and appear to be reducing sales for many retailers.

An ongoing war, the threat of terrorism, and increases in interest rates all are reducing consumer sentiment and spending. The residential real estate market has already been hit, severely in some markets. Recession may be around the corner. Based on historical patterns, lease disputes rise in difficult economic times, and the parties—especially tenants—will even challenge the enforceability of the entire lease itself.

CAREFULLY CONSIDER WORDING

When a determined party seeks to challenge a lease, sometimes even apparently simple

lease provisions, such as the description of the premises, can present surprisingly complex issues and adverse results. While the insertion of a simple store number suffices in many leases, in others the parties must carefully consider and draft the description of the premises. An improperly drafted description of the premises can produce unintended results such as changes in the rent, the grant of unintended tenant rights, or even termination of the lease.

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Consider the situation in which the landlord is leasing premises in a shopping center that is yet to be constructed. Under the law of virtually every state, in order for a lease to be binding, the lease must contain at least three key terms: the rent, the term

of the lease, and a description of the premises. This description of the premises must be sufficiently definite so that a court can enforce the description—the location and boundaries of the premises—either by reference to the lease or by reference to some objective standard set forth in the lease.

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PRE-CONSTRUCTION LEASE LANGUAGE

Consider the challenge facing the lease drafter when the exact location of the buildings at a shopping center has not been determined, or when the demising walls may be adjusted based on a variety of factors, such as the application of construction codes and zoning requirements. If the as-built demising walls vary from the description of the premises in the lease, then is the lease



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still enforceable? If the premises are larger or smaller than described in the lease, then is the lease still binding? Will the rent be adjusted? Well, it depends.

Typically, leases are challenged in these circumstances when one party has second thoughts and wants out of the lease. In other situations, there is a good faith desire to terminate the lease because a party's expectations of a particular premises' size or location are not borne out when the actual premises varies from the description in the lease.

In one case, the court was called upon to determine the enforceability of the following description of the premises:

The proposed store is to be 45 feet fronting on Colesville Road by a depth of 115, inside dimensions, with full basement thereunder and to be built according to plans and specifications approved by your company [the Tenant] with the understanding that the store will be designed in general conformity with the most recent stores opened by your company.

In this case, the tenant desired to terminate the lease. The court held that this description was insufficiently definite and ruled that the lease was unenforceable. *People Drug Store v. Fenton Realty Corp.*, 191 Md. 489, 62 A.2d 273 (1948)

DON'T LEAVE AN ESCAPE

In another case, the parties negotiated and documented the entire lease, but left the description of the premises to future agreement between them-

selves. Specifically, the parties agreed that they would work on a space plan for the premises that would, among other things, denote the boundaries of the premises. The lease provided that this space plan would be mutually prepared by the parties and attached to the lease as an exhibit. Prior to the parties' agreeing upon this space plan, the tenant got cold feet and sought to terminate the lease. Because of the failure to include in the lease a description of the premises, the tenant was permitted to do so.

The best protection to avoid an insufficiently definite description of the premises is to attach the plans and specifications as an exhibit to the lease or to attach a space plan that shows the demising walls and any key features of the premises.

Note, however, that when the premises is yet to be constructed, the landlord should include provisions that address and allow minor deviations, such as industry standard construction tolerances in the location of walls and the like.

OFFER SIMILAR EXAMPLES

Alternatively, you may wish to reference other similar premises as a sample of the demised premises. As one of the cases above illustrates, however, sample premises must be used cautiously. It may not be sufficient to merely identify similar premises as a model for the premises to be constructed. Rather, it is advisable to add additional parameters, such as

an identification of the boundaries of the premises, plus or minus a fixed number of feet.

Further, do not leave unknown terms to the "mutual agreement" of the parties. Many courts will determine that if the parties have left a significant lease term to future mutual agreement, the lease is not enforceable. Instead, consider similar variations that are generally enforced, such as a lease that requires one party to initially determine, for example, the location of the premises, subject to the reasonable approval of the second party.

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In other situations, a lease may remain enforceable, but the description of the premises produces unanticipated, adverse consequences. For example, in cases where the landlord referred to the premises by street address, courts have held that the premis-

es included the sidewalk in front of the premises — despite the landlord's desire to preserve the sidewalks as common areas. *See, e.g., Kuschinsky v. Flanigan*, 170 Mich. 245, 136 N.W. 362 (1912).

PRECISE PREMISES DESCRIPTIONS

In still other cases, inadequate descriptions of the premises produce disputes regarding the rent payable under the lease. In one such case the parties signed a lease for existing premises. The lease stated that the premises consisted of 4060 square feet. The lease also provided that in the event that the actual square footage of the premises was more or less than 4060 square feet, the rent would be adjusted accordingly. During the first year of the lease term, the landlord determined that the premises contained 4625 square feet and increased the rent by approximately 14%. In the second lease year, a new owner of the building determined that the premises contained 4883 square feet and demanded that the rent be increased by approximately 20% over the original rent set forth in the lease.

The tenant was already having financial difficulties and sought to have the lease declared unenforceable. The court ruled in favor of the tenant on the basis that the lease should only permit small adjustments in the rent. However, upon appeal, a higher court ruled that the lease was, in fact, enforceable. This appellate court reasoned that the rent could have gone up or

down and certainly the parties could have measured the premises themselves to eliminate any risk. The court also distinguished this case from situations in which there is no rent adjustment provision in the lease and, instead, the lease merely states that the number of square feet of the premises is “approximately” or “more or less” the number stated in the lease. *Hart v. Vermont Investment Ltd.*, 667 A.2d 578 (D.C. 1995)

In cases where “approximately” or “more or less” have been used to describe the square footage of the premises (or to describe the area of real estate being purchased), courts have allowed adjustments in rent (or the purchase price) of 10-12% and have rejected adjustments exceeding 30-40%, with amounts in between these ranges falling into a gray area that must be determined on a case by case basis.

THREE RULES TO CONSIDER

The cases regarding such rent disputes suggest the following practice pointers:

- 1) Limit the maximum amount of any adjustment in rent. For example, the lease might provide that the rent may not be increased or decreased by more than an amount equal to 5% of the annual base rent originally set forth in the lease.
- 2) Limit the time period in which either party may seek to adjust the square footage. For example, a party shall only be per-

mitted to seek adjustment in the square footage (and rent) if such party measures the premises and provides notice of a variance in square footage within the first 90 days after delivery of the premises to the tenant. This time limitation will not only help minimize disputes, but also will reduce the pain to the affected party by limiting any large accumulation of rent deficiency or overpayment that must be corrected.

- 3) Specify a method for measuring the premises. For example, the lease might provide that the premises shall be measured from the exterior surface of all demising walls, except that if a demising wall is shared with another premises, then the premises shall be measured from the centerline of such shared wall.

As discussed last month, difficult economic times often produce creative attempts to avoid or adjust lease obligations. Pre-empt those attempts now by focusing your diligence and creativity on enhancing the clarity of the parties' lease obligations and the enforceability of your leases.

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