Thursday, November 4, 2021
2:15 PM – 3:30 PM

Peer to Peer 7

Late Delivery and the Rent Commencement Date - When Good Delivery Goes Bad

Presented to

2021 U.S. Law Conference
San Francisco Marriott Marquis
San Francisco, CA
November 3-5, 2021

by:

Karen Levine
Seyfarth Shaw LLP
620 Eighth Avenue, 32nd Floor
New York, NY 10018
kalevine@seyfarth.com

David P. Vallas
Shareholder
Polsinelli PC
150 N. Riverside Plaza, Suite 3000
Chicago, Illinois 60606
dvallas@polsinelli.com

DESCRIPTION OF SESSION

While landlords and tenants go into leases with the same objective – to get the tenant open, operating and paying rent – they may have a difference of opinion as to whether the conditions required to get to that point have been met. This interactive workshop will explore what the parties in the fact patterns discussed below did correctly, or could have done differently, in order to get to the same place – delivery of possession and rent commencement.

Participants at each table should analyze each fact pattern, and select someone to take notes for the table and someone to be the "Reporter" – it is okay for one person to serve both positions. We will then discuss key issues raised when trying to achieve delivery of possession and rent commencement.

FACT PATTERN NO. 1

Charge-Them-More Developers, LLC ("Landlord"), a global developer, owner and operator of shopping centers, has entered into a lease with Give-Me-More Enterprises, Inc. ("Tenant"), a national retailer of discount and off-price widgets, for a store containing approximately 10,000 square feet (the "Premises") in a shopping center known as Schitts Creek Commons (the "Shopping Center"). Unfortunately, neither party used an attorney who regularly attends the ICSC Law Conference, and some issues have arisen regarding whether the "Delivery Date" has occurred. The lease provides that the Delivery Date will not occur until the following criteria have been met:

(i) completion of Landlord's Work and delivery of Landlord's notice regarding completion;

(ii) Landlord and Tenant have jointly inspected the Premises to confirm substantial completion of Landlord's Work and prepare a punch-list;

(iii) written acceptance of the Premises by Tenant;

(iv) Landlord has entered into a lease with SaveMore/EatMore Supermarket for 50,000 square feet, and such tenant has opened for business;

(v) Landlord has delivered to Tenant a subordination, non-disturbance and attornment agreement in the form attached to the lease as Exhibit G, executed by the holder of the mortgage encumbering the Shopping Center;

(vi) Landlord has delivered to Tenant a certificate of occupancy for the Premises;

(vii) receipt by Tenant of Landlord's written approval of the plans for Tenant's Work;

(viii) Tenant's receipt of all required building permits and approvals for Tenant's Work from local governing agencies; and

(ix) Tenant's receipt of the first installment of the Construction Allowance at least ten (10) days before Tenant is ready to commence its work.

Questions for Fact Pattern No. 1

1. During the walk-through Tenant agreed that the work was substantially complete, but due to the volume of new stores Tenant is opening this quarter, it cannot get its construction manager to focus on signing the acceptance letter. How could this concept have been addressed, other than requiring a written acknowledgement from Tenant?

2. SaveMore/EatMore has opened, but it is primarily a fulfillment center. Only 15,000 sf is open for the public to walk around and take items off the shelves; the rest is used for preparation of delivery and drive-up orders. Tenant argues that this operation doesn't qualify as a true supermarket. Has Landlord met the supermarket delivery requirement?

3. Landlord's Work (demo the existing improvements and provide a vanilla box with some improvements) does not require Landlord to provide any ADA-accessible restrooms. Pursuant to the Schitts Creek Zoning Code, the building inspector cannot issue a certificate of occupancy until the restrooms are installed, which is part of Tenant's Work. Tenant will not start its construction until Landlord satisfies the delivery conditions, but Landlord cannot achieve the Delivery Date without the certificate of occupancy. How should the lease have been drafted to avoid this Catch-22?

4. Tenant dragged its feet in submitting a complete application for its building permits and, once submitted, it has half-heartedly followed up with the town, whether to answer questions or make requested adjustments to the plans. Because Landlord has a good working relationship with the town, it would like to step in and obtain the permits on Tenant's behalf, which Tenant is resisting. Does Landlord have the right to pursue the permits for Tenant?

5. Tenant has mobilized its general contractor and is ready to start work. However, since Landlord was not aware of the start date it has not paid the first installment of the allowance. Accordingly, Tenant argues that the Delivery Date has not occurred. Landlord believes that Tenant had a moral (if not contractual) obligation to notify Landlord of the construction start date, so the funds could be paid in a timely manner. Who has the upper hand in this argument?

Discussion of Fact Pattern No. 1

Sophisticated parties (and sometimes even those who are not too sophisticated) will spend a lot of time negotiating the conditions for "Delivery of Possession". Some conditions may seem straightforward – completion of the landlord's work, while others may be hotly debated before the lease is signed – satisfaction of opening co-tenancy requirements and the tenant's receipt of the permits for its work.

Whether a landlord has completed its work can be addressed, first and foremost, by defining the word "completion". Does it mean that every aspect of the landlord's work must be done, including minor items such as installation of all electrical outlet covers and touch-ups where the paint was nicked? Or can the landlord achieve this prong of the delivery requirements by substantially completing its work? If so, the parties must agree what substantial completion means – perhaps all work other than punchlist items. Or all work necessary for the tenant to come in and start its construction.

In *1710 Realty, LLC v. Portabella 308 Utica, LLC*, 189 A.D.3d 944 (2nd Dept. 2020), the landlord, 1710 Realty, LLC entered into a lease with Portabella 308 Utica, LLC, pursuant to which 1710 Realty agreed, in one section of the lease, to deliver the premises "on the Commencement Date as-is", while an earlier section of the lease defined "Commencement Date" as "the later to occur of the date that (i) Tenant is delivered occupancy of the Demised Premises in the Delivery Condition (hereinafter defined), (ii) Tenant has been issued permits from the Department of Buildings of New York City in connection with Tenant's Work and (iii) January 15, 201[6]." However, the Delivery Condition was defined as "vacant, broom clean and free of the prior tenants['] personal property and fixtures". The lease further provided that Portabella could terminate if the premises were not delivered within 90 days of lease execution. The lease was signed on December 16, 2015,

By letter dated April 19, 2016, Portabella notified 1710 Realty that it was terminating the lease due to 1710 Realty's failure to satisfy the Delivery Condition within such 90-day period. In 1710 Realty's suit against Portabella for breach of contract and damages, 1710 Realty argued that Portabella's termination constituted a unilateral surrender of the premises. In its defense, Portabella claimed that its lease termination was valid because 1710 Realty did not timely meet the Delivery Condition and offered evidence that the premises contained enough debris to fill multiple dumpster containers. 1710 Realty pointed to the lease section which provided for delivery "as is" and argued that the parties did not intend for the premises to be broom clean because Portabella would be performing demolition and renovation work.

In its decision finding for Portabella, the trial court quoted *Vermont Teddy Bear Co. v. 538 Madison Realty Co.*, 1 N.Y.3d 470, 475 (2004), by saying that "[w]hen parties set down their agreement in a clear, complete document, their writing should be enforced according to its terms. [This rule has special import] in the context of real property transactions, where commercial certainty is a paramount concern, and where the instrument was negotiated between sophisticated, counseled businesspeople negotiating at arm's length. In such circumstances, courts should be extremely reluctant to interpret an agreement as impliedly stating something which the parties have neglected to specifically include. Hence, courts may not by construction add or excise terms, nor distort the meaning of those used and thereby make a new contract for the parties under the guise of interpreting the writing."

The Appellate Division disagreed with the lower court's ruling that the "as is" clause in the lease modified (and thus negated) the "broom clean" requirement, by reasoning that such an interpretation rendered the Delivery Condition meaningless. The court reconciled the contradictory provisions in the lease by stating that since the Delivery Condition was a condition precedent to the occurrence of the Commencement Date, the "as is" nature of the premises would be determined on such date – that is, after satisfaction of the Delivery Condition.

The *1710 Realty, LLC* case illustrates, in stark terms, the result when parties to a lease do not ensure that delivery requirements are spelled out clearly, in terms that do not require a court to interpret the language. A lease which provides that space would be delivered as is, but must nevertheless meet certain delivery criteria regarding the physical condition of the space, is inconsistent at best and setting the parties up for a fight at worst. The contradictory requirements for delivery of possession speak to the "best practice" that just before a heavily negotiated lease (or even one that has gone through any revisions) is submitted for signature, it should be read quietly, cover-to-cover, to ensure that all negotiated terms mesh with one another – in effect, that all lease provisions play well together.

Another contentious issue when negotiating the requirements for Delivery of Possession is co-tenancy. Sometimes it can be as simple as a possession co-tenancy requirement ("Landlord has signed a lease with Tenant ABC for 2,500 square feet in the Shopping Center"), or impose additional conditions ("Tenant ABC has opened for business in the Shopping Center"). In the fact pattern that will be discussed during the session, the landlord must have entered into a lease with a named supermarket for 50,000 square feet, and such tenant must be open for business. As with most issues in retail leasing, the proverbial devil is in the details. Even a "simple" condition – whether the landlord has entered into a lease with the supermarket – is open for discussion. Is the sole requirement that the landlord and the supermarket have signed a lease? What if the supermarket lease is fully executed and delivered, but the tenant can terminate within a certain number of days if it doesn't receive an SNDA? In the latter case, our hypothetical lease should specify that the landlord has entered into a binding lease with all conditions satisfied, and that it is not subject to termination other than for standard events such casualty and condemnation.

A more nuanced condition deals with whether the supermarket has opened for business. The hypothetical lease only requires that the landlord and the supermarket have entered into a lease for 50,000 square feet and that the supermarket is open for business, not that the supermarket is conducting business in the entire space. If the supermarket reduces its footprint before the landlord is ready to deliver possession, our hypothetical tenant could argue that the delivery co-tenancy condition has not been satisfied. On the flip side, the landlord could respond that it only needed to ***enter into*** such lease for 50,000 square feet, and if the hypothetical tenant wanted the supermarket open in the entire space, the lease should have specified that.

One California case addressed the issue of opening co-tenancy in great detail as it relates to the commencement date but, interestingly, the facts do not indicate whether such co-tenancy requirement was also necessary to trigger delivery of possession. In *Grand Prospect Partners, L.P. v. Ross Dress for Less, Inc. et al.*, (2015) 232 Cal. App. 4th 1332, the lease provided that the commencement date would not occur unless Mervyn's was open for business in 76,000 square feet. In late July 2008, after Grand Prospect completed its work but prior to the date Ross was required to accept possession, Mervyn's filed for bankruptcy and subsequently closed its store in the center on December 31, 2008. On February 6, 2009, Ross advised Grand Prospect that it accepted delivery of the premises, subject to its rights under the lease – e.g., its co-tenancy protections. On May 10, 2009, the date on which the commencement date would have otherwise occurred, Ross elected not to open for business or pay

rent, based on its rights under the co-tenancy section of the lease.

The *Ross* case does not address whether the tenant also had the protection of a co-tenancy delivery condition. Many tenants want to know that their co-tenants are open and operating (or have at least accepted delivery and undertaken their respective construction work) when they get the keys. If co-tenancy protection is limited to an opening/commencement date scenario, a tenant could find itself in a situation where it has spent time and money to build out its store, only to get to the planned commencement date without the synergy it expected to get from the named co-tenant. Many leases will give a tenant the right (or even require a tenant) to open in the absence of the co-tenant, in which case the tenant only pays a pre-determined alternate rent. However, the tenant may not want to commit other resources – for example, hiring personnel and ordering seasonal merchandise – if it feels the store does not have a good chance of success without its co-tenant's doors also being open.

FACT PATTERN NO. 2

Landlord also entered into a lease with Seafood Shack ("Tenant"), a local restauranteur. Landlord is excited about bringing Tenant to Schitts Creek Commons and the foot traffic it will draw. Landlord jumps at the opportunity and completes the improvements it agreed to make to the space by August 15, 2020.

On August 30, 2020, Landlord sent Tenant a delivery of possession letter stating:

> "As of 08/01/2020, Landlord will have substantially completed its construction, if any. Accordingly, possession of the Premises is hereby tendered to you and the date hereof shall establish the "Possession Date" for all purposes under the Lease.
>
> You may now enter the space and commence construction of your leasehold improvements in accordance with plans approved by Landlord only after the following requirements are satisfied:
>
> - Plans and Specifications have been approved by Landlord
> - Fully executed lease by Landlord or executed early access letter
> - A building permit has been issued, if applicable
> - Certificate of Insurance, as defined under the Lease
> - Construction security deposit
> - Pre-construction meeting with mall management
> - Construction scheduled."

Landlord approved Tenant's Plans and Specifications on October 1, 2020, and Tenant obtained its building permits on January 15, 2021. Landlord gave Tenant keys to the Premises on that same day (January 15, 2021). Unfortunately, Tenant's build-out has been moving slowly. By May 1, 2021, Tenant seems to be running out of money. Landlord still believes that Tenant is a good catch (*pun intended!*) and wants to help Tenant to open for business. Landlord pays Tenant the first installment of the Tenant Allowance on May 20, 2021, even though Tenant has not satisfied all of the conditions for that payment.

The situation has only gotten worse by July. Tenant has not made much progress, and Landlord is now convinced leasing space to Tenant was a mistake. Landlord calls its outside counsel and asks for help. Landlord's counsel identified the following provisions in the Lease:

(i) The Term of the Lease shall commence on the date (the "Commencement Date") of the execution of this Lease by Landlord and Tenant. Tenant's obligation for the payment of Base Rent and Additional Rent shall commence on the date (the "Rent Commencement Date") which is the earlier to occur of (a) the date Tenant opens its store in the Premises for business to the public; or (b) the Latest Commencement Date set forth in the Data Sheet.

(ii) The Data Sheet provides that the Latest Commencement Date is one hundred twenty (120) days after the latest to occur of (a) the date that Landlord tenders possession of the Premises to Tenant, (b) the date Landlord approves Tenant's Plans and Specifications, and (c) the date Tenant obtains its building permit for Tenant's Plans and Specifications.

(iii) The Lease defines "Default" as, among other things, (a) failing to pay Rent when due (after notice and an opportunity to cure) or (b) failing to open within ten (10) days after the Rent Commencement Date.

(iv) Upon a Default, Landlord may, at its sole discretion, take any of the following actions (A) immediately terminate this Lease and Tenant's right to possession of the Premises by giving Tenant written notice that the Lease is terminated, or (B) have the Lease continue in effect for so long as Landlord does not terminate the Lease and Tenant's right to possession of the Premises.

Questions for Fact Pattern No. 2

1. When did Tenant get possession of the Premises?

2. Did a "Default" occur? If so, when? If not, what needs to happen for a Default will occur?

3. When was the Rent Commencement Date?

4. Can Landlord terminate the Lease and/or Tenant's right to possession of the Premises?

Discussion of Fact Pattern No. 2

What does it mean for a landlord to deliver possession of leased premises? Although Landlord's August 30, 2020 letter provided that "possession of the Premises is hereby tendered to you" and establishes the "Possession Date", it is unclear when or even whether possession of the Premises was tendered to Tenant. Initially, the letter is grammatically incorrect and factually questionable insofar as it states on August 30 certain events that will have transpired by August 1. Substantively, in the absence of a lease provision defining or describing what the parties meant when Landlord "tenders possession of the Premises[,]" the meaning of "tenders possession" is ambiguous. If contract language is reasonably susceptible to more than one meaning, that language is ambiguous. *MS Real Estate Holdings, LLC v. Donald P. Fox Family Trust*, 362 Wis. 2d 258, 280 (Wis. 2015). The phrase tendering possession may very well have more than one reasonable interpretation. When contract terms are ambiguous, courts should look beyond the four corners of the document to establish what the parties intended.

A defining characteristic of a lease is that it transfers "exclusive possession" of the property such that the lessee has the right "to exclude other members of society in general from any present occupation of the land". *Osguthorpe v. Wolf Mountain Resorts, LLC,* 232 P.3d 999, 1007 (Utah 2010); *Keller v. Southwood N. Med. Pavilion,* 959 P.2d 102, 107 (Utah 1998) ("A lease must convey a definite space and must transfer exclusive possession of that space to the lessee.") To determine whether Landlord conveyed exclusive possession of the Premises to Tenant, courts should look to the plain language of the written instruments. *See Keller,* 959 P.2d at 107. "However, a court is not bound by the parties' characterization of their transaction or by any title they may have given in writing." *Id.*

In Fact Pattern No. 2, Landlord characterized its August 30, 2020 letter as delivering possession of the Premises to Tenant. Landlord specifically stated that the date of this letter shall establish the possession date for all purposes. A court should look beyond this characterization, however, and instead look to whether Landlord conveyed the right to Tenant to exclude others from the Premises. Landlord's August 30, 2020 letter does not, by itself, convey this exclusive right, however, because Landlord conditioned Tenant's access to the Premises on Landlord's receipt of various events or documents. Tenant should have no right to exclude others from the Premises until Tenant itself has the right to possess the Premises.

Landlord's delivery of keys to the Premises to Tenant four months later may suggest that from that point forward Tenant and not Landlord has the right to exclude others from the Premises. However, courts have historically held that a landlord's duty to deliver possession of leased premises means only the duty to transfer the legal right to claim possession of the property. *See Sigmud v. The Howard Bank of Baltimore*, 29 Md. 324 (1868) (a lessor is not required to give the lessee possession, but only the right to possession); *Reynolds v. McEwen*, (1952) 111 Cal. App. 2d 540 (a commercial tenant is required to pay rent as of the date " there is no impediment to the tenant's taking possession or if the tenant is given a legal right of entry and enjoyment during the term.'"). This general rule will not be applied if the lease provides that the tenant was not obligated to pay rent until the landlord actually "delivers possession of the Premises."

It is unclear from Fact Pattern No. 2 whether the Lease required Landlord to deliver actual possession of the Premises to Tenant – perhaps signified by the gesture of delivering keys – or whether tendering the right to possession is enough to trigger Tenant's obligations under the Lease. Again, in the absence of a lease provision defining what is meant be tendering or delivering possession of the Premises to Tenant, a court will be left to glean the meaning on its own. Regardless, Landlord's August 30, 2020 letter is arguably insufficient to deliver possession because that letter, without more, does not entitle Tenant to possession of the Premises, at least not until Tenant satisfied each of Landlord's seven conditions.

By conditioning delivery of possession of the Premises on various events – some of which are within Tenant's control – Landlord may have lost its ability to enforce the Lease in a timely manner. Pursuant to the Lease, a Default will not occur until some period *after* Tenant is in possession of the Premises. Tenant's obligations to pay rent and to open for business do not begin until on or after the Rent Commencement Date. The Rent Commencement Date occurs when Tenant opens its store in the Premises for business to the public (which necessarily requires Tenant to be in possession of the Premises) or the Latest Commencement Date. The Latest Commencement Date is the latest date of various events to occur, including the date that Landlord tendered possession of the Premises to Tenant. While Landlord clearly intended August 30, 2020 as the date it tendered possession of the Premises to Tenant, Landlord conditioned that tender upon various events within Tenant's control, thereby effectively giving Tenant control over whether and when it must open for business and begin paying rent. Tenant cannot delay its satisfaction of these conditions forever; every contract contains an implied promise by the parties to perform with reasonable expediency. *Martin v. Star. Pub. Co.*, 126 A.2d 238, 244 (Del. 1956) ("If there is not a time period in the contract, the Court will infer a reasonable time for performance.") However, the Lease leaves open the question of when Tenant must satisfy its obligations.

Even once a Default occurs, Landlord's remedies may be in question. Pursuant to the Lease, upon a Default, Landlord may "immediately terminate this Lease and Tenant's right to possession of the Premises", or have the Lease continue in effect for so long as Landlord does not terminate the Lease and Tenant's right to possession of the Premises. "Immediately" means as soon as possible or without undue delay. It has been held repeatedly that where the doing of an act is required to be done immediately, performance shall be with due within reasonable diligence in view of the circumstances of the case, and without unnecessary or unreasonable delay. *Niagara Fire Ins. Co. v. Scammon*, 100 Ill. 644 (1881); *State v. Bonsfield*, 24 Neb. 517 (Neb. 1888); *Remington v. Fidelity, Co.*, 27 Wash. 429 (1902); *Board of Commissioners of Park County v. Big Horn County*, 25 Wyo. 172 1917); *Fairly v. Albritton*, 121 Miss. 714 (1920). Landlord's right to terminate the Lease arises "immediately" after a Default. This remedy may exist only it is exercised promptly.

Further, in Landlord's haste to get Tenant open for business Schitts Creek Commons, Landlord may have made a critical mistake. Landlord paid Tenant some of the Tenant Allowance after Tenant was (arguably) in Default under the Lease. Waiver is the intentional relinquishment of a known right. *Santino v. Glens Falls Insurance Co.*, 54 Nev. 127 (Nev. 1956). In Fact Pattern No. 2, upon a Default, Landlord had various rights upon a Default, namely to terminate the Lease or Tenant's right to possession of the Premises. Landlord did not exercise either of these remedies, at least not immediately. Instead, Landlord paid Tenant a portion of the Tenant Allowance, apparently encouraging Tenant to complete its construction and open for busines in the Premises. If a party's intent to waive a right is to be implied from a party's conduct, the conduct must speak to the intention clearly. *Id.* Landlord decision to help Tenant open for business by advancing some of the Tenant Allowance before it was due surely seems to contrary to Landlord's right to terminate the Lease or Tenant's right to possession of the Premises and may work to waive those rights. Even if the Lease – like most commercial leases – contained a provision requiring that any waiver by landlord of a tenant default be in writing, Landlord may not be saved. *Kmart Corp. v. Footstar, Inc.*, No. 09 C 3607, 2009 U.S. Dist. LEXIS 111330, at * 12-15 (N.D. Ill. Dec. 1, 2009). A "no waiver unless in writing" provision does not necessarily bar a defense of waiver because these provisions themselves may be waived by the words and deeds of the parties. *Chicago College of Osteopathic Medicine v. George A. Fuller Co.*, 776 F.2d 198, 202 (7th Cir. 1985).

Fact Pattern No. 2 illustrates several errors a landlord may make when it is anxious – and perhaps overeager – to have a tenant open for business in its shopping center. These seemingly minor errors may be difficult to undo and can have very important ramifications for a landlord.