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Advanced Lease Defaults: It's Not Over Until It's Over

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1. Notice Issues

The majority of courts hold that a party declaring another party in contractual default must comply strictly with the notice requirements. These courts reason that “equity abhors forfeitures of valuable leasehold interests.” *Metro. Transp. Auth. v. Cosmopolitan Aviation Corp.*, 99 A.D.2d 767, 471 N.Y.S.2d 872, 873 (1984), and forfeiture is a result “so harsh [that] the law requires that every prescribed requirement be met unless waived by agreement of the parties.” *Boyd v. Boone Mgmt., Inc.*, 676 S.W.2d 24, 26-27 (Mo. Ct. App. 1984). See *Tiller v. YW Hous. Partners, Ltd.*, 5 So. 3d 623, 629 (Ala. Civ. App. 2008); *Boston LLC v. Juarez*, 245 Cal.App.4th 75, 199 Cal. Rptr. 3d 452, 460 (2016); *Wood v. Ensworth*, 430 So. 2d 617, 618 (Fla. Dist. Ct. App. 1983); *Preferred Real Estate Equities, Inc. v. Hous. Sys., Inc.*, 248 Ga.App. 745, 548 S.E.2d 646, 648 (2001); *Tage II Corp. v. Ducas (U.S.) Realty Corp.*, 17 Mass. App. Ct. 664 (1984); *ARE-100/800/801 Capitola, LLC v. Triangle Labs., Inc.*, 144 N.C.App. 212, 550 S.E.2d 31, 35 (2001); *Elizabethtown Lodge No. 596, Loyal Order of Moose v. Ellis*, 391 Pa. 19, 137 A.2d 286, 290 (Pa. 1958); *Litchfield Co. of S.C.; Vinson Minerals, Ltd. v. XTO Energy, Inc.*, 335 S.W.3d 344, 354 (Tex. App. 2010).

A minority of states, on the other hand, concludes that mere substantial compliance with contractual notice terms is sufficient. See *Kimmel v. Cockrell*, 161 Ind.App. 659, 317 N.E.2d 449, 451 (1974) (finding notice sufficient when it “substantially complie[d] with the terms of the lease”); *First Nat'l Bank of Commerce v. DiRosa*, 545 So. 2d 692, 694 (La. Ct. App. 1989); *Equity Props. & Dev. Co. v. Entinger*, No. 188302, 1996 WL 33347540, at *2 (Mich. Ct. App. Dec. 27, 1996); *Hil-Roc Condo. Unit Owners Ass'n v. HWC Realty, Inc.*, No. 87344, 2006 WL 2627553, at *3 (Ohio Ct. App. Sep. 14, 2006).

Importantly, the fact that a default notice demands more than the landlord is entitled to receive under the lease may not invalidate the notice. *Burnham Management Co. v. Davis*, 302 Ill. App. 3d 263 (Ill. Ct. App. 1998); *Elizondo v. Medina*, 100 Ill. App. 3d 718 (Ill. Ct. App. 1981). In *Elizondo*, the landlord's default notice required a tender of \$900 and the trial court found only \$800 was due. The court found the defendant's tender of \$400 when \$800 was due an insufficient tender, noting that it is well settled that the defendant must pay the entire amount due to escape the effect of a default notice.

2. Liability Issues

Tenants often have a Hobson's Choice – or really no choice at all – when it comes to responding to a Notice of Default. The failure of a tenant to cure a valid default typically opens to the door to a landlord's remedies, including an unlawful detainer proceeding (*i.e.* an eviction) and/or a breach of contract action. “A covenant to pay rent at a specified time ... is an essential part of the bargain as it represents the consideration to be received for permitting the tenant to remain in possession of the property of the landlord. Often the landlord relies on timely payment of rent to meet its own outstanding obligations, such as a mortgage on the demised premises.” *Fifty States Mgt. Corp. v. Pioneer Auto Parks*, 46 N.Y.2d 573 (N.Y. Ct. App. 1979). The payment of the rent in accordance with the terms of the lease is one of the essential obligations of the tenant, and the failure of a tenant to properly discharge this obligation is a cause for dissolving the lease. *Bawa v. Terhune*, 33 Cal. App.5th Supp. 1 (Cal. Sup. Ct. 2019). Landlords may use its remedies as leverage to achieve concessions by tenant (such as an extension of lease terms). In some jurisdictions, a self-help eviction may be allowed. In either case, the timeframe can be very quick.

a. Does the voluntary payment doctrine apply?

A tenant faces a challenge, however, if it disputes the amount due under a lease, particularly because the voluntary payment doctrine may prevent the tenant from recovering any overpayment. The voluntary payment doctrine bars the recovery of payments voluntarily made with full knowledge of the facts, and in the absence of fraud or mistake of material fact or law. *Dillon v. U A Columbia Cablevision of Westchester*, 100 N.Y.2d 525 (2003), citing *Gimbel Bros. v. Brook Shopping Centers*, 118 A.D. 2d 532 (2d Dept. 1986); *Scott v. Fairbanks Capital Corp.*, 284 F. Supp. 2d 880 (S.D. Ohio 2003). *Gimbel Bros.* offers a good example. The lease in *Gimbel Bros.* was drafted when New York's “Sunday Blue Laws” prohibited businesses from operating on Sunday. After the “Blue Laws” were declared unconstitutional, the landlord began charging the tenant for a “Sunday charge”, although the lease did not provide for “Sunday charges”. The tenant filed suit against seeking, among other things, a declaration that it could offset the previously made “Sunday charges” against future rent. The court relied on the voluntary payment doctrine to reject this argument, stating:

Indeed, we find that the weight of the evidence supports the conclusion that [tenant] was not operating under an actual mistake of law but, instead, made the subject payments voluntarily, as a matter of convenience, without having made any effort to learn what its

legal obligations were....When a party intends to resort to litigation in order to resist paying an unjust demand, that party should take its position at the time of the demand, and litigate the issue before, rather than after, payment is made. [Tenant] displayed a marked lack of diligence in determining what its contractual rights were, and is therefore not entitled to the equitable relief of restitution.

When applying the voluntary payment doctrine, courts distinguish between a mistake of fact and a mistake of law. A mistake of law occurs “where a person is truly acquainted with the existence or nonexistence of facts, but is ignorant of, or comes to an erroneous conclusion as to, their legal effect.” *Nationwide Life Ins. Co. v. Myers*, 67 Ohio App. 2d 98, 102-03 (Ohio Ct. App. 1980). Payment made by reason of an incorrect construction of a contract is made under a mistake of law. *Id.* Generally, when a party makes a payment based in its misunderstanding of its legal obligations, the party cannot recover the overpayment that was not required to be made.

While a mistake of law is insufficient to permit a party to recover amounts paid in error, a mistake of fact may be taken as a payment outside the harsh result of the voluntary payment doctrine. See *Illinois Graphics Co. v. Nickum*, 159 Ill. 2d 469 (1994) (noting that a cause of action for the recovery of voluntary payments made because of a mistake of fact has long been recognized). However, courts typically do not allow a party to recover overpayments when the facts to determine the correct payment amount were available to the payor. For example, in *Sixth Ave., LLC, 2020 NY Slip Op. 30650(U)*, the court held that the voluntary payment doctrine prevented a tenant from recovering its overpaid share of taxes because tenant made payments over several years without inquiry. Because a simple review of the tax bill would have allowed tenant to determine the proper amount, the court did not allow a tenant to recover its overpayment. Similarly, in *Citicorp North America, Inc. v. Fifth Avenue 58/59 Acquisition Company, LLC*, 895 N.Y.S. 2d 39 (2010), the court applied the voluntary payment doctrine to bar tenant’s recovery of rent overpaid for approximately nine years because tenant made payment without comparing the rent provisions of their lease to the rent amounts invoiced by landlord to determine; tenant merely paid the invoiced rent amounts without protest or even inquiry.

Critical to the application of the voluntary payment doctrine is the assumption that the payment was made voluntarily. The voluntary payment doctrine does not apply when payment is “made under duress or compulsion.” See *Geary v. Dominick’s Finer Foods, Inc.*, 129 Ill.2d 389, 395 (1989). In determining whether payment is made under duress, the main consideration is whether the party had a choice, namely whether there was “some actual or threatened power wielded over the payor from which he has no immediate relief and from which no adequate opportunity is afforded the payor to effectively resist the demand for payment.” *Smith v. Prime Cable of Chicago*, 276 Ill. App., 3d 843, 849-850 (1st Dist. 1995). In the context of lease disputes, payments of disputed rent made in response to a notice to terminate the tenancy have been held to be made involuntarily and under the compulsion of avoiding “disastrous effects” by the termination of a valuable leasehold. *Kanter & Eisenberg v. Madison Associates*, 116 Ill.2d 506 (1987).

b. A tenant’s obligation to pay rent is independent from the landlord’s obligations under the lease.

A tenant faces additional challenge if it received a notice of default, even when the tenant believes the landlord has itself breached the lease. Some tenants may be tempted to withhold rent to compel a landlord to honor its lease obligations, but these tactics could be dangerous. Absent a lease provision to the contrary, a tenant is unable to withhold rent if it remains in possession of the leased premises. Initially, many commercial leases are clear that the tenant must pay rent without regard to the landlord’s lease obligations and contain provisions like:

“Minimum Annual Rental, Percentage Rental, Additional Rent and all other sums payable to Landlord pursuant to this Lease shall be paid to Landlord . . . without any deductions or offsets whatsoever.”

“Tenant covenants to pay all charges under this Lease, including, without limitation, Minimum Annual Rental, Percentage Rental and Additional Rent and other charges, independent of any obligation of Landlord. No breach of this Lease by Landlord shall relieve Tenant of its obligation and duty to pay all such charges when due under the terms of this Lease.”

Most courts follow this same independence requirement. Courts have generally ruled that the obligation to pay rent under a lease is generally independent of the parties’ other lease obligations. *Westchester County Indus. Dev. Agency v. Morris Indus. Builders*, 278 A.D.2d 232 (2d Dept. 2000); *Brigham Young University v. Seman* (1983) 206 Mont. 440, 672 P.2d 15 (affirming commercial landlord’s recovery of unpaid rent starting from the date the tenant stopped paying through the term of the lease, reduced by any mitigated costs); *Alderson v. Republican-*

Courier Co., (1923), 69 Mont. 271, 221 P. 544, 546 (holding that courts should interpret lease covenants to be independent rather than dependent, because “[i]t is a general rule that covenants are to be treated as independent, rather than as conditions precedent.”)(internal citations omitted). It would be “inequitable for the tenant to claim substantial interference with the beneficial enjoyment of his property and remain in possession without payment of rent.” *Barash v. Pennsylvania Terminal Real Estate Corp.*, 26 N.Y.2d 77, 83 (Ct. App. 1970). Even in a situation where a landlord has breached its lease obligations, the tenant’s obligation to pay rent continues unless there is an express lease provision to the contrary. The independence of the obligation does not, however, limit a tenant’s right to bring a separate legal action against the landlord for damages.

Some courts have rejected “the independence-of-obligations approach” where the landlord’s promise to perform “is a significant inducement to the making of the lease by the tenant.” *Teodori v. Werner*, 490 Pa. 58, 63-64 (1980), quoting Restatement (Second) of Property, Landlord and Tenant, Introductory Note to Chapter 7.

c. What can a tenant do?

Some states, including New York, provide a mechanism for commercial tenants to extend a cure period and maintain the status quo while the tenant disputes the claimed default. A so-called “Yellowstone injunction” allows a tenant to protect its investment in the leasehold by obtaining a stay tolling the cure period so that upon an adverse determination on the merits the tenant may cure the default and avoid a forfeiture of the lease. *JT Queens Carwash, Inc. v. 88-16 N. Blvd., LLC*, 101 A.D.3d 1089 (N.Y. Sup. Ct. 2017). “[A]n application for Yellowstone relief must be made not only before the termination of the subject lease . . . but must also be made prior to the expiration of the cure period set forth in the lease and the landlord’s notice to cure” *Riesenburger Props., LLLP v. Pi Assoc., LLC*, 155 A.D.3d 984 (N.Y. Sup. Ct. 2017), quoting *Korova Milk Bar of White Plains, Inc. v. PRE Props., LLC*, 70 A.D.3d 646 (N.Y. Sup. Ct. 2010). A Georgia court reached a similar result in *Yeazel v. Burger King Corp.*, 241 Ga. App. 90 (Ga. Ct. App. 1999), finding that, in response to a notice of intent to terminate the lease due to alleged underpayment of rent, tenant could have moved for an injunction preventing the landlord declaring default until the rent dispute was resolved. See also *Theatre of the Stars v. Atlanta Woman’s Club*, 184 Ga. App. 810 (Ga. Ct. App. 1987) (tenant sought declaratory judgment that attempted termination of lease was ineffective).

d. Is a tenant excused from its immaterial non-compliance with lease?

The “substantial compliance doctrine” furthers the general policy disfavoring forfeitures by allowing equity to intervene and rescue a tenant from forfeiture of a lease when the tenant has substantially complied with the lease in good faith. *Grassy Meadows Sky Ranch Landowners Ass’n v. Grassy Meadows Airport, Inc.*, 2012 UT App 182, 283 P.3d 511 (Utah Ct. App. 2012). However, courts generally hold that the late payment of rent is material. *Medlock Crossing Shopping Center Duluth, Ga. Ltd. Partnership v. Kitchen & Bath Studio, Inc.*, 126 A.D.3d 1463, 2015 WL 1380213 (Ga. 2015)(tenant breached a material term of its commercial lease, which obligated them to pay minimum rent and additional rent “without any prior demand therefore,” by failing to pay full amount of rent due under lease for period of 18 months); see *Rubloff CB Machesney, LLC v. World Novelties, Inc.*, 363 Ill. App. 3d 558 (2d Dist. 2006) (Tenant’s breach of lease by paying its rent late barely three months after agreeing, at landlord’s request, to strictly comply with terms of commercial lease, was material; landlord was deprived to a large extent of the benefit that it reasonably expected in demanding strict compliance with lease”).

In *Cyber Land, Inc. v. Chon Property Corp.*, 36 A.D.3d 748 (2d Dep’t 2007), a commercial tenant’s repeated breaches of covenant to timely pay rent were not de minimis. As a result, the tenant was not entitled to specific performance of lease agreement’s right of first refusal to purchase premises, even though landlord did not give tenant notice of default, where right of first refusal was conditioned on tenant not being in default during lease term, and tenant frequently paid its rent late and had failed to pay full rent that was due. However, in *Cumberland Farms, Inc. v. Dairy Mart, Inc.*, 225 Conn 771 (1993), the court held that tenant’s failure to pay rent and taxes was not willful or grossly negligent, such that the trial court properly relieved tenant from forfeiture of lease where tenant had initiated and pursued communications with landlord and had tendered rents and taxes due within 30 days of receiving landlord’s recalculation of those amounts. “Further, the impact of forfeiture on defendant would have been wholly disproportionate to injury suffered by plaintiff since defendant’s interest included option to purchase leased premises and value of capital improvements it had made.” Similarly, in *Kiriakides v. United Artists Communications*, 440 SE 2d 364 (S.C. 1994), the record supported the court’s holding that a commercial tenant’s breach of a lease was so immaterial as to render forfeiture inequitable where (1) the tenant owed \$4,732 in past-due rent out of a total yearly rental of \$59,379, (2) the tenant’s breach was inadvertent rather than willful or in bad faith, (3) on receiving notice of default, the tenant attempted to cure the default by sending a check to the landlord, (4) the tenant had more than 20 years remaining on the lease, and the value of the tenant’s improvements to the leasehold after depreciation was \$1.2 million, and (5) the landlord made no claim of damage by the delay in payment. See also *Foundation Development Corp. v. Loehmann’s, Inc.*, 163 Ariz. 438, 788 P.2d 1189 (1990)(the Arizona Supreme Court considered whether a commercial tenant’s delay in paying a common-area charge could warrant forfeiture

and held that a lease may not be forfeited for an immaterial breach even if it specifically provides that any breach is cause for termination).

3. Damages Issues

a. Failure to Operate Damages – Continuous Operation Clauses

In the context of commercial lease agreements, “continuous operation clauses” refer to provisions that require a tenant to continuously operate their business on the leased premises during the term of the lease. These clauses are typically included to ensure that the property is being utilized effectively and that the tenant maintains a presence in the space. These clauses are important for landlords because they want to ensure that their property is being used as intended and that they are receiving the agreed-upon rent in exchange for the space. However, tenants may seek to negotiate these clauses to allow for temporary closures due to renovations, repairs, or other unforeseen circumstances. The specific consequences for breaching a continuous operation clause can vary depending on the language of the lease agreement, the severity of the breach, and applicable state or local laws.

Some states have laws or regulations that restrict or limit the enforceability of continuous operation clauses in commercial lease agreements. These restrictions are often designed to protect tenants’ rights and ensure fairness in lease agreements. However, the specific regulations vary by state. For instance, courts in New York may scrutinize continuous operation clauses to ensure they are reasonable and not overly burdensome on tenants. Courts typically consider factors such as the reasonableness of the clause and its potential impact on the tenant’s business.

- **Connecticut**

In the case of *Pequot Spring Water Co. v. Brunelle Pequot Spring Water Co. v. Brunelle*, 46 Conn. App. 187, the court considered whether the lease agreement between the parties inherently included a commitment to sustain operations and revenue generation throughout its term. Appellant landlord gave a long-term lease to appellee tenant, a bottled water company, for a very low base rent plus a percentage of the profits. After several years the tenant sold out and closed the business which meant no profits and little rent for the balance of the lease. The trial court held that there was no implied covenant to continue in business, so the landlord was not entitled to any damages or unpaid rent. Landlord appealed. It was determined that this implied commitment was essential for a coherent interpretation of the lease. Additionally, the court established that in case of a breach of this implicit covenant, damages would be calculated based on the fair rental value of the property during the breach period. In this case the court adopted factors to determine whether there was an implied covenant to continue to remain in business. The factors adopted by the court included the reviewing the base rent, whether the percentage payments were substantial in relation to the base rent payments, the term of the lease- especially if lengthy, whether the lease contained a subletting provision, the right of the lessee to remove fixtures from the leased premises and whether a non-competition provision was present in the lease.

- **New York**

In *1611 Bway LLC v. Times Square JV, LLC*, 2018 NY Slip Op 31044(U) (Sup.), the parties entered into a 35-year commercial lease for restaurant space within a New York City hotel. Initially, the tenant operated a restaurant on the premises but later sublet the space to a coffee shop until 2017. Since then, the space has remained vacant, with the tenant continuing to pay rent. In April 2018, the landlord issued a termination notice citing the tenant’s breach of the continuous operation provision of the lease. The tenant sought an injunction, arguing that the lease doesn’t stipulate a grace/cure period for violations of the continuous operation clause. However, the court rejected the tenant’s request for a preliminary injunction and determined that the tenant failed to demonstrate a likelihood of success on the merits since it had indeed breached the continuous operation provision by leaving the space unoccupied for over six months after the departure of the subtenant. Additionally, the court found that the tenant couldn’t establish irreparable harm, as any resulting losses would be financial in nature and could be compensated through monetary damages.

- **Florida**

In *Mayor’s Jewelers v. California Public Employee Retirement System*, 685 So. 2d 904, 21 Fla. L. Weekly 2608 (Dist. App. 1996), the appellant, a commercial tenant, informed the appellee landlord of its intention to terminate its lease for mall space. The landlord then sought a temporary injunction to prevent the tenant from leaving and to enforce the lease terms. The trial court granted the injunction, but the appellant appealed the decision. On appeal, the court reversed the temporary injunction. The court found that *appellant intended to terminate the commercial lease by breach of contract and to vacate*. The court held that under those facts, the breach of contract

was not susceptible to the remedy of an injunction requiring specific performance, because it would require supervision by the trial court. Therefore, the court concluded that specific performance via injunction was inappropriate since it would require ongoing court supervision of lease compliance, which would improperly involve the court in managing the shopping center.

- **Texas**

In the case of *DDR DB Stone Oak, LP v. Rector Party Co., LLC*, 2017 Tex. App. LEXIS 11296, the landlord sued its former tenant breach of contract. The lease at issue contained a “continuous operation” clause that required the tenant to be open for business, fully stocked and staffed, on all business days for approximately three years. Rector agreed to pay liquidated damages of \$100 per day for any breach of the continuous operations clause. Rector breached this clause by closing its store and removing its furniture, fixtures, and inventory from the premises.

- **California**

In *Nmc Anaheim v. Dash*, 2021 Cal. Super. LEXIS 93859, the court found that the defendant tenants clearly had breached the lease by failing to continuously operate their business as required under the continuous operations provision of the lease, which obligated them to continue operations during normal business hours. The court found that the defendant tenants failed to prove their crossclaims for breach of contract and fraud against the plaintiff landlords. The plaintiffs and defendant executed a commercial lease in 2013 for the defendants to operate a Fiesta Auto Insurance franchise. The defendants closed the business in November 2015 without notice and vacated the premises in January 2016, before the lease term ended in 2019. The landlord plaintiffs sued for breach of lease, seeking unpaid rent.

- **Indiana**

In *Simon Prop. Grp., L.P. v. Starbucks Corp.*, 2017 WL 6452028 (Ind. Super.) (Trial Order), Simon sought to prevent Starbucks from closing 77 Teavana stores located in Simon malls before the leases expire, all which contain continuous operations clauses. Simon argued it would suffer irreparable harm from lost rent, harm to its reputation, and damage to its relationships with other tenants if Starbucks closed the Teavana stores early, while Starbucks argued keeping the unprofitable Teavana stores open would cost it over \$15 million. The court granted Simon’s motion for a preliminary injunction preventing Starbucks from closing its Teavana stores before a full trial on the merits. The key controlling law was Indiana state law regarding preliminary injunctions, including the requirements to show a likelihood of success on the merits, irreparable harm, balance of harms favoring the movant, and that an injunction would not harm the public interest. In granting Simon’s motion, the court found Simon would suffer irreparable harm from lost rent, diminished reputation, and harm to relationships with other tenants. Simon’s harms were difficult to quantify, while Starbucks’ were *purely* monetary, so balance of harms favored Simon. The court also noted that public interest favored enforcing contractual obligations.

b. Recovery of Unamortized Tenant Allowances or Brokerage Expenses

When a tenant improvement allowance (TIA) is provided by a landlord to a tenant, it is typically meant to cover the cost of customizing or improving the leased space to fit the tenant’s needs. These improvements might include things like installing walls, flooring, or other fixtures. In accounting, the TIA is often treated as a form of lease incentive and is amortized (spread out) over the term of the lease. However, if the tenant vacates the premises before the end of the lease term, there may be unamortized (remaining) TIA that needs to be dealt with. In the case of *31 Tobey Rd., Ltd.*, 2016 Conn. Super. LEXIS 2370, damages were awarded to a tenant for loss of the use of tenant improvements when a landlord’s misconduct forced a tenant to abandon the premises. The court calculated damages by determining the percentage of time the tenant had used the improvements compared to the time they had the right to use them under the lease and applied that percentage to the cost of the improvements. In this case, the tenant had used the improvements for only four years out of a ten-year lease term, so the court awarded 60 percent of the improvements’ cost as damages.

In *Demmert Building Co. v. AMP, Inc.*, 2008 Bankr. LEXIS 503 (Bankr. E.D.N.Y. Feb. 25, 2008), a letter of intent may be interpreted as a stand-alone binding agreement of the parties to the extent that it does not alter the terms of the lease. Thus, where a commercial tenant agreed in a letter of intent to pay improvement costs in excess of a certain amount, but the costs were not again addressed in the lease, the letter of intent obligating it to pay was held a valid separate agreement as to those costs. The bankruptcy court found that the landlord debtor and the tenant entered into a valid preliminary agreement for renovation of the building, that the tenant agreed to reimburse the debtor for expenses it incurred to renovate the building if those expenses exceeded \$ 23,760, and that the lease the tenant signed did not negate the preliminary agreement because it contained a merger clause. Similarly, in *SR Int’l Bus. Ins. Co. v. World Trade Ctr. Props., LLC*, 445 F. Supp. 2d 320 (S.D. New York 2006), the court granted

insureds' motion requesting that full appraised value of tenant improvements affixed to destroyed property be included in replacement cost calculation because destroyed improvements might be replaced. Further, as defendants, insureds one and two, owned the improvements at the time of loss and had an insurable interest in their full value, the appraisal was to include the improvements in the hypothetical replacement cost at full appraised value.

In *Aldana v. Colonial Palms Plaza, Ltd.*, 591 So. 2d 953, 16 Fla. L. Weekly 2761 (Dist. App. 1991), a landlord entered into a lease agreement with a tenant that included landlord's agreement to pay tenant a construction allowance after completion of certain improvements to the leased premises. Before completion, tenant assigned its right to part of the construction allowance to appellant in exchange for appellant lending tenant funds to finance the construction. Appellant recorded the assignment and sent appellee notice of its existence. Upon completion of the improvements, landlord ignored the assignment and tendered the full construction allowance to tenant. Appellant sued landlord for money due under the assignment. The trial court granted landlord's motion for summary judgment based on the lease agreement's anti-assignment clause. The appellate court reversed and held that under ordinary contract principles, the lease provision at issue did not prevent the assignment of the right to receive the contractual payments. The prohibition prevented assignments of contractual duties but not contractual rights to payment. The appellate court reversed the trial court's grant of summary judgment in favor of landlord and the court held that the landlord was bound by the tenant's assignment of the right to contractual payment because ordinary contract principles did not prevent the assignment of the right to receive payment.

The plaintiff in *Long v. Keller*, 104 Cal. App. 3d 312, 163 Cal. Rptr. 532 (1980) leased property from defendant sellers with a purchase option. Plaintiff exercised the option after making improvements to the property. Defendants maintained fire insurance on the property. Plaintiff did not. The buildings on the property were destroyed by fire prior to closing. Defendants' insurance collection included the improvements made by plaintiff. Plaintiff filed a complaint for specific performance and alternatively, for damages from failure to convey the property or the insurance money. Plaintiff claimed on appeal that the trial court should have credited the insurance proceeds to the unpaid balance of the purchase price and that she was entitled to recover for good faith improvements made to the property. The court rejected plaintiff's claim because plaintiff carried the risk of loss as the purchaser in possession and because plaintiff did not have an insurable interest in defendants' insurance policy.

In the case of *Qi v. FDIC*, 755 F. Supp. 2d 195 (D.D.C. 2010), the lessor sued the FDIC, acting as receiver for a failed institution, for breach of contract. The plaintiff's claim for the unamortized portion of the tenant improvement credit was dismissed. The court ruled that the tenant improvement credit was not contractual rent due and owing on the date of repudiation, nor unpaid rent due and owing on the date of the FDIC's appointment as receiver. The court further clarified that the plaintiff's recoupment of the tenant improvement allowance, if at all, was to be in the form of the improvements and additions themselves (i.e., non-monetary reimbursement). The claim could not be deemed back rents under the Financial Institutions Reform, Recovery and Enforcement Act of 1989 (FIRREA). Under FIRREA, contractual rent should be narrowly construed as only those sums that are fixed, regular, periodic charges § 1821.

c. Accelerated rent: Is it enforceable or a penalty?

Many commercial leases allow a landlord to recover some or all of future rent – the rent that accrues after a tenant is evicted or that would have otherwise accrued after the lease was terminated. Whether these provisions are enforceable will depend on the particular jurisdiction.

- **Massachusetts**

In Massachusetts, landlords can recover accelerated rent under commercial leases, but whether a provision is enforceable hinges on whether it is considered a reasonable estimate of damages or an unfair penalty. In one case, an accelerated rent provision was upheld as enforceable because it was seen as a valid estimate of damages, especially for significant breaches like failure to pay rent. However, another case deemed an acceleration clause an unenforceable penalty when it allowed the landlord to reclaim the property, relet it, and collect rent without considering payments from the new tenant. Massachusetts law mandates tenants to pay rent due before termination, but they're generally not obligated to pay post-termination rent unless the lease specifies a rent acceleration clause binding them to the full remaining rental amount. While landlords can pursue accelerated rent in Mass, those clauses must be carefully drafted to ensure enforceability and reflect reasonable damage estimates. In the case, *Cummings Properties, LLC v. Hines*, 102 Mass. App. Ct. 28, 201 N.E.3d 295 (2022), the court found that a rent acceleration clause in a commercial lease was unenforceable as a penalty, thus limiting the enforceability of acceleration clauses in MA. The court concluded that the clause was not a reasonable forecast of damages expected to occur in the event of a breach, given that it permitted the landlord to repossess the premises, relet it,

and collect rent from the new tenant, as well as recover the full five years of rent from the original tenant, without having to account for the rent received from the new tenant during the term of the original lease.

- **Connecticut**

In Connecticut, the ability to collect accelerated rent in commercial leases hinges on the lease's specific terms. If the lease includes an acceleration clause, allowing the landlord to demand unpaid rent if the tenant defaults, the landlord can pursue accelerated debt. However, without such a clause, seeking money damages for accelerated rent may not be an option. In the event of a breach, landlords in Connecticut have two choices: terminating the tenancy or refusing to accept surrender. If they opt to continue the tenancy, they can sue for rent as per the lease terms without needing to mitigate damages. Conversely, if they terminate the tenancy, they're obligated to mitigate damages. Thus, the ability to collect accelerated rent in Connecticut's commercial leases depends on the presence of an acceleration clause. In the case *K & R Realty Associates v. Gagnon*, 33 Conn. App. 815, 639 A.2d 524 (1994) the landlord terminated a tenancy, and pursued an action against the tenant for breach of lease and unpaid rent. Since the action was one for breach of lease, basic contract principles applied and the appropriate measure of damages was one that would put the landlord in the same position it would have been in had the tenant not breached the lease. The landlord claimed that the trial court improperly determined that it was not entitled to recover the difference in rent between the two leases because the landlord was not acting as an agent of the tenant when it re-let the demised premises. Consequently, appellate court concluded that the landlord would be entitled to recover the damages that naturally followed from such a breach and that portion of the judgment, which denied recovery for lost rent, was reversed and remanded to the trial court to determine the amount, if any, of such damages, to the landlord.

- **New York**

In New York State, landlords have the right to recover accelerated rent under commercial leases through an acceleration clause, enabling them to collect remaining rent if a tenant defaults. This provision is generally enforceable unless challenged on grounds of fraud, overreaching, or unconscionable conduct. The landlord can pursue future rent even after terminating the lease and retaking possession of the premises. However, the enforceability of such a clause is subject to specific conditions, and the landlord isn't obligated to mitigate damages by reletting abandoned premises. Challenges may arise regarding the proportionality of accelerated rent to actual losses, with courts considering the nature of the contract and circumstances. Therefore, while landlords in New York can recover accelerated rent, the clause's enforceability hinges on legal considerations and conditions. In the case of *172 Van Duzer Realty Corp. v. Globe Alumni Student Assistance Assn., Inc.*, 2014 NY Slip Op 08872, 24 N.Y.3d 528, 2 N.Y.S.3d 39, 25 N.E.3d 952 the court held that the plaintiff's damages claim was not barred by res judicata, as the civil court lacked authority to award accelerated rent in a prior holdover proceeding. The lease's acceleration clause wasn't inherently invalid merely because the plaintiff terminated the lease, and the tenant was no longer in possession. The trial court erred in restricting the damages hearing solely to the issue of whether the plaintiff relet the premises. Both the tenant and guarantor should have been given the opportunity to present evidence regarding the proportionality of the undiscounted accelerated rent to the plaintiff's actual losses, despite the plaintiff having possession and no duty to mitigate. In *Ross Realty v. V & A Iron Fabricators, Inc.*, 2004 NY Slip Op 24396, 5 Misc. 3d 72, 787 N.Y.S.2d 602 (App. Term) appellant landlord sought to recover rent following nonpayment and moved to amend its petition to include accelerated rent which was allegedly due under the lease *at the landlord's option* upon a default. The District Court awarded the landlord the rent plus costs but declined to award the landlord the accelerated rent. The landlord appealed. The appellate court affirmed on the grounds that although accelerated rent clauses were generally enforced in New York, where the lease did not require a landlord to re-rent the premises upon its recovery of possession after a default and to apply the rent received from the re-renting to the benefit of the tenant, the accelerated-rent clause was deemed to impose a penalty and was not enforceable.

- **Florida**

In Florida, landlords have the right to collect accelerated rent under commercial leases, typically outlined in the lease agreement. However, there are restrictions: if the landlord accelerates rent, they cannot demand possession of the premises simultaneously. Moreover, they cannot collect the full accelerated amount and then relet the premises, but rental proceeds must offset the accelerated rent. Tenants can negotiate to make these remedies mutually exclusive, forcing the landlord to choose one. Additionally, if a landlord repossesses for reletting, they're entitled to future rents unless they solely use the premises for themselves. In *Bucky's Barbeque of Fort Lauderdale, LLC v. Millennium Plaza Acquisition, LLC*, 67 So. 3d 1207, 36 Fla. L. Weekly 1922 (Dist. App. 2011) The landlord and tenant entered into a 10-year lease agreement. Tenant defaulted on rent payments. Landlord retook possession and re-let the property. Landlord sued for accelerated rent for the remainder of the lease term. The trial court erred in granting summary judgment to the landlord because it did not determine the landlord's actual use of the property after retaking possession, which determines the available remedies. The landlord's remedies depend on whether it retook possession for its own use, for the tenant's account, or took no action. Without

determining the landlord's use, the court could not properly assess damages. The landlord cannot both accelerate rent and retain proceeds from re-letting the property during the remainder of the lease term. The landlord must apply any proceeds from re-letting the property during the remainder of the lease term against the accelerated rent due from the tenant. The appellate court reversed the summary judgment and remanded for a determination of damages only.

- **Texas**

The right to accelerate rent in Texas is limited. Texas courts have held that where the acceleration provision is coupled with repossession irrespective of the type of breach, this constitutes an unenforceable penalty. See *Synergy Center, Ltd. v. Lone Star Franchising, Inc.*, 63 S.W.3d 561 (Tex. App. 2001). The plaintiff restaurant filed a lawsuit against the defendant landlord, seeking an injunction to prevent the landlord from: (1) declaring the restaurant in default of its lease for failing to pay accelerated rent after ceasing operations, and (2) demanding payment under the restaurant's letter of credit provided as security under the lease. The District Court granted temporary injunctive relief, which the landlord appealed. One of the landlord's arguments was that Texas law prohibited enjoining the presentation of a letter of credit unless there was evidence of significant fraud that undermined the entire transaction. The restaurant contended that the acceleration clause in the lease, which triggered the demand for accelerated rent, was unlawful and amounted to material fraud justifying the temporary injunction. However, the court of appeals sided with the landlord. It held that a disagreement over lease terms couldn't prevent the landlord from presenting the letter of credit for payment to the bank. Even if the acceleration clause was unenforceable, the court could not conclude that the landlord's actions constituted intentional or unethical behavior that would deprive the restaurant of the lease's benefits or turn the letter of credit into a tool for fraud. The court determined that the landlord's reliance on the letter of credit didn't meet the legal threshold for fraud under the business and commerce code, which would warrant an injunction against presenting it. Consequently, the court of appeals overturned the trial court's decision and sent the case back for further proceedings.

- **California**

In California, the recovery of accelerated rent under a commercial lease is generally not permissible. The law views provisions in a lease that allow the lessor, on the lessee's default in payment, to accelerate payments due under the lease as invalid attempts to fix liquidated damages. However, clauses that allow the lessor to repossess the property, to sell it or to relet it, and then to recover any deficiency between the proceeds of sale or reletting and the present value of the rent due for the unexpired term are generally valid if they are not unjust. In *Jjd-Hov Elk Grove Llc v. V.*, 2021 Cal. Super. LEXIS 18745 a commercial lease agreement between Jo-Ann and landlord JJD, co-tenancy provisions allowing Jo-Ann to pay reduced "Substitute Rent" were deemed valid and enforceable. Despite landlord JJD's claim that these provisions constituted an unenforceable penalty under California law, the court ruled in favor of Jo-Ann. The provisions were upheld as they were freely negotiated by both parties, had a reasonable relation to potential damages from lower occupancy, and differed from previous cases. The court granted summary judgment in favor of Jo-Ann on both declaratory relief and breach of contract claims brought by JJD.

d. Late Fees plus Interest equal double recovery?

Many leases also impose an obligation on a tenant to pay both late fees and interest on the late or missed payment of rent. In the case of *Benderson-Wainberg, L.P. v. Atlantic Toys, Inc.*, 228 F. Supp. 2d 584 (E.D. Pa. 2002), the court held that late fees could be collected on unpaid rent, taxes, utilities, and insurance, but not on liquidated damages, as this would constitute partial double recovery. The New York case of *L. Shaffer Co. LLC v. Glick*, 2023 NY Slip Op 32977(U) (Sup.) highlights that the enforceability of late fees can also be influenced by other factors, such as whether they exceed the amount specified in the Penal Law. That case involves a lease between commercial landlord and restaurant tenant which required that the tenant help the landlord obtain new liquor license if tenant returned possession. Landlord alleges tenant damaged premises and failed to help obtain liquor license. Lease provides for 60% late fees on unpaid rent/damages. The court found that 60% late fee was unenforceable as usurious under Penal Law § 190.40 - Maximum allowable interest rate, and the claim for failure to help obtain liquor license dismissed because complaint lacked factual allegations of breach of unambiguous terms.

In *1448 Second St. v. Co. V.*, 2023 Cal. Super. LEXIS 33787, Plaintiff owns commercial property and leased it to defendant. Defendant has not paid rent since April 2020. Plaintiff seeks attachment for unpaid rent and charges under the lease of over \$1.3 million. Defendant has longstanding complaints about roof leaks causing business interruption. The petition for writ of attachment was granted in part. The court found defendants' evidence about roof leaks was insufficient at this stage to warrant an offset against the attachment amount but did not preclude them from establishing this later. Plaintiff was allowed to submit a revised order with a lower amount excluding interest and late fees during the moratorium period.

In *UAP-Columbus JV326132 v. O. Valeria Stores, Inc.*, 2008-Ohio-588 (App.) This case involves a dispute regarding a commercial lease for retail. Appellants entered into a three-year lease in 2005 but vacated the premises in 2006 due to financial struggles. UAP filed a complaint seeking past due rent and future rent through 2008. The trial court granted summary judgment in favor of UAP for past and future rents but referred the issue of mitigating damages to a magistrate. The magistrate awarded updated damages, which appellants objected to, claiming the magistrate exceeded the scope of referral and that charges for late fees and interest were unlawful penalties. They also argued that UAP didn't adequately mitigate damages and misinterpreted the lease regarding common area maintenance charges (CAM). The court overruled appellants' objections, finding that evidence supported the damages and UAP's mitigation efforts were reasonable. It also determined that the lease itself provided sufficient basis for calculating CAM charges. The court upheld the magistrate's decision, leading appellants to appeal the judgment, but the appellate court affirmed the trial court's ruling.

4. Guarantor Issues

A guaranty is a contract by which the guarantor agrees to satisfy the underlying obligation of a primary obligor to an obligee in the event that the primary obligor defaults on the underlying obligation. The Law of Guaranties: A Jurisdiction-by-Jurisdiction Guide to U.S. and Canadian Law, Friedberg, et. al., (2013) p. 503. The scope of a guaranty will vary depending on the circumstances. The general rules for contract formation will apply to the creation of guaranties (i.e. competent parties, subject matter, legal consideration, mutuality of agreement and mutuality of obligation). Interpretation of guaranty provisions will vary across jurisdictions. Accordingly, it is important to make sure the language of a specific guaranty clearly sets forth the obligations and agreements of the parties and to include any state-specific requirements with respect to enforcement and collection pursuant to the guaranty.

The scope of a guaranty will vary depending on the circumstances. Common types of guarantees include:

Absolute Unconditional Guaranty: The broadest form of guaranty whereby the guarantor promises to pay or perform all obligations, upon primary obligor's default, without contingencies.

Limited Guaranties: A guaranty may be limited with respect to payment or performance obligations only, limited in duration or in dollar amount. For example: Payment Guaranty, Fixed-Term Guaranty, Capped-Amount (Fixed or Formula-Based Amount) Guaranty, Good Guy Guaranty, Rolling Guaranty.

Hot-Button Issues for Drafting Consideration:

Modifications, Terminations, and Amendments of Leases: In many states, a modification of a guaranteed lease made without guarantor's consent will operate to release guarantor from liability under the guaranty. Some states require the modification to be material. Some jurisdictions discharge guarantor only to the extent guarantor's obligations were altered, but others discharge guarantor's obligations completely. Landlords would prefer to draft the guaranty broadly enough so that guarantor prospectively consents to lease amendments, extensions, and other modifications to avoid these conflicts. Guarantors would want their liability limited to the duration of the original term of the lease or in the event of a modification made between landlord and a future tenant that is unaffiliated with the guarantor.

Enforcement Costs: Particularly with respect to limited guaranties costs of enforcing the guaranty may be capped by the limiting language. Without an express statement, the potentially high legal costs and court fees may not be recoverable by landlord in connection with an enforcement action.

What Kind of Guaranty Is It Really? In practice, it is commonplace to see language in the guaranty that results in a merger of the various forms of limited guaranties. For example, consider that a landlord has agreed to limit the exposure of the guarantor to twelve (12) months after the expiration of the third (3rd) year of the lease term, however, if the tenant does not vacate the premises (as required by the terms of a typical Good Guy Guaranty), then Landlord could potentially incur more costs than the guarantor is liable even though landlord does not have possession of the premises to enable the landlord to release the space. Accordingly, a landlord may want to require that tenant vacate the premises as a condition precedent to any limitation of liability. Landlords and guarantors must carefully negotiate the terms of the guaranty to ensure that the intentions of the parties are clearly captured.

Hot-Button Issues for Litigation Consideration:

Role of Judge versus Jury. A judge will determine meaning of contract if unambiguous. If judge determines contract term ambiguous, then jury may resolve meaning by consideration of extrinsic evidence. Specific rules vary by state.

Focus Will Be on Words of the Guaranty. Written terms of guarantee will determine the scope. For example, guarantee limited to initial term if that is language of contract. *665-75 Eleventh Ave. Realty Corp. v. Schlanger*, 265 A.D.2d 270 (N.Y. App. Div. 1999). Circumstances that trigger guarantee will depend on words of contract.

Lease and Guaranty Are to Be Construed as One Instrument. Courts recognize that, where a guaranty agreement is executed in consideration of the execution of the lease, “the lease and the guaranty must be construed to be but one instrument, amounting to a single contract upon which the liability of the guarantors, to the extent of their obligation, was co-extensive with that of the lessee.” *Davenport v. Stratton*, 141 P.2d 713, 720 (Cal. 1943); see *id.* (Where “the lease and the guaranty each constituted consideration or an inducement for the other, the two instruments are not to be treated as though they were two separate instruments, but under such circumstances, for the purpose of interpretation, the instruments are to be considered as one.”). Accordingly, “the guarantor may not be liable for that which the principal is not.” *Combined Props. L.P. v. Fred Knight Enters.*, 20 Va. Cir. 545, 548 (1988).

Consideration of Other Evidence Will Depend on Law of the State. Some states have a strong parol evidence rule that does not allow consideration of parol evidence unless contract unclear on its face. New York is an example. Other states have a weak parol evidence rule that allows consideration of parol evidence to consider whether evidence clear on its face is ambiguous. California is an example. Types of parol evidence considered includes: Drafting history, Course of performance, Course of dealing, Custom and practice.

Guarantor Has a Right to Intervene in Landlord’s Action Against Tenant. Because a judgment against the tenant constitutes *prima facie* evidence against guarantor as to liability and amount under the guaranty (which guarantor can attempt to rebut), guarantor has a material interest in the outcome of the judgment. Therefore, a guarantor may intervene in an action by a landlord against tenant, even if guarantor does not intend to contest liability under the guaranty. *Koules v. Dolce Grp. Atlanta, LLC*, 326 757 S.E.2d 233 (Ga. Ct. App. 2014).