

**Thursday, October 24, 2024
10:30 AM- 11:30 AM**

Workshop 11

What Non-Leasing Lawyers Need to Know About Leasing: The Good, the Bad & the Ugly

Presented to

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INTRODUCTION

Confounded by permitted uses, exclusives, kick-out rights, and co-tenancy provisions? Confused by radius clauses, percentage rent and operating covenants? Clueless as to what REAs, OEAs, COREAs, NNN and CAM mean? This workshop will provide you with an introduction and insight into “the good, the bad and the ugly” concepts unique to leasing about that every non-leasing lawyer should be familiar.

GENERAL DISCUSSION AND OVERVIEW

The market of commercial real estate is an interesting place. As lawyers, we find that it “ebbs and flows” in certain inevitable cycles. With the current cycle, those of us who focused primarily on acquisitions and dispositions, may have started to focus more on leasing as the buying and selling market has slowed.

For those who are not regularly involved in leasing, there are a number of concepts which are NEED TO KNOWS and others that are NICE TO KNOW.

So today, we welcome you to this special episode of “ICSC Feud” focused on the good, the bad and the ugly of leasing. Our hosts are Hans Lapping and Brad Siegal.

First, let's run through the rules of the game.

- A. All audience members are encouraged to participate.
- B. We will move around the audience with a microphone so all can hear.
- C. Remember, there is no such thing as a “wrong” or “bad” answer.
- D. Points are awarded for participation, like when you played on the soccer/baseball team when you were 6.
- E. Prizes may or may not be awarded.
- F. Just because your concept did not make the list, does not mean it is not important...so our hosts will discuss those at the end of the game if time permits.

The top 6 answers to the following question are on the board: What do Non-Leasing Lawyers Need to Know About Leasing?

1. Co-Tenancy Provisions
2. Exclusives and Restrictions
3. Common Area Maintenance Costs(Gross/Net/NNN)
4. Permitted Uses/Continuous Uses
5. Percentage Rent/Gross Sales
6. Subordination/Non-Disturbance/Attornment Agreements

1. Co-Tenancy Provisions.

What is co-tenancy? Co-tenancy provisions are provisions that grant rights and remedies (typically rent reduction or termination rights) to tenants in the event certain “other” tenants are not open in centers. There are also various times in which these clauses are activated, such as possession requirements, opening requirements, and others which constitute on-going co-tenancy obligations. In today's economic climate, more and more tenants are requiring co-tenancy provisions as they don't want to be the only open tenant in a shopping center or the first tenant to open in a new development.

Examples of Opening Co-Tenancy and Ongoing Co-Tenancy:

OPENING CO-TENANCY. Landlord and Tenant hereby and agree that if, on the Commencement Date, the Opening Requirements (as herein defined) are not met, Tenant shall not be obligated to open its restaurant in the Premises or pay any Basic Rental, Percentage Rental or other charges to the Landlord until the Opening Requirements have been fulfilled. The Tenant has the option, however to open the restaurant prior to the fulfilling by the Landlord of the Opening Requirements and if the Tenant so elects it shall not be obligated to pay Basic Rentals and other charges as set forth in Section 5 above, but shall only be obligated to pay four and one-half percent (4.5%) of Adjusted Gross Receipts as its Basic Rental until the first to occur of (i) Opening Requirements are met, or (ii) twenty-four (24) months following the Commencement Date have occurred. In the event Item (ii) above, that being the occurrence of twenty-four (24) months following the Commencement Date, is the first to occur, then, within thirty (30) days subsequent to the end of the twenty-fourth month, Tenant must elect to either commence paying Basic Rental at the

rate set forth in Section 5 herein or terminate the Lease and vacate the Premises immediately. If the Tenant elects to terminate the Lease, the Landlord must promptly reimburse the Tenant, as its sole and exclusive remedy, the costs of Tenant's FF&E paid for by Tenant with Tenant's funds rather than the Tenant Allowance minus the accumulated depreciation, if any, deducted by Tenant on its books and records on the FF&E and the additional sum of \$_____ to partially reimburse the Tenant for its internal costs and expenses directly and indirectly relating to the development of the restaurant on the Premises and operating losses sustained by the Tenant during its operation of the restaurant during the twenty-four (24) month period. For purposes here, the "Opening Requirements" shall mean all of the following:

1. Two Anchor Tenants with a minimum square footage of 80,000 square feet for each anchor tenant are opened to the public and operating in the enclosed mall portion of the Shopping Center.
2. Seventy percent (70%) of the small shop space in the enclosed mall portion of the Shopping Center is open to the public and operating.
3. One additional restaurant besides Tenant is open on one of the four (4) pads shown on Exhibit "A" and the construction shell building on the front pad adjacent to the Pad has been substantially completed to give the appearance to the public that a restaurant will be opening shortly.
4. The street adjacent to the Pad is completed, all sidewalks and landscaping in front of the Pad are completed and the free valet parking to the Tenant's customers is operational.

Once the Opening Requirements are met, the terms and provisions of this Section 54.A shall automatically terminate.

ONGOING CO-TENANCY. As used in this Section 54.B, the "On-Going Co-Tenancy Requirement" shall mean all of the following:

1. Two Anchor Tenants with a minimum square footage of 80,000 square feet for each anchor tenant are open to the public and operating in the enclosed mall portion of the Shopping Center.
2. Seventy percent of the small shop space in the enclosed mall portion of the Shopping Center are open to the public and are operating.
3. The Tenant's free customer's valet parking is fully operational in the street in front of the Premises in the area designated as "Valet Parking Pick-Up" or similar definition on Exhibit "A".

If the On-Going Co-Tenancy Requirement is not satisfied at any time after the Commencement Date all Basic Rental shall be abated until such time as the On-Going Co-Tenancy Requirement is satisfied; and in lieu thereof, Tenant shall pay to Landlord, on a monthly basis, thirty (30) days after the end of each calendar month, as "Alternative Rent", an amount equal to the product of (i) the entire amount of Adjusted Gross Receipts made from the Premises during such month or the portion thereof for which Alternative Rent is payable, multiplied by (ii) four and one-half percent (4.5%). Landlord is obligated to give the Tenant written notice within thirty (30) days after the date when the On-Going Co-Tenancy Requirement has not been met ("Landlord Notice of Violation"). If Landlord fails to give Tenant the Landlord Notice of Violation and the Tenant has paid to the Landlord any Basic Rental and/or Percentage Rental subsequent to the date on which the On-Going Co-Tenancy Requirement has not been met, then the amount of Basic Rental and/or Percentage Rental paid shall be reimbursed by the Landlord to the Tenant plus interest at the Default Rate per annum if not paid after thirty (30) days. If the non-satisfaction of the On-Going Co-Tenancy Requirement shall continue for a period of twelve (12) months beyond the date on which the Tenant receives the Landlord Notice of Violation and for so long as such non-satisfaction shall continue, Tenant shall have the right to terminate this Lease by providing sixty (60) days' written notice, delivered to Landlord, within sixty (60) days following the expiration of twelve-months subsequent to the date on which the Tenant receives the Landlord Notice of Violation ("Tenant Lease Termination Notice"). The failure by the Tenant to deliver the Tenant Lease Termination Notice shall automatically invoke the rent reinstatement provisions set forth herein. In the event Tenant fails to terminate the Lease at the end of such twelve-month period, Tenant shall be deemed to automatically have elected to begin paying Basic Rental and Percentage Rental plus all other charges at the rates set forth in Section 5, 6, 10, 11, 25 and 28. Notwithstanding the above, if at the expiration of twelve (12) months subsequent to the date on which the Tenant receives from the

Landlord the Landlord Notice of Violation, Landlord has not yet cured an On-Going Co-Tenancy Requirement Violation, and provided further that Tenant's Adjusted Gross Receipts have fallen over such twelve (12) month period by at least twenty percent (20%) from the previous twelve (12) month period (or lesser period of time since the Commencement Date on a monthly average of Adjusted Gross Receipts), Tenant may, at its sole option, upon written notice to Landlord, extend the cure period for the Landlord to satisfy the On-going Co-tenancy Requirement by an additional twelve (12) months during which time Tenant may continue paying four and one-half percent (4 1/2%) of Adjusted Gross Receipts in lieu of Basic Rental ("Additional Cure Period"). If, however, Tenant's sales have not fallen by at least twenty percent (20%) as set forth above, Tenant must elect within thirty (30) days after the expiration of the twelve month cure period to either terminate this Lease or resume the payment of all Basic Rental, Percentage Rental and all other charges as set forth in Sections 5, 6, 10, 11, 25 and 28.

At any time during the Additional Cure Period or up to thirty (30) days thereafter, Tenant can elect to terminate this Lease by giving the Landlord thirty (30) days' written notice of the election to terminate the Lease, unless the On-Going Co-Tenancy Requirement has been met prior to such election having been received by the Landlord.

If the Tenant elects to terminate this Lease under the terms of this Section, upon such termination, the Landlord must pay to the Tenant its unamortized book value of both its improvements to the Building and Tenant's FF&E that were paid for using funds other than the Tenant Allowance. Upon such a termination, the Tenant has no obligation to pay to the Landlord any portion of the Tenant Allowance.

How do these impact what you are doing with leases in today's market? What remedies should be negotiated? Is reduced rent acceptable or should the tenant be required to make an election to stay in the center or terminate from the lease? What happens if there is a co-tenancy failure but the tenant exercises an option to extend?

2. Exclusives and Restrictions.

The words are easy to understand, but how are they applied in the leasing world.

An **exclusive** is the right of a tenant to be the "only" tenant offering a certain service or selling a certain product or good. For example, a sandwich or shop might want to be the exclusive sandwich or coffee shop in the center and a sporting goods retailer might want to be the only tenant selling sporting goods in the center. How do we work through these issues when most restaurants coffee or sporting goods and also balance the desire to lease to a popular tenant but also offer more than one coffee shop or retailer that sells sporting goods and equipment? Moreover, what do we mean by a sandwich or coffee? What about sporting goods? Do sporting goods include shoes? What about sports attire or athleisure wear? Would a sandwich exclusive prohibit a landlord from leasing space to a hot dog vendor? Or would a BBQ exclusive prohibit a landlord from leasing space to a Korean BBQ restaurant? Would a sporting goods exclusive prohibit a landlord from leasing space to a Peloton store? What may seem like an easy "give" to sign an important tenant can turn out to have severe and long lasting repercussions on a landlord's ability to lease other space.

A **restriction** is a limitation contained in a lease which prohibits certain activities of a landlord or tenant, which should include the exclusives granted to other tenants and rules and obligations which the landlord has agreed with other tenants to enforce.

Remedies for a breach of an exclusive or a restriction are also challenging. Should tenants accept merely a reduction in rent or should they seek the right to terminate the lease or maybe they should pursue other remedies. Should a tenant have to make an election to waive the exclusive or terminate the lease after a violation continues for a set period of time? Should a tenant have to demonstrate that it actually suffered a loss as a result of a breach of the exclusive or restriction? These are all issues that need to be considered when negotiating these sorts of provisions.

Example of an Exclusive & Related Remedies:

Section __ Restrictive Use.

(a) Throughout the Term, Landlord agrees, subject to the terms of this Section __, not to enter into any lease for space within the Project with any other tenant for the use of its premises primary for the sale _____ (the "Exclusive Use"); provided, however, that the foregoing Exclusive Use shall not apply to (a) a Pre-Existing Tenant (as defined herein), or (b) any tenant or occupant who has been permitted to operate for the Exclusive Use based upon or as a result of a bankruptcy, insolvency or similar action or otherwise permitted to do so as a result of an action or order by a court. A "Pre-Existing Tenant" shall mean any tenant or occupant (whether such tenant or occupant occupies its original premises or relocated and/or expanded its premises) (i) who is open for business on or prior to the date hereof, or (ii) whose lease is dated on or prior to the date hereof, or (iii) who is in possession of its space pursuant to a renewal or extension of the lease of a tenant described in either of the immediately preceding clauses (i) or (ii) (whether or not such renewal or extension is pursuant to an express right to renew or extend contained in the lease), or (iv) who is an assignee, sublessee or licensee of a tenant described in any of the immediately preceding clauses (i), (ii) and/or (iii). The exclusive right granted to Tenant under this Section shall automatically terminate and become void and of no further force or effect (A) if Tenant is in default of this Lease beyond any applicable notice and cure period, (B) if Tenant fails to operate its business in the entire Premises for the Primary Use under the Trade Name on all days and at all times required by this Lease, excluding temporary cessations due to excepting closures due to casualty, eminent domain taking or other Force Majeure, (C) if Tenant Transfers the Lease other than pursuant to a Permitted Transfer, or (D) upon the expiration or earlier termination of the Lease.

(b) If Landlord violates Tenant's Exclusive Use and such violation remains uncured for more than five (5) consecutive days from the date Landlord receives Tenant's written notice thereof, then Tenant, as its sole and exclusive remedies, shall have the right to (i) abate fifty percent (50%) of the Rent until such time as such violation is cured, and (ii) terminate this Lease upon sixty (60) days written notice (the "Exclusive Termination Notice") to Landlord. If Tenant exercises its right to terminate this Lease pursuant to this Subsection (b), then this Lease shall terminate effective upon the sixtieth (60th) day after the date of the Exclusive Termination Notice with the same effect as if such date was the Natural Expiration Date scheduled expiration date of this Lease; provided, however, that if Landlord cures such violation prior to such sixtieth (60th) day, then the Exclusive Termination Notice shall be vitiated and rendered null and void and this Lease shall remain in full force and effect. Notwithstanding the foregoing, Tenant shall not have the right to abate Rent or terminate this Lease as set forth in this Subsection (b) for a violation of Tenant's Exclusive Use if another tenant or occupant of the Project violates a provision of its lease agreement regarding its premises (a "Rogue Tenant"), which lease agreement either does not permit or specifically prohibit a use specified in Tenant's Exclusive Use provided that Landlord, following receipt of notice from Tenant advises of a violation of the Tenant's Exclusive Use by the Rogue Tenant (the "Rogue Tenant Notice"), commences an action or proceeding against such Rogue Tenant and thereafter uses commercially reasonable efforts and good faith efforts to enforce its right under such lease. If Landlord is unable to cure the violation of Tenant's Exclusive Use by the Rogue Tenant within ninety (90) days of Landlord's receipt of Tenant's Rogue Tenant Notice, then Tenant shall be permitted to abate Rent or terminate the Lease as set forth above.

(c) Notwithstanding anything contained in this Section to the contrary, if Tenant is entitled to abate Rent as a result of a violation of Tenant's Exclusive Use for three hundred sixty-five (365) days from the date Landlord's receives Tenant's written notice thereof, and Tenant has not previously exercised its right to terminate this Lease, then (i) Tenant shall be deemed to have waived the particular violation of Tenant's Exclusive Use, (ii) Tenant shall not longer have the right to terminate this Lease as a result of such violation of Tenant's Exclusive Use, and (iii) Tenant's right to abate further Rent shall be null and void and Tenant shall immediately commence paying the full amount of Rent due hereunder.

(d) Notwithstanding anything contained herein to the contrary, Landlord shall not be obligated to maintain or enforce the terms of this Section or any similar provision of the Lease to the extent the same would be in violation of any anti-trust law applicable to similar business transactions within the State. If such anti-trust violation is the basis of a claim or counterclaim against Landlord in connection with Landlord's attempted enforcement of the Exclusive Use, then Landlord shall promptly consult with Tenant regarding Tenant's desire to further pursue enforcement of the Exclusive. In addition, Tenant shall defend, indemnify and save Landlord and its employees, agents and assigns harmless from and against any and all losses, damages, actions, causes of action, claims, liabilities, demands, costs and expenses including, without limitation, reasonable attorneys' fees, arising out of any claim or counterclaim against Landlord in connection with Landlord's attempted enforcement of the Exclusive. Landlord shall have the right to provide a copy of this Section or a description of the terms hereof to any tenant or occupant or prospective tenant or occupant of the Project.

3. Common Area Maintenance Costs (Gross/Net/NNN)

Owners of shopping centers have many expense items to account for and which are typically passed through to the tenants in the leases. Base rent or minimum rent is the payment for the use of the premises while the payment of taxes, insurance utilities and other costs related to the operation of the center are typically prorated among the tenants, and these costs are often called "common area maintenance costs", "CAMs", or "operating expenses".

One of the most heavily negotiated sections of a commercial lease is the common area maintenance cost section. These provisions contain what costs the landlord may and may not pass through to the tenants; however, there are a number of different ways to negotiate these sections including how these costs are passed through to the tenants. For example, there are "gross" leases, "net" leases and "NNN" or "triple net leases." Most retail leases are "net" leases where most, but not all, costs are passed through the tenant.

In addition to defining the applicable costs, there are a number of other issues that need to be addressed including caps on CAM costs, annual reconciliations of CAM costs and tenant audit rights.

Example of Common Area Cost Provision:

"CAM Costs" shall include (1) all costs and expenses of every kind and nature paid or incurred by Landlord in operating, equipping, improving, policing and protecting, lighting, heating, air conditioning, providing sanitation and sewer and other services, insuring repairing, replacing and maintaining (A) the common areas; (B) all buildings, improvements, facilities, areas and roofs within, beneath, supporting or serving the Retail Area and/or common area, and (C) all other areas, facilities, improvements and buildings, including improvements, offices, signs, parking facilities, and transportation facilities.

Example of Provision addressing exclusions to CAM Costs:

"CAM Costs" shall not include any of the following:

(1) Repair of Buildings and Capital Expenditures. Costs of original construction of the Center or any expansion, remodeling or renovation thereof, whether mandated by law or otherwise. Without limiting the generality of other exclusions contained herein, capital expenditures including, but not limited to, acquiring, constructing, remodeling, refurbishing or expanding the Center or any portion thereof, including without limitation buildings, improvements, common areas, parking areas or any related facilities or services, repaving, or resurfacing of the parking area of the Common Areas shall also be excluded from CAM Costs except that the following capital expenditures shall be permitted to be included in CAM Costs, all of which must be commercially reasonable in amount: (a) capital expenditures that reduce CAM Costs (but not to exceed the amount of any savings); (b) the depreciation of the cost of parking lot resurfacing, calculated on a straight line basis over a useful life of not less than seven (7) years; (c) depreciation of the cost of replacement of HVAC equipment serving the common areas, calculated on a straight line basis over a useful life of not less than ten (10) years, and (d) costs of equipment (or rentals therefor) directly used in the performance of maintenance functions calculated on a straight line basis over a useful life of the item in question but not less than ten (10) years.

(2) Compliance with Law/Violations of Law. The cost of (i) compliance with any legal requirements (including, without limitation, the Americans With Disabilities Act) and, (ii) costs, fines, or fees incurred by Landlord due to violations of any federal, state or local law, statute or ordinance, or any rule, regulation, judgment or decree of any governmental rule or authority;

(3) Casualty and Eminent Domain Restoration Costs. Costs of replacing, repairing, or restoring the Center, or any portion thereof, in the event of (i) a casualty of any type, regardless of whether insurable or uninsurable, insured or uninsured and regardless of whether any costs (or deficiencies) result from deductibles or self-insured retention; or (ii) the exercise of the power of eminent domain;

(4) Earthquake and Terrorism Insurance. Premiums for earthquake or flood or terrorism insurance of any kind;

(5) Excessive Insurance Premiums. Any excess premiums for insurance coverage arising or resulting from extra-hazardous activities of any tenant or occupant of the Shopping Center, or their agents, employees or contractors, other than Tenant;

- (6) Hazardous Materials Cleanup. Any costs or expenses associated with the investigation, monitoring, removal, cleanup or remediation of any Hazardous Materials (as herein defined) from the Center, any restoration in connection therewith or compliance with any Environmental Laws (as herein defined);
- (7) Loan Repayment. Principal and/or interest payments on any financing for the Shopping Center or any portion thereof or rental under any ground lease or other underlying lease;
- (8) Reserves. Reserves for anticipated future expenses which would be incurred subsequent to the then current accounting year;
- (9) Costs Related to Other Tenant Spaces. Costs or expenses related to any leasable area in the Center including, without limitation, the cost of performing repairs, renovations or remodeling to individual tenant spaces (including the Premises), costs or expenses of leasehold improvements made or performed for any occupant of the Center (including any construction allowance) whether or not (i) pursuant to Landlord's obligations under this Lease and other tenants' leases, or (ii) such spaces are unleased or unoccupied;
- (10) Fees and Operational Expenses. Legal fees, leasing commissions, advertising expenses, audit fees and other costs incurred either in connection with Tenant or this Lease or with the development, leasing or operation of the Center, or in connection with negotiations or disputes with tenants (including Tenant), occupants or prospective tenants or person, firm, corporation or other entity related to Landlord which is in excess of the amount which would have been paid in the absence of such relationship based on the fair market value of such costs in the geographic area of the Center;
- (11) Management Fees. Any costs, fees, charges or commissions paid or allocated to management, administrative or supervising functions performed by Landlord or by any other entity or person whether or not such amounts are represented as a cost or a fee paid to unrelated third parties or are paid, charged or imputed by or to Landlord or any entity related to Landlord, for the performance of such management or supervising functions; provided however, that the _____percent (%) Administrative Fee shall be permitted;
- (12) Landlord's Other Business Costs. Any and all other costs associated with the operation of the business of Landlord as distinguished from the costs of maintenance of the common areas. Such excluded items shall specifically include, but shall not be limited to, formation of the Landlord entity, internal accounting and legal matters including, but not limited to, preparation of tax returns and financial statements and gathering of data therefor, costs of selling, syndication, financing, mortgaging, hypothecating or encumbering any portion of Landlord's interest in the Center (including, without limitation any mortgage taxes), salaries and bonuses of officers and executives of Landlord and compensation paid to clerks, attendants or other persons (except as otherwise provided herein) and costs of any disputes between Landlord and its employees;
- (13) Contributions by Non-Prorata Occupants. CAM Costs shall be reduced (before Tenant's proportionate share thereof is calculated) by contributions to CAM Costs by tenants or occupants whose space is permitted by the provisions of this Lease to be excluded from the denominator of the Tenant's proportionate share fraction;
- (14) Landlord Violations. Expenses resulting from any violation by Landlord of the terms of any lease or occupancy agreement for space in the Center or of any ground or underlying lease or any mortgage or the cost of any indemnity obligations of Landlord to others or to Tenant;
- (15) Late Payment Interest or Penalties. Any interest, late charges, or penalties incurred as a result of Landlord's failure to pay any bill as the same shall become due including, without limitation, costs or expenses arising from any bad debt of Landlord;
- (16) Acts or Negligence of Other Parties. The cost of any repair to remedy damage caused by or resulting from the acts or negligence of any other tenant(s) or occupant(s) in the Shopping Center, including their agents, contractors or employees;
- (17) Promotional Events and Decorations. The cost of promotional and seasonal events and decorations, including the purchase, leasing, storage, installation and/or removal and clean-up of same;
- (18) Pylon and Monument Signs. Costs and expenses for the construction and maintenance of any pylon or monument signs for the Center;
- (19) Duplication of Costs. Any duplications of CAM Costs; and

(20) Income From Common Areas. Any income received by Landlord from the use of portions of the Common Areas for which Tenant reimburses Landlord for Tenant's share of CAM Costs, such as, for example, income received by Landlord for use of the Common Areas for advertising or for special events, all of which shall be deducted from CAM Costs prior to the computation of Tenant's proportionate share thereof.

4. Permitted Uses/Continuous Operation Clauses

What is the tenant allowed to "do, sell, operate" under the lease? A permitted use clause in a lease agreement defines how a tenant can use the leased premises and states that any other use is not permitted. The clause can be as broad as "any use permitted by law" or as specific as how, when, and where a tenant can provide services or products from the premises. Landlords often negotiate use clauses to protect the tenant mix in a center and/or to ensure compliance with other tenants' exclusive rights. Tenants often negotiate use clause to ensure that their business can evolve or to facilitate assignment and subletting rights.

Landlords have a strong interest in making sure all of the tenants are open and operating—especially if the lease contains a percentage rent component or if there are co-tenancies. As a result, many leases also include continuous operation clauses which may have an impact on the permitted use.

Continuous Operations Clause:

Tenant agrees to open and continuously operate the Premises to the public for business fully fixtured, stocked and staffed for the Permitted Use no later than thirty (30) days following the Commencement Date. In the event that Tenant fails to open the Premises for business as required by this Section Landlord shall have, in addition to any and all remedies herein provided, the right at its option to collect Additional Rent at the rate of _____ and No/100 Dollars (\$_____) per day for each and every day that Tenant shall fail to commence to do business as herein provided. Notwithstanding anything herein to the contrary, Tenant shall have no duty to continuously operate in the case of an event of force majeure (as defined in Section 17.6 hereof), provided that Tenant provides written notice to Landlord of such force majeure event within five (5) business days of the occurrence thereof.

5. Percentage Rent/Gross Sales

We discussed the various "charges" a landlord collects from a tenant, which included rent. Rent can be calculated in many ways, including having a fixed rent, a rent that is adjusted on a yearly or less frequent basis, and a percentage rent where the tenant pays the landlord a percentage of its gross sales (whether as the base rent or as additional rent for additional income to the landlord and additional payment obligations for the tenant).

Percentage rent clauses in retail leases are significant in both how it is calculated (i.e., the definition gross sales and the definition of the "breakpoint"), how often is it paid, and what are the audit rights for confirming how the rent is paid.

Example of Percentage Rent Clause:

In addition to the Minimum Rent, Tenant shall pay Landlord as percentage rent (the "Percentage Rent") an amount for each Lease Year equal to the Percentage Rate multiplied by the Gross Sales for such Lease Year in excess of an amount ("Base Amount") equal to the quotient obtained by dividing the Annual Minimum Rent payable for such Lease Year by the Percentage Rent Rate. For the purpose of computing the Percentage Rent for the first Lease Year, the Gross Sales for and the Annual Minimum Rent payable for the partial calendar month, if any, preceding the first Lease Year shall be included in the Annual Minimum Rent and Gross Sales for the first Lease Year. Within 60 days following the end of each Lease Year, Tenant shall furnish Landlord with a statement, verified by a corporate officer of Tenant, showing the amount of Gross Sales for the preceding Lease Year, which statement shall be accompanied by Tenant's payment of Percentage Rent, if any, is due.

Landlord shall have the right, not more often than once each year, to audit Tenant's records of Gross Sales, but only for the purpose of ascertaining the amount of the Gross Sales during the preceding Lease Year. Such audit shall be made on behalf of Landlord by a certified public accountant to be selected by Landlord. If Landlord wishes to audit Tenant's records for any Lease Year, Landlord shall notify Tenant and proceed with such audit within 12 months after the end of the Lease Year in question. Should Landlord fail to exercise the right to audit the records of Tenant within 12 months after the end of any Lease Year, then Landlord shall have no further right to audit the records of Tenant for such Lease Year, and Tenant's statement of Gross Sales for such Lease Year shall conclusively be deemed to be correct. Any such audit by Landlord shall be at Landlord's own expense, except as hereinafter provided. If any such audit discloses that Tenant has understated the Gross Sales for such Lease Year by more than 3% and Landlord is entitled to any additional Percentage Rent as a result of such understatement,

then Tenant shall promptly pay to Landlord the cost of such audit. Tenant shall, in any event, pay Landlord the amount of any deficiency in Percentage Rent. Any information obtained by Landlord from such statements or inspections shall be kept confidential and shall not be disclosed except as provided below.

For purposes of this Lease, the term "Gross Sales" shall mean: (i) the entire amount of the price charged, whether wholly or partially in cash or on credit, or otherwise, for all goods, wares, merchandise and chattels of any kind sold, leased, licensed or delivered, and all charges for services sold or performed in, at, upon or from any part of or through the use of the Premises or any part thereof by Tenant or any other party; and (ii) all gross income of Tenant and any other party from any operations in, at, upon or from the Premises which are neither included in nor excluded from Gross Sales by other provisions of this Lease, but without duplication. Notwithstanding the foregoing, Gross Sales shall not include, or if included, there shall be deducted (but only to the extent they have been included), as the case may be, (a) the net amount of cash or credit refunds upon Gross Sales, where the merchandise sold or some part of it is returned by the purchaser to and accepted by Tenant (but not exceeding in any instance the selling price of the item in question); (b) the amount of any sales tax, use tax or retail excise tax which is imposed by any duly constituted governmental authority directly on sales and which is added to the selling price (or absorbed therein) and is paid to the taxing authority by Tenant (but not any vendor of Tenant); (c) exchanges of merchandise between the Premises and other locations of Tenant or its Affiliates to the extent the same are made solely for the convenient operation of Tenant's business and not for the purpose of depriving Landlord of the benefit of Gross Sales; (d) returns of merchandise to shippers, suppliers or manufacturers; (e) the sale of Tenant's Property; (f) discount sales to employees and agents of Tenant of merchandise not intended for resale; (g) all receipts or proceeds from borrowings; (h) gift certificates or like vouchers, if not issued for value, until the time they have been converted into a sale or redemption; (i) income, revenues, receipts or proceeds from Tenant's investment of any funds in a deposit institution; and (j) separately stated interest and service charges.

6. Subordination/Non-Disturbance/Attornment Agreements

SNDA's... we have all heard the abbreviation. But what does it really mean? Let's discuss each:

Subordination: The Tenant agrees to have its lease subordinate or "after" the lender in terms of rights in the event of a default by the landlord/lender's borrower.

Non-Disturbance: Please ensure that this is included, as this is the "tenant benefit" part of the SNDA. This section provides that as long as the tenant is not in default under the terms of the lease, the lender "won't disturb" the tenant's tenancy in exercising its rights under its security instrument.

Attornment: This section provides that the tenant will look to the lender as tenant's landlord if the lender takes the property from the landlord/lender's borrower either through a foreclosure or deed in lieu thereof.

When leases are negotiated, depending upon which party prepared the draft, these sections may look very differently and need to be reviewed carefully from both the landlord's and tenant's perspective. A poorly drafted subordination provision could result in the lease not being financeable by the landlord or may not afford the tenant sufficient protections. Moreover, since lenders are the primary drivers for these provisions, changes/uncertainty in the capital markets can have significant impacts on how these provisions look and are negotiated.

Example of Subordination Provision:

SUBORDINATION OF LEASE. This Lease and Tenant's interest hereunder shall at all times be subject and subordinate to the lien and security title of any deeds to secure debt, deeds of trust, mortgages, or other encumbrances heretofore or hereafter granted by Landlord or which otherwise encumber or affect the Premises and to any and all advances to be made thereunder and to all renewals, modifications, consolidations, replacements, substitutions, and extensions thereof (all of which are herein called the "Mortgage"); provided, however, that with respect to any Mortgage hereafter granted, such subordination is conditioned upon delivery to Tenant of a commercially reasonable non-disturbance agreement which provides that Tenant shall not be disturbed in its possession of the Premises hereunder following a foreclosure of such Mortgage (or delivery of a deed-in-lieu-of-foreclosure) and that the holder of such Mortgage or the purchaser at a foreclosure sale (or grantee under such deed-in-lieu-of-foreclosure) shall perform all obligations of Landlord under this Lease. In confirmation of such subordination, however, Tenant shall, at Landlord's request, promptly execute, acknowledge and deliver any commercially reasonable instrument which may be required to evidence subordination to any Mortgage and to the holder thereof.