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Peer to Peer 8

CAM Costs and Audits: Will Cutting Corners While Cutting Costs Lead to a Successful Reconciliation -- or a Reckoning?

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CAM COSTS AND AUDITS IN RETAIL LEASES

Introduction

The subject retail lease is a landlord form dated October 2021 for a national tenant with a 20% proportionate share in a shopping center 30 years old of approximately 750,000 rentable square feet. The shopping center has extensive common areas and landscaping, including a large playground for kids and a significant outdoor patio used by a large restaurant tenant. Very recently, Landlord installed a row of EV chargers for customer parking near the north entrance of the center (which parking spaces are located far away from the subject tenant's store and appear to be non-exclusive).

Landlord has negotiated with other tenants detailed CAM provisions unique to each tenant, such as controllable caps, extensive OpEx exclusions, right to challenge tax increases, etc. Here, the CAM and audit provisions in the subject lease were also heavily negotiated. The tenant here frequently audits the annual reconciliation statement and has hired an aggressive lease auditing firm to review the most recent reconciliation statement.

Hypothetical #1

The Lease provides for a first-year cap on all CAM and a fixed administrative fee equal to 10% of all CAM. In addition, the lease contained a list of CAM exclusions which, among other exclusions, prohibited the pass-through of the following costs:

- management, administration, supervision, accounting, and bookkeeping costs other than the fixed 10% administrative fee
- reserves
- legal fees, including costs incurred in disputes with other tenants, and
- costs for services provided to a particular tenant or group of tenants where such services are not provided to Tenant.

The first year after opening, Tenant audited Landlord's annual CAM reconciliation and provided the following audit statement:

Description	Note	LL Billed	Adjustments	Allowed Per Tenant
Office Phone & Fax	A	1,807.00	(1,807.00)	-
Legal Fees	B	1500.00	(1500.00)	-
Management Fees	A	16,392.00	(16,392.00)	-
Accounting	A	769.00	(769.00)	-
Trash/Recycling	C	5,529.00	(5,529.00)	-
Capital Reserve	D	11,133.00	(11,133.00)	-
Administrative Fee FIXED (10% of CAM)	A		2,061.47	2,061.47

NOTE A:	Section W excludes all costs for management, administration, supervision, accounting, and bookkeeping other than the fixed administrative fee (fixed at 10% of Tenant's Pro Rata Share of Common Area Expenses). We have removed the administrative expenses and management fee included in Landlord's CAM reconciliation and have allowed for the 10% administrative fee.

NOTE B:	Section X specifically excludes legal fees, including legal disputes with other tenants. We have removed the XYZ lease dispute legal fee for this reason.
NOTE C:	Tenant contracts directly with an outside vendor for trash services. Section Y states CAM shall exclude the cost of any service that inures primarily to the benefit of a particular tenant or group of tenants. We have removed costs related to trash services provided to other tenants.
NOTE D:	Section Z specifically excludes any reserves from CAM.

Landlord argued that the CAM exclusions flagged by Tenant were included in Landlord's calculation of CAM when figuring the first year CAM cap, and that by accepting the CAM cap in the lease Tenant waived the right to object to inclusion of these items.

Tenant argued that the lease specifically excluded these items from CAM and that any calculation provided by Landlord in coming to the CAM cap prior to lease negotiations did not waive Tenant's rights to enforce the terms of the lease.

- Discussion Point #1: Is Tenant's analysis of the CAM exclusions supported by the lease?
- Discussion Point #2: Is Landlord's calculation of the CAM cap relevant to the CAM exclusions?
- Discussion Point #3: Regarding Landlord's waiver contention, what leverage may be available to either party outside of the lease under common law, statute, or equity? Please base your argument on a state that you're familiar with and assume the center is located in such state.
- Discussion Point #4: **NEW FACT**: Tenant's Audit is after the first lease year, so the first year cap has expired. Tenant's new audit challenges costs believed to arise from the large restaurant patio and the recently installed EV chargers, citing the Lease language above that excludes "costs for services provided to a particular tenant or group of tenants where such services are not provided to Tenant."
    a. What facts and/or additional lease provisions are needed to support or deny Tenant's auditor?
    b. The EV chargers are at the north entrance of the center by a popular anchor tenant, unclear if non-exclusive, and the subject Tenant is located at the south entrance. How material are these facts?
- Discussion Point #5: If you've recently experienced a contentious audit, please share a few practical tips or useful lessons that are not confidential and could be useful for the group.

Hypothetical #2

Same facts as in the introduction above. The parties recently agreed that controllable OpEx costs will not increase more than five percent (5%) of the prior year. Landlord has proposed the following to be included in a lease amendment:

> "**Controllable Operating Expenses**" shall mean all Operating Expenses, but expressly excluding charges for security, utilities, Landlord's compliance with applicable laws, snow and ice removal, storm cleanup costs, trash and recycling, taxes, insurance, capital improvements or replacements, management fees, any expense related to a Force Majeure, and emergency repair costs of any major mechanical, plumbing, HVAC, life safety or security systems serving the Building or Property. Notwithstanding anything to the contrary in the Lease, commencing on next immediate calendar year of the Term and each calendar year during the Term thereafter, the Parties agree that Controllable Operating Expenses for Tenant's Proportionate Share of Operating Expenses shall not increase by more than five percent (5%) than the immediately prior calendar year."

- Discussion Point #1: What language should be included or excluded from the Tenant's and Landlord's perspective?
- Discussion Point #2: When evaluating such language, what other Lease provisions are material and should be checked and/or perhaps revised?
- Discussion Point #3: When negotiating such language, what specific facts and circumstances of the Center, Premises, and/or the parties' business relationship are most important from the Tenant's and Landlord's perspective?
- Discussion Point #4: **NEW FACT**: Landlord has negotiated different CAM caps for numerous tenants in the Center over the years. From a Landlord's perspective, any practical tips to help the Landlord's lease administrator stay organized and/or avoid audits? From a Tenant's perspective, any practical tips for an audit when the Tenant is aware of numerous CAM negotiations with other tenants in the Center? Please share to the extent not confidential and useful for the group.

Hypothetical #3

Same facts as in the introduction above. Landlord's CAM reconciliation statement was circulated to all tenants on March 1, 2025. Forty days later, Tenant requests an Audit via FedEx but the notice is not sent to all the parties per the Lease. Tenant's audit notice challenges "all the excessive and improper charges by Landlord, including the large playground and the EV stations that our employees and customers never use" and asserts that going forward it will stop paying CAM charges until the Audit is complete. About 9 months ago, the Landlord received notice that the original Tenant entity was changed to a Permitted Transfer as defined in the Lease.

Soon after receipt of the Audit notice, Landlord's counsel says the Audit request should be rejected because Tenant failed to comply with the Lease's Audit Right language. The attorney specifically references the following lease language:

> "Audit of Landlord's Books and Records. Provided no Event of Default has occurred (and no event has occurred that, with the passage of time and/or with notice, would become an Event of Default), Tenant shall have the right, at Tenant's sole expense, to inspect Landlord's books and records relating to any Operating Expenses for the purpose of verifying such information ("Tenant Audit"), provided that (i) Tenant shall have sent notice of the Tenant Audit no later than 30 days after receipt of Landlord's annual reconciliation statement ("Audit Notice"); (ii) the Audit Notice should identify with reasonable specificity the particular item(s) in the annual reconciliation statement that the Tenant believes is/are incorrect; and (iii) Tenant has paid the annual reconciliation statement. Except for a Permitted Transfer, the Tenant Audit right is personal to Tenant and such right shall automatically terminate upon any Transfer of this Lease."

- Discussion Point #1: What are the strengths and weakness of Landlord counsel's position?
    a. The Audit lease language does Not have express waiver language and is silent whether Tenant must continue to pay OpEx during the Audit. Does that make a material difference?
    b. Assume the Permitted Transfer did Not comply with the Lease, but Landlord has only noticed this now. Does that make a material difference?

- Discussion Point #2: The lease's audit language also says "The Tenant Audit shall be conducted only during regular business hours at the office where Landlord maintains its books and records." Tenant's auditor is located over 1,000 miles away from Landlord's office and requests online access. How should the Landlord respond?

- Discussion Point #3: The lease's audit language does not have a confidentiality clause. What steps should Landlord take regarding the Audit?

ANSWERS & DISCUSSION NOTES TO HYPOTHETICALS

Hypothetical #1

- Discussion Point #1:

    a. Office Phone and Fax: If the phone and fax costs are for Landlord's management office, then Tenant's argument is supported under exclusion for all management/administrative costs other than the 10% fixed administrative fee.

    b. Legal Fees: Supported by the lease, Landlord is prohibited from passing through costs for legal disputes with other tenants.

    c. Management Fee: Supported by the lease, Landlord is prohibited from passing through any management fee other than the 10% fixed administrative fee.

    d. Accounting: Supported by the lease, Landlord is prohibited from passing through any accounting or bookkeeping fee in excess of the 10% fixed administrative fee.

    e. Trash/Recycling. Any portion of the cost attributable to removal of trash and recycling from the common areas should remain (all tenants receive benefit of trash and recycling removal from the common areas). Costs of providing trash/recycling removal services to tenants should be excluded.

    f. Capital Reserve: Supported by the lease, Landlord is prohibited from passing through any reserves. Depending on the lease language (not provided in these facts), Landlords are typically allowed to pass through actual costs or a portion of actual costs for certain capital improvements and repairs.

- Discussion Point #2:

    a. Tenant argument: No, CAM caps are for the benefit of the Tenant only. It's a cap not a fixed cost (or even an estimate of actual costs). Also consider if the lease contains an entire agreement provision stating that there are no representations, promises, agreements, etc., between Landlord and Tenant other than as set forth in the Lease. If so, this would further support Tenant's argument that the exclusions contained in the Lease control over any prior discussion of CAM.

    b. Landlord argument: It's a difficult argument for Landlord to make with little support on these facts. Outcome would be different if first year figure was fixed instead of a cap. Landlord might also have some equitable argument if the facts were different and there was obvious inequity in the negotiations (e.g. Tenant is sophisticated, used Tenant's form, Tenant was represented by counsel v. Landlord is unsophisticated, little or no modification to Tenant's form, not represented by counsel, etc.) and Tenant knew that Landlord intended to pass through these costs.

- Discussion Point #3:

    a. Examples: 1) California statutes have significant tenant protections, but usually must be expressly waived in the lease. If no such waiver, tenant should have such protections.

    2) Feedback from audience on a few jurisdictions with unique statutory and/or

common law rights regarding waivers

3) If the tenant has a significant financial hardship (or major personal emergency if small business) could equitable principles defeat Landlord's waiver argument in court?

- Discussion Point #4:

    a. Deny Auditor Examples (and EV charger issues):

        1. All other Tenants pay their prorata share for both areas; Landlord can correct current challenged audit and keep such correction in future reconciliation statements

        2. Landlord isn't providing "services" re: the patio or EV charges

        3. EV chargers in certain parking spaces benefit all of the mall's customers and are located by a popular anchor, so customers likely to visit the anchor and then go to the tenant's store

        4. *Alternative to above*: A certain tenant is paying Landlord directly for the cost of the EV chargers, but such arrangement is not on the reconciliation statement. Landlord can correct challenged audit accordingly (perhaps keeping the other tenant's identity confidential) and keep such correction in future reconciliation statements

    b. Support Auditor Examples (and EV charger issues):

        1. Only the Restaurant tenant receives the benefit of the patio – subject tenant shouldn't pay for such costs

        2. Landlord needs to provide more objective data on popularity and use of the EV spaces

        3. If the EV chargers in certain parking spaces are for all customers at the center, signage should be clear such spaces are non-exclusive and subject tenant shouldn't pay for such ambiguity in current reconciliation statement. Tenant could also leverage audit to obtain more details of the actual costs passed through for the EV chargers to confirm if such costs are reasonable. And perhaps Tenant initiate an informal survey of its customers regarding use or interest of the EV chargers.

        4. If only certain tenants are paying for EV chargers, the subject tenant's Lease is clear that such costs should be excluded.

- Discussion Point #5:

    a. Seek a few non-confidential stories from the audience.

Hypothetical #2

- Discussion Point #1:

    a. Tenants prefer a much narrower list of exclusions to prevent watering down the protections. A good example from a Tenant's perspective is for controllables to include all costs except for taxes, insurance, utilities, snow and ice removal, and sometimes security.

    b. Cumulative basis (Landlord preferred because Landlord can carry over unused allowed CAM increases to future years) vs. Non-cumulative basis (Tenant preferred because no carry over of unused allowed CAM increases to future years)

    c. Is adding Force Majeure language here customary in your experience? Regardless, how can this concept be limited to certain uncontrollable events?

    d. Should there be more specifics re: capital improvements, replacements and repairs? Are such issues specifically defined and/or limited elsewhere in the Lease?

    e. Regarding Landlord's compliance with applicable law – perhaps narrow to latent defect(s) only? Or such compliance after the Effective Date or Delivery Date? Are there additional carve outs that could be useful?

    f. Perhaps clarify more specifics re: management fees? Are they limited in the general OpEx section of the Lease?

    g. Does the cap apply to a lease extension? Regardless, in your experience when does such a cap typically apply to lease extensions? (For example, perhaps such a cap applies to one option for a three year term, but not automatically for four options at five years each).

- Discussion Point #2:

    a. Are Insurance, Taxes, and Utilities defined in the Lease?

    b. How are maintenance and repairs of the Center and subject premises allocated between Landlord and Tenant?

    c. The Denominator/GLA of the shopping center – does the lease give the Landlord discretion to change this number?

- Discussion Point #3:

    a. The length of lease term & options to renew

    b. Leasing experience and financial resources of a National tenant vs. small business tenant; or a similar dynamic regarding a family-owned Landlord vs. a national Landlord with a large portfolio

    c. Importance and/or current popularity of subject tenant's use in the Center (for example, long standing anchor tenant at center vs. small business focused on a trending use)

    d. History of parties' business relationship (including leases at other centers, if applicable)

e. Age of Center and Premises (for example, what is the reasonably expected useful life of the common area parking lot, HVAC components, or plumbing serving the Premises)

f. What are Landlord's anticipated capital repairs in the near future? If there are extensive tenant improvements to the Premises, how does that effect a controllable OpEx cap?

- Discussion Point #4:

  a. Seek a few brief stories from the audience regarding such practical tips.

Hypothetical #3

- Discussion Point #1:

  i. Tenant's notice is untimely so void (but is this argument too technical? How could this position effect the partes' long term business relationship?)

  ii. Tenant's notice needs more specifics (but the playground and EV chargers are identified in the audit notice and the Lease only requires "reasonable specificity")

  iii. All tenants benefit from the playground and EV chargers – costs are shared by all tenants

  iv. Other sections of the Lease require that Tenant pay OpEx each month (but the Audit notice only requires payment of the reconciliation statement and Tenant has paid that).

a. Audit notice without express tenant waiver and silent on continuing payment of OpEx during audit.

1. Such facts may make a difference.

   a. Specific language requiring such continual OpEx payment during an audit is best

   b. Most Leases have an independent obligation for Tenant to pay monthly OpEx

   c. Certain jurisdictions may have common law or statutory rules that could be helpful to Landlord or Tenant (for example, the requirement that tenant's waiver of a lease obligation must be expressly waived to be enforceable).

b. Audit exercised by Permitted Transfer recently discovered as non-complaint under the Lease

1. Largely depends on the parties' business relationship, the lease term's length, and size of Premises.

2. Likely unpersuasive for Landlord to deny audit solely because of a non-compliant permitted transfer just recently discovered, especially if the tenant is current on rent. But Landlord could likely leverage this issue for other concessions of the tenant.

- Discussion Point #2:

a. Landlord's response largely depends on its confidentiality controls and all parties' experience using cloud-based or remote resources.

b. Perhaps Landlord could allow more time for audit to allow for physical inspection of books and records.

- Discussion Point #3:

a. Require that Tenant and auditor sign a NDA specific to the audit

b. Negotiate side letter or lease amendment addressing confidentiality issues re: the audit, but also future audits

c. Require an in-person review of Landlord's books and records in Landlord's office with a staff person present.