Beware the Boilerplate — 10 Costly Pitfalls for the Office Tenant

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When entering into an office lease agreement, tenants often focus on rent and other "money" provisions (as they should), but shrug aside the "boilerplate" language of the landlord's form as "standard" (which they should not). These standard provisions can cost money — potentially a lot. Here is our list of 10 costly pitfalls for the office tenant to avoid when entering into an office lease agreement.

Measurement of the Premises and the Building

Be wary when a landlord's form lease states "the parties agree that the premises is "X" rentable square feet and the building is "Y" rentable square feet." The tenant should request an agreed method of measurement (such as BOMA) in the lease document, with the ability of the tenant to verify the measurement of the premises and the building. Otherwise, the tenant may be paying more than need be. Tenants should understand the concepts of "usable area," "rentable area," and "load factor," and how they apply to each building under consideration. Depending on the efficiencies of these buildings, a lower stated annual rental rate per square foot may not be a bargain.

Acceptance of Premises

In many transactions, the tenant is responsible for constructing its leasehold improvements, for which the landlord often provides a tenant improvement allowance, generally specified as a dollar amount per rentable square foot of the premises. In such cases, the tenant accepts the premises in "as is" condition, which is fine, but beware the potential hidden cost. Rather, acceptance should be "as is" subject to the landlord delivering possession in the "delivery condition," being vacant, "broom clean" (and potentially, with agreed items removed), in compliance with laws, and with all base building systems serving the premises in good operating condition.

Compliance with Laws

Most every office lease requires the tenant to comply with laws applicable to the premises during the term of the lease, under the rationale that the tenant is the "owner of the premises during the term." While this is generally acceptable for long term leases, should an office tenant be responsible for maintenance of, or required modifications to, elements of the base building systems within its premises? Likewise, if an alteration performed by a tenant triggers a legal requirement (such as under the Americans with Disabilities Act) to construct alterations in the common areas, many form leases impose that obligation on the tenant. Should a tenant be required to bear that expense if the triggering alteration to the premises is typical for office use? And if hazardous materials are discovered in the premises, should remediation be the tenant's responsibility if either the hazardous materials predated the tenant's occupancy, or were introduced during the tenant's occupancy, but not by the tenant, its employees, or contractors? The lease document should properly allocate the respective risks of these potential problems.

Operating Expenses

Typically, office tenants pay a pro rata share of the expenses of operating, maintaining, and repairing the building. All well and good, but the tenant should review what the lease specifies to be included in "operating expenses." Since the lease definition of operating expenses is usually all encompassing (such as "any and all costs and expenses incurred by landlord in connection with owning, managing, operating, maintaining, repairing and replacing the Building, Common Areas and elements thereof"), costs appropriately attributed to ownership rather than operations are frequently **excluded** from the definition of operating expenses. Among the items often excluded: capital improvements (except under certain limited circumstances), mortgage and ground lease costs, leasing costs (including brokerage commissions), depreciation, costs relating to the legal entity of landlord (annual fees, entity accounting) rather than building operations, and above market expenses paid to an affiliate of the landlord. In addition to the substance of the operating expenses definition, the tenant should seek lease language providing annual audit rights, so that the books and records of the landlord may be reviewed in order to reveal overcharges, if any.

Changes in Building Configuration or Operations

Leases often provide that the landlord "retains dominion and control over the common areas" (or similar language) and the flexibility to change the building configuration or operations. The tenant should seek lease language guaranteeing its bargained for expectations. A landlord may need flexibility to construct additional improvements on the property, but not in a manner that would completely block the tenant's view, or render access to the building and premises (and parking garage) cumbersome. If there are services or amenities the tenant is counting on (such as a conference facility, fitness facility, or a minimum number of elevators in operation), the lease should obligate the landlord to maintain those services and amenities to an agreed standard during the term of the lease. The tenant should also understand (and seek to properly limit) the landlord's ability to take rentable area "out of service" (i.e., converting rentable area to common area), thereby increasing the tenant's pro rata share of operating expenses and real estate taxes.

Surrender Condition

"At the expiration or termination of the Term, Tenant shall surrender the Premises in the same condition as on the Commencement Date, normal wear and tear excepted." That doesn't sound so bad (or does it?). Depending on how the lease is written, the surrender provision could require the tenant not only to **remove** all leasehold improvements it constructed (including those constructed by the tenant prior to move in), but also to **restore** any elements of the premises removed during construction. Tenants must review any restoration obligation carefully, and may attempt to negotiate to limit the removal obligation to the "oddballs," such as raised flooring, internal stairwells and sensitive compartmented information facility (SCIF) rooms. It is also useful for the lease to require the landlord to call out any oddballs at the time of consent (rather than at the end of the term) so the tenant may make an informed choice regarding the "true cost" of the improvement (and have the ability to explore alternatives for which removal would not be required).

Assignment and Subletting

Exit strategy is a key element of the lease for a tenant, in terms of (i) shedding a portion of its space during a business decline, (ii) needing to relocate to another building during a business expansion if the existing landlord cannot accommodate the tenant's growth needs, and (iii) accommodating corporate changes, such as mergers or acquisitions. Lack of flexibility in the lease document can be costly, raising the specter of multiple locations, lease buy outs, or simply paying the landlord for consent. Landlord form leases typically require the landlord's consent for any assignment or subletting. The tenant should carefully consider its exit needs and negotiate accordingly. For example, the tenant may seek a "carve out" from the landlord consent requirement for corporate transactions, such as mergers or acquisitions, so long as the successor tenant has sufficient financial strength.

Attorneys' Fees

Under the "American Rule," parties to a lawsuit pay their own attorneys' fees (except in certain narrow circumstances), as opposed to the "English Rule" of "fee shifting," whereby the losing party pays its own attorneys' fees **and** reimburses the prevailing party for its attorneys' fees. Office leases invariably contain a fee shifting provision (thereby invoking the English Rule by contract), but generally in favor of the landlord only. It is important for the tenant to negotiate for mutual fee shifting, whereby in any lawsuit, the losing party (whether the landlord or the tenant) reimburses the prevailing party for its attorneys' fees. Otherwise, for every potential legal dispute that may arise during the term of the lease, the tenant is left with the practical dilemma of an "uneven playing field," i.e., risking the requirement to pay the landlord's legal fees (in the event of a loss), but without the corresponding "upside" benefit of obtaining reimbursement of its legal fees (in the event it prevails). This imbalance has potential effect on every right and remedy in the lease, as it skews the cost/benefit analysis of maintaining a dispute, and tends to cause the tenant to be less assertive of its legal rights.

Rent Abatement for Inability to Use the Premises

The requirement to pay rent is generally an "independent" covenant in a lease agreement: "Tenant shall pay all rent without notice, demand, deduction, set-off or counterclaim." Accordingly, if the landlord is in breach of the lease, the tenant must nonetheless pay rent and seek separate judicial remedies for the landlord's breach, essentially, requiring the landlord to perform its obligations ("specific performance") or reimburse the tenant for damages (or both). For situations in which the premises is not usable, whether due to the landlord's breach (such as failure to properly maintain the elevators) or outside causes (such as a power outage not limited to the building), it is important for the tenant to have the express right in the lease to abate (i.e., not pay) rent until the premises again becomes usable. Furthermore, in the COVID-19 era, office tenants are discovering that force majeure clauses (if in the lease and benefitting the tenant) and the common law doctrine of "impracticability" (if the lease does not contain a force majeure clause benefiting the tenant) generally do not relieve the tenant of its contracted monetary obligations. Rent abatements for inability to use the premises for pandemics or other force majeure events present risks for both parties, and in the future we expect these to be heavily negotiated.

Notice and Cure Provisions for Default, Late Fees and Interest

The tenant should seek notice and cure rights before being put in default under the lease or being liable for payment of late fees or default interest. Notice and cure provisions are standard for non-monetary defaults, but not necessarily for monetary defaults. Often, a compromise is to require the landlord to deliver notice and an opportunity for the tenant to cure a monetary default and avoid late fees and default interest, but limiting the landlord's obligation to provide that notice to a specified number of times in a year and/or during the lease term.

Final Note

As the saying goes, "awareness is often curative," and all of these issues are solvable.

If you have a need, please contact any member of the Cozen O'Connor Leasing Team for consultation.