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### ***Real Estate And Construction Highlights***

***A Newsletter For Real Estate  
and Construction Professionals***

**THOITS, LOVE, HERSHBERGER & MCLEAN**  
***By Kenneth R. Van Vleck***

## **Terminating/Protecting Commercial Tenancies**

THIS ISSUE: Commercial Tenancies: Defending or terminating them in times of changing market conditions.

FACTUAL SCENARIO: A commercial tenant enters into a 10-year lease during a very competitive market. The tenant pays a premium for the space, a large security deposit, and agrees to covenants in the lease that put all maintenance obligations on the tenant rather than the landlord. Although a significant burden on the tenant's finances, the 10-year term in a fully occupied office complex with predictable rent increases offers stability and security against the unknown.

Two years later, there are millions of square feet of unoccupied commercial space, with landlords offering substantial incentives to enter into leases on very favorable terms, often with the landlord paying for tenant improvements and agreeing to forego rent during the tenant improvement period and even unilateral options to extend the term.

The tenant wants to terminate the 10-year lease and take advantage of the substantial improvement in market conditions. The tenant hires a savvy lawyer to review the multi-page lease and write to the landlord about the deplorable conditions of the property, the unfair negotiating tactics of the landlord, the unsuitability of the premises for its intended purpose and the landlord's outrageous common area maintenance charges. The tenant's attorney demands immediate termination of the lease and return of the substantial deposit extracted from the tenant. Can the tenant get out of this lease, and if so, at what cost?

LEGAL ANALYSIS: This scenario is now common throughout Silicon Valley. Landlords are receiving these letters virtually every day.

The general rule is that a tenant is stuck with the lease, and the only way out of it may be an expensive negotiation.

Binding Contracts: The lease agreement is a binding contract. Although in residential tenancies the landlord cannot extract enormous deposits, demand a waiver of maintenance of the premises, or force the tenant to waive other public policy-related rights, all of those rights may be waived in a commercial tenancy agreement. Though these waivers appear "unfair" later, courts are reluctant to disturb a negotiated agreement of this type.

Changed Conditions: A tenant may allege that conditions have changed so significantly that the premises cannot be used for its intended purpose. "Commercial frustration of purpose" requires that the lease specifically identified the intended use of the premises, that it cannot be used for that purpose under any circumstances, and that the change in conditions was unforeseeable and beyond the tenant's control. This sounds as if it may give a delicatessen owner the right to terminate the lease where the once-full office complex becomes a deserted wasteland. But the "commercial frustration" must be virtually complete – the "frustration" is that the property cannot be used for the intended business, not merely an unprofitable business, the high cost of the lease, or the availability of cheaper space elsewhere.

Condition of the Premises: By far the most frequently played tenant card is the “condition of the premises.” The tenant’s attorney recites the long list of complaints about the premises: “the electricity is frequently interrupted, the water smells bad, the heat/air conditioning is ineffective, the doors and windows are drafty” and the ultimate ace in the hole, “there is mold and mildew and our workers are complaining of respiratory conditions.” A \$10 mold test kit from the hardware store can bolster this claim with “scientific proof.”

In commercial tenancies, there is no implied warranty of habitability or statutory obligation to repair the premises. Repair obligations are a matter of contractual agreement between the landlord and tenant. Modern leases, especially those negotiated in a landlord-friendly market, often assign the entire obligation of maintenance to the tenant. Even without that kind of assignment of obligation, however, California courts have said that absent an express contractual obligation a landlord has no duty of repair.

The unfortunate tenant who writes to the landlord about the deplorable condition of the premises may well be faced with a demand from the landlord that the tenant take all steps necessary to correct the conditions and maintain the premises appropriately. Or the landlord might simply take significant and expensive steps to alleviate the “deplorable conditions” and charge those costs the tenant.

**CONCLUSION:** In the scenario above, it is unlikely that the tenant would be able to terminate the lease. But the tenant is not without hope. He might negotiate with the landlord to buy his way out of the lease. The amount he saves on future lower rent might “pay” for the negotiated termination payment, but in the absence of a clear breach by the landlord, the wisdom and success of such a tactic will be based more on economics and the willingness of the respective parties, than on legal rights. If the tenant is already in financial difficulty, a landlord may be willing to accept a fixed sum up front rather than risk the tenant’s later default. The tenant wants to save money on rent, and the landlord does not want to lose money on rent: Usually this provides the

basis for a discussion. But in most situations, where the tenant simply regrets the deal he made when the market was more competitive, the options for termination of the lease without a substantial payment to the landlord (who is holding a large security deposit) are minimal.

Because the legal terms and conditions of a commercial lease control most situations in the tenancy, a tenant or landlord faced with any of these issues should consult an attorney who understands the intricacies of commercial leases.

NEXT ISSUE: Commercial Unlawful Detainers: What happens when landlords want out of leases?

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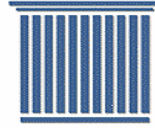
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