

How to Avoid (and Resolve) Landlord and Tenant Disputes

By

Bradley S. Fishman, Esq.



Brad Fishman received his BBA from Emory University and law degree from the University of Houston. As General Counsel with Caldwell Commercial, a Houston-based commercial real estate company, he supervises all Caldwell's legal functions and transaction-related legal requirements.

“Just read your lease.” By the time such words are spoken, it is probably too late to avoid a landlord/tenant dispute. Chances are a dispute already exists. However, careful planning prior to executing a lease can avoid many common pitfalls that routinely challenge both landlords and tenants. This article is intended to provide a guide to both parties in a commercial lease transaction on how to avoid such disputes. Since best laid plans are not infallible, this article will also address how to resolve disputes that do arise. Because the lease document could embody months of planning followed by years of governance, it is prudent for a party to minimize the potential for disputes every step of the way.

Risk-Reducing Strategies

There are a few basic risk-reduction strategies a party can employ prior to negotiating a lease. The simplest measure for either party to take is to engage an experienced real estate broker to represent his or her interest in the transaction. A seasoned broker can bring much to the table in the areas of market knowledge, relationships, practical industry recommendations, and even insights into a particular landlord or tenant's reputation. In addition, a tenant should analyze its fundamental business needs to identify which topics need to be addressed in the lease. For example, to avoid unwanted consequences, a tenant should consider such issues as signage requirements, scalability (i.e., the ability to expand or contract leased space), merger or acquisition strategy, the need for future credit facilities, fluctuating work force, parking requirements, excessive power consumption, and 24-7 access. Likewise, the landlord should be making his or her own similar inquiries about the tenant. Questions such as past financial performance, credit worthiness, business stability, and hazardous materials risk are all appropriate topics to consider and they all affect the drafting of the lease. By carefully examining such foreseeable factors, the parties can identify material issues that merit special attention during negotiations.

Rights and Obligations

The next and perhaps the most obvious opportunity to avoid a dispute, occurs during lease negotiations when the actual rights and obligations of the parties are being apportioned. Based on the analysis of the pre-leasing considerations, the parties can focus their efforts on crafting

acceptable lease parameters for identified concerns. One such noteworthy lease provision pertains to the transferability of a lease by the tenant. Generally, state law will govern the transferability of a lease when the lease is otherwise silent. In some jurisdictions, unless the lease expressly provides for the ability to assign or sublease, such action is not permitted. Therefore, a tenant should look carefully at the assignment provisions to make sure the limitations comport with expected business requirements.

Restrictions of Transfers of Property

In the broader context of a business merger or acquisition, restrictions on transfers in a commercial lease should not create an impediment for executing an overriding business plan. Therefore, in order to avoid unwittingly complicating a corporate reorganization, the tenant should preserve flexibility by negotiating broad transfer rights with respect to assignment and subletting. While it is customary for the landlord to place reasonable restrictions on such rights, the tenant should negotiate a pre-approved list of circumstances in which landlord consent is not required. Such permitted transfers will allow the tenant to carry out its business objectives and still preserve the landlord's economic interest. If necessary, the tenant may agree to impose a net worth qualifier on the transfer so that the landlord is in an equal financial position.

Expansion Rights

Likewise, a tenant's business strategy may dictate the need for more space or, conversely, a desire to contract its premises during the lease term. It is imperative for both parties to deal with the matter upfront and arrive at a solution before there is a situation of potential conflict. Expansion options, rights of first offer, and rights of first refusal are all useful tools that provide a tenant with flexibility to expand as business needs dictate. To avoid a dispute on the rental rate a tenant may pay if he or she requires additional space after the initial space lease, the parties should carefully define the future market rental rate and also provide a mechanism, such as the use of appraisers, to resolve a difference in opinion about future rates. Similarly, the right to relinquish space may be crucial to a tenant that operates on a project basis or relies on government contracts. In such case, the landlord needs to protect him or herself for un-recouped costs incurred in connection with the lease, such as commissions and tenant improvement allowances. One approach is for the tenant to offer to reimburse the landlord for any such unamortized costs as of the date of termination.

Calculations of Operating Expenses

One of the biggest areas of landlord/tenant conflict can be the calculation and assessment of operating expenses. A few simple steps can reduce the potential for disputes in this area. For a start, the tenant should research the building's historic operating expense levels. When using an expense stop, the tenant should request documentation of current operating expenses to determine the appropriateness of the proposed expense stop figure. Further, if the building is new construction, budgeted expenses can be nothing more than a ballpark estimate.

The tenant can protect him or herself from a landlord's good faith, but completely erroneous prediction of operating expenses by setting the cap at the greater of the proposed stop or first years' actual expenses. Also, the tenant should look carefully at the list of both included and excluded expense items. A tenant should be mindful to exclude expenses associated with the landlord's cost of doing business generally, as opposed to operating the subject building. Should a dispute arise about operating expenses, one useful tool to resolve a dispute is a lease audit. At first blush, the landlord may think that such scrutiny may lead to more conflict. However, experience suggests the contrary. Demanding the tenant pay a potentially large sum of money without the ability to verify the figures usually leads to more distrust and slower collection rates. Audit rights need to be negotiated prior to lease execution. Often these rights include a set

acceptable margin of error and recovery for the cost of the audit if the results fall outside such permissible range.

Understand the Rights and Obligations Stated in the Lease

Finally, there are opportunities to avoid and resolve disputes even after the lease is fully executed. Probably the most fundamental principle is often the most overlooked: Fully understand the rights and obligations contained in the lease. Disputes may arise because a party does not adequately comprehend the operation or applicability of a particular lease provision. This does not imply that either landlords or tenants are unsophisticated. It simply recognizes that certain lease provisions can be quite complex and combine both legal and commercial terms. By taking the time in advance to analyze the lease and truly understand the pertinent clause, a party demonstrates to the other side that it has carefully considered the matter at hand and has based its demand on sound principles.

Another basic approach to avoiding or resolving a landlord/tenant dispute is to recognize that the lease represents more than merely a contractual obligation. Execution of a lease signifies the beginning of a relationship. As with any relationship, there may be times of stress, but the desire to maintain an ongoing relationship between the parties may put events into a different perspective. Perhaps a small-ticket maintenance item rightfully is a tenant obligation under a strict reading of the lease, but it may also present an inexpensive opportunity for a landlord to foster a great deal of good will. Come renewal time, the tenant will reflect on the landlord/tenant relationship. Parties will tend to stay in a relationship that has been enjoyable for both sides. By avoiding or resolving disputes, the parties can maintain a healthy relationship that may prove mutually beneficial for years to come.