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COMMERCIAL TENANT AND LANDLORD ISSUES

GARY W. BARR
Stoll Keenon Ogden PLLC
Lexington, Kentucky

RICHARD A. NUNNELLEY
Stoll Keenon Ogden PLLC
Lexington, Kentucky

I. [20.1] Scope

This chapter examines basic concepts of commercial leasing under Kentucky law. Because the lease agreement in the commercial setting often exceeds the number of pages devoted to the subject in this chapter, the treatment of commercial leases in this chapter can by no means be considered exhaustive. In an effort to provide further assistance to the practitioner in the drafting and/or review of commercial leases, a checklist suggestive of miscellaneous matters to be considered is attached as Appendix A to this chapter. For more in depth research, a list of selected authorities is attached as Appendix B.

The text of this chapter is primarily devoted first to an examination of the nature of the relationship between the parties and the estate or interest created by a lease agreement, and next to an examination of some of the basic elements which are involved in most commercial leasing relationships. Some practical considerations are discussed separate and apart from controlling legal authorities.

Because commercial leases often run for a relatively long period of time and frequently involve real property of considerable value which is subject to substantial mortgages and frequent refinancing, attention is also devoted to estoppel, subordination, non-disturbance and attornment provisions of the commercial lease, all provisions which can become important in a commercial lease setting. Finally, miscellaneous lease provisions which are common to commercial lease agreements are briefly considered.

II. [20.2] Basic Concepts

A. [20.3] Nature of Relationship Between Landlord and Tenant

1. [20.4] The Lease

The landlord/tenant relationship is predominantly contractual in nature, with the lease agreement or contract delineating the rights and obligations of both parties. As stated in *Estes v. Gatliff*, 163 S.W.2d 273, 275 (Ky. 1942), "[t]he relation of land-lord [sic] and tenant does not depend upon the landlord's title but upon the agreement." Of course, the landlord must have sufficient title to support the interest leased, and the absence of sufficient title may well be a defense in any action brought by the landlord. *Id.* at 275. Despite a number of statutory provisions relating to the relationship of landlord and tenant (*see* Kentucky Revised Statutes ("KRS") Chapter 383), the inclusion of provisions in a lease varying from the statutory rules, which control when there is no express agreement, does not render the lease illegal. *Coldiron v. Good Coal Co.*, 125 S.W.2d 757, 761 (Ky. 1939).

2. [20.5] Intent of the Parties

Although the lease agreement is paramount, the intent of the parties and the actual circumstances and situation surrounding the use, rental, and possession of the property which is the subject of the lease are also of great significance in determining the parameters of the relationship. This concept is illustrated by the case of *Campbell v. Hensley*, 450 S.W.2d 501 (Ky. 1970). In *Campbell*, a tenant entered into a lease agreement for property upon which was located a service station with full knowledge of the existence of a prior lease agreement in favor of Texaco Oil Company. In response to the tenant's assertion that its lease was void because of the prior lease agreement, the court stated:

> A tenant who enters into a lease with full knowledge of the facts and is in full undisturbed possession of the premises at the time an action for unpaid rent is instituted and prosecuted may not assert want of title to the premises on the part of his landlord as a defense – whether the question of title is concerned with lack of the type of titular interest as would be represented in the execution and delivery of a prior lease for the same term on the same premises or otherwise.

Campbell, 450 S.W.2d at 504.

3. [20.6] Control and Possession

In addition to demonstrating the importance of intent and actual circumstances, *Campbell* further demonstrates the critical importance of control and possession of the premises in the landlord/tenant relationship. As stated in *Mercantile Realty Co. v. Allen Edmonds Shoe Corp.*, 92 S.W.2d 837, 839 (Ky. 1936), "[t]o constitute a tenancy of any kind, the tenant must acquire some definite control and possession of the premises."

B. [20.7] Nature of Estate of Interest Created

Although the relationship of landlord and tenant is founded in contract, a lease is more than an executory agreement. It is also a present conveyance or grant of an interest in real estate, less than a fee, with conditions attached. *Pikeville Oil & Tire Company v. Deavors*, 320 S.W.2d 782, 785 (Ky. 1959). The conveyance accomplished by a lease divests the owner for a given time of a certain estate in the land, leaving in the owner the right of reversion at the expiration of the grant. *Moore v. Brandenburg*, 28 S.W.2d 477, 478 (Ky. 1930). It is this right of reversion with whatever rights are attached to it, including the right to collect rents, which characterizes the landlord's interest. Conversely, it is the right to possession for the designated time period, with the conditions that are attached, that characterize the tenant's interest.

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Once the relationship of landlord and tenant has been validly created, *viz.* the leasehold estate has been conveyed to tenant,

> the lessee is as much the owner of the right of possession of the leased premises as the grantee in a deed is the owner of the freehold. If a landlord refuses to put his lessee in possession of the premises leased, an action for specific performance may be maintained.

Dan Cohen Realty Co. v. National Savings & Trust Co., 125 F.2d 288, 289 (6th Cir. 1942) (citing *Mattingly's Executor v. Brents*, 159 S.W. 1157, 1160 (Ky. 1913)).

C. [20.8] Essential Elements of Lease

A well drawn commercial lease will contain a vast array of contractual provisions addressing the many concerns which landlord and tenant may have in a complicated commercial setting. Nevertheless, the essential elements of a lease are really quite simple. As stated in *Moore*, "[i]n every lease there must be a lessor, a lessee, and a thing demised." *Moore*, 28 S.W.2d at 478. The court in *Walker v. Keith*, 382 S.W.2d 198 (Ky. 1964), would apparently add to this short list of essential elements the rental to be paid by the tenant. In *Walker*, the court stated that, "[n]othing could be more vital in a lease than the amount of rent." *Walker*, 382 S.W.2d at 202. More importantly, however, *Walker* appears to stand most strongly for the proposition that the provisions of a valid lease agreement, as with the provisions of other contracts, must not be so indefinite and uncertain that the parties cannot be held to have agreed upon the basic terms. *See also, Brooks v. Smith*, 269 S.W.2d 259, 260 (Ky. 1954) (finding that an agreement which on its face leaves some essential term to future negotiation is incapable of enforcement for want of certainty).

This discussion of essential elements assumes that there is in fact a written lease agreement, signed by the parties. KRS 371.010(6) requires that a lease of real property for a term of more than one (1) year be in writing to be enforceable.

Beyond the requirements of lessor, lessee, thing demised and rent, it appears that the essential elements of a lease agreement are simply those of any other valid and enforceable contract. *See, e.g., Dean v. Stillwell*, 145 S.W.2d 830, 832 (Ky. 1940) (discussing mutuality of contract).

III. [20.9] The Demised Premises

The demised premises or "thing demised" is the essential element of a lease which probably receives and deserves the most discussion, both by the terms of actual lease agreements and by commentary concerning the relationship

of landlord and tenant. It is the demised premises out of which and about which the entire relationship revolves.

A. [20.10] Parameters of Demised Premises

1. [20.11] Description of Premises

In order to have a valid and enforceable lease agreement, the parties must have a clear understanding of the demised premises which should be properly and adequately described. Although the cases concerning the description of the demised premises do not appear to require a great deal of specificity, it is clear from the cases that the description must be sufficient in order to demonstrate a meeting of the minds between landlord and tenant. *Cf. Brooks v. Smith*, 269 S.W.2d 259, 260 (Ky. 1954) (failure to agree on specifications of building to be constructed by landlord rendered lease incomplete and invalid); *Hall v. Baker*, 215 S.W.2d 945, 946-947 (Ky. 1948) ("three rooms on the upper side of East Main Street...as soon as Gene Baker Motor Company vacates" sufficient where both parties aware of the property where the "Gene Baker Motor Company" was located).

In addition to the demised premises described in the lease, appurtenances which belong to the demised premises and which are reasonably essential to their enjoyment pass as incident to them, unless specifically reserved. 51 CJS *Landlord & Tenant* § 293. *See also, Phelps v. Fitch* 255 S.W.2d 660, 661 (Ky. 1953) (holding that the lessee of a dominant estate is entitled to the use of easements legally appurtenant to the demised premises and reasonably necessary to their enjoyment). Despite this general rule, it is prudent to specifically designate as a part of the demised premises those appurtenances which the tenant is expecting to enjoy.

2. [20.12] Size and Location of Tenants

Not only is the description of the leased premises of considerable importance in a commercial lease, but in a multi-tenant development such as an office building or shopping center, the covenants in a lease regarding the size or location of other tenants may also be of considerable significance, as evidenced by *W. T. Grant Company v. Indiana Trail Trading Post, Inc.*, 423 S.W.2d 251 (Ky. 1968). In *W. T. Grant Company*, the site plan of a commercial shopping center which was attached to the W. T. Grant Company lease contained the dimensions and locations of future buildings, together with a covenant in the lease that all store premises in the shopping center would be constructed as shown on the exhibit. Under those circumstances, W. T. Grant Company was granted an injunction preventing F. W. Woolworth Company from occupying a large building that had been constructed for it on the site designated by the site plan on the W. T. Grant Company lease for a much smaller building. *Id.* at 255.

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3. [20.13] Metes and Bounds or Plat Descriptions

Although somewhat imprecise descriptions of the demised premises have been approved by Kentucky courts, a complete and accurate description of the demised premises together with any significant appurtenances is desirable in order to avoid disputes and uncertainty. If the premises constitute an entire tract or parcel, inclusion of a metes and bounds description or plat description is desirable and appropriate.

If the premises constitute only a portion of a structure, attachment of a plat or drawing with the demised premises clearly marked is suggested. However, in describing leased premises which constitute less than an entire tract or parcel, one must be aware of KRS 100.111(22), which defines a "subdivision" for purposes of the planning and zoning statute and states that a subdivision "means the division of a parcel of land...for the purpose, whether immediate or future, of sale, **lease**, or building development..." (emphasis added). Accordingly, to the extent that a lease of real property deals only with a portion of a greater tract in a city or county which has adopted planning and zoning regulations, a subdivision plat may be required in order to comply with statutory requirements.

4. [20.14] Expansion Areas

If a lease contains an option to expand the demised premises at any time during the term or any renewal, the expansion area should also be adequately described and the impact of such expansion should be evaluated as to potential conflicts with the rights of other tenants in a multi-tenant development. For example, to grant a tenant in a shopping center the right to expand its premises may violate the provisions of another tenant's lease as to the size of other buildings, as in *W. T. Grant Company*, 423 S.W.2d at 254-255, or the proposed expansion may impact required parking ratios as they relate to other leases or with local planning and zoning regulations. Such expansions in multi-tenant developments may also conflict with rights in common areas granted to other tenants. In any such multi-tenant development, all other leases must be carefully reviewed and analyzed.

B. [20.15] Care, Improvement, Repair and Replacement of Demised Premises and Condemnation

1. [20.16] Generally

It is suggested that all obligations for the care, improvement, repair and replacement of the demised premises be specifically allocated between landlord and tenant by the lease agreement. If the premises are to be accepted by tenant "as is," that fact should be so stated in order to avoid disputes.

2. [20.17] Alterations or Improvements

If the landlord is to construct additional improvements, plans and specifications should be incorporated into the lease by specific reference and the time for completion should be specifically agreed upon. If the tenant is to be permitted or required to construct additional improvements, consideration should be given to including provisions for requiring prior written approval of the plans and specifications by the landlord, an obligation upon the tenant to keep the premises free of liens and a corresponding default provision for any breach, and, in some cases, security to protect the landlord from default.

3. [20.18] Allowances for Improvements by Tenant

Frequently, the tenant will be provided a construction allowance to make improvements to the leasehold. Although the construction allowance to be given by the landlord to the tenant is often a critical part of a commercial lease negotiation, the tax consequences of such an allowance are generally not discussed by the parties and are frequently overlooked altogether. However, consideration of tax issues related to construction allowances has become a more prominent issue in light of treasury regulations which require that landlords and tenants provide specific information to the Internal Revenue Service ("IRS") about construction allowances. *See* Treas. Reg. § 1.110-1, 65 Fed. Reg. 53,584 (September 5, 2000). While an exhaustive discussion of the tax ramifications of construction allowances in commercial leases is beyond the scope of this chapter, some general information will be reviewed as a starting point for more detailed research and consideration by the practitioner.

In reviewing the tax consequences of construction allowances, two fundamental tax principles must be kept in mind. First, income received is taxable in the year it is received. Second, the owner of a leasehold improvement must depreciate the improvement ratably over 39 years (with limited exceptions). These fundamental principles create directly competing interests and objectives for landlords and tenants. Tenants want to avoid receipt of income equal to the construction allowance, and landlords desire to avoid having to depreciate the construction allowance over 39 years. Because of the directly competing interests, the maximum advantage is gained by each party if it can foist ownership of the improvements built with the allowance upon the other party. Ownership dictates who depreciates the improvements, the depreciation period, and whether the allowance constitutes income.

To clarify how to determine ownership from a tax perspective, the Taxpayer Relief Act of 1997 added a new Section 110 to the Internal Revenue Code. However, Section 110 applies only to a lease of retail space for a term of 15 years or less entered into after August 5, 1997, and then only if the construction allowance is expended for the construction of improvement of real property for use in the tenant's trade or business at the retail space. If the requirements of Section

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110 are satisfied, a safe harbor exists and the allowance or free rent to the tenant is not included in the tenant's income. If Section 110 does not apply, prior law continues to control.

Under the treasury regulations cited above, the rules of Section 110 apply to any "qualified lessee construction allowance," that is any amount received in cash (or treated as a rent reduction) by a tenant from a landlord under a "short-term lease" of "retail space," provided certain "purpose" and "expenditure" requirements are met. All of these elements must be satisfied in order for the safe harbor provision to apply. Section 110 contains legal definitions for these elements. The practitioner will wish to familiarize himself with Section 110 in order in order to determine if the safe harbor provision applies.

4. [20.19] Maintenance and Repair

Whether any additional improvements are to be erected by either party, the lease should allocate the responsibility for maintenance and repair of the demised premises. In multiple tenant structures, the landlord is most often contractually bound to maintain the roof, exterior walls and other structural components together with common areas. These obligations may also be imposed upon the landlord in a single-tenant structure.

The duty to restore or replace improvements on the demised premises which may be damaged by fire or other casualty should also be addressed. The duty to restore or replace by reason of casualty loss appears to be logically placed upon the party contractually bound to maintain casualty insurance, which obligation should also be clearly expressed.

5. [20.20] Improvement and Condemnation

The right or obligation of a tenant to remove improvements or, as is commonly provided, the right of the landlord to retain all improvements other than "trade fixtures" upon expiration of the term, should also be agreed upon. Further, the possibility of condemnation should be considered and its effect should be addressed, both as to the condemnation of a part of the demised premises and as to the whole.

6. [20.21] Allocation of Obligations in Absence of Lease Provision

In the absence of agreement as to the matters set forth above, the following legal principles apply:

a. The tenant takes possession of the demised premises as he finds them, and the landlord, absent an express covenant to the contrary, has no obligation to make repairs. *Miles v. Shauntee*, 664 S.W.2d 512, 518 (Ky. 1983); *Milby v. Mears*, 580 S.W.2d 724, 728 (Ky. Ct. App. 1979); *Lambert v. Franklin Real Estate Co.*, 37 S.W.3d 770, 775 (Ky. Ct.

App. 2000). This general rule is subject to some exceptions, however, such as the obligation imposed upon the landlord for defective or dangerous conditions which are not discoverable by the tenant by ordinary care where the landlord conceals or fails to disclose the dangerous condition (*Lambert*, 37 S.W.3d at 775-776); *Milby*, 580 S.W.2d at 728; *Carver v. Howard*, 280 S.W.2d 708, 711 (Ky. 1955); *Holzhauer v. Sheeny*, 104 S.W. 1034, 1035 (Ky. 1907)) and the obligation imposed upon the landlord for that portion of the demised premises retained by the landlord for the common use and benefit of a number of tenants. *Mackey v. Allen*, 396 S.W.2d 55, 59 (Ky. 1965); *Carver*, 280 S.W.2d at 711;

b. The law imposes a duty upon the tenant to take ordinary care of the demised premises. *Home Insurance Company v. Hamilton*, 395 F.2d 108, 109 (6th Cir. 1968);

c. The landlord is not required to rebuild the demised premises upon substantial destruction by fire, unless he is obligated to do so by the terms of the lease, even if the lease requires landlord to keep the demised premises insured against such loss. *Morris v. Durham*, 443 S.W.2d 642, 643 (Ky. 1969). Further, pursuant to KRS 383.170, a tenant is not required by a provision in the lease which requires him to repair or leave the premises in repair to erect a similar building if, without the tenant's fault or neglect, the building is destroyed by fire or other casualty, nor is the tenant required to continue payment of rent for the remainder of the term if the building is so destroyed, unless provisions to the contrary are expressly set forth in the lease;

d. If the lease requires the landlord to insure against fire, such a provision is apparently sufficient to evidence an intent that the risk of loss by fire is solely upon the landlord, even if the tenant's negligence causes the fire. *Diocese of Covington v. Christian Appalachian Project*, 787 S.W.2d 704, 704-705 (Ky. Ct. App. 1990); *Liberty Mutual Fire Insurance Company v. Jefferson Family Fair, Inc.*, 521 S.W.2d 244, 245 (Ky. 1975). However, in the absence of such a provision in the lease, the risk of loss by reason of a fire caused by the tenant's negligence is upon the tenant, even where the lease provides that, "[i]n the event the leased premises are destroyed by fire...the Lessee may surrender this lease without further obligation and this lease shall be cancelled." *Britton v. Wooten*, 817 S.W.2d 443, 445-447 (Ky. 1991);

e. The intention of the parties controls the ultimate disposition of improvements erected or installed by a tenant, and

in the absence of anything appearing to the contrary, the presumption is in favor of the right of the tenant to remove from the leased premises upon expiration of the term the improvements which the tenant erected for business purposes. *Ratliff v. Utilities Elkhorn Coal Co.*, 186 S.W.2d 415, 416 (Ky. 1945). On the other hand, a tenant cannot recover from the landlord the value of improvements and repairs on the leased premises which are left by the tenant except in accordance with an express agreement to that effect. *Kessler v. Grasser*, 187 S.W.2d 1012, 1012 (Ky. 1945); and

f. The tenant is entitled to that portion of the award granted in a condemnation proceeding which corresponds to the fair market value of the leasehold, ascertained by simply subtracting the fair market value of the land as a whole if sold subject to the lease, from the fair market value of the land as a whole if sold free and clear of the lease. *Commonwealth, Department of Highways v. Sherrod*, 367 S.W.2d 844, 850 (Ky. 1963).

C. [20.22] Use of Demised Premises

Lease provisions permitting or restricting the use of the demised premises must be carefully drafted and may become troublesome or unmanageable in a multiple tenant development if sufficient attention is not given to such provisions as set forth in *all* of the relevant leases. In the absence of contrary provisions in the lease agreement, under Kentucky case law:

1. There is no implied covenant not to injure the landlord's business (or that of third parties) by refraining from competition with such parties. In *Saad v. Hatfield*, 80 S.W.2d 583, 584 (Ky. 1935), the court stated that: "Ordinarily, the dominion of the tenant is as absolute during the demised term as that of the owner previous to the demise, and he may make the same use of the premises as the owner";
2. A provision in a lease authorizing the use of the demised premises for a particular purpose is generally "permissive," instead of "restrictive," and does not limit or impliedly forbid their use for similar or related purposes. *Otting v. Gradsky*, 172 S.W.2d 554, 556 (Ky. 1943);
3. Restrictive covenants in a lease are strictly construed and will not be extended beyond literal requirements of a reasonable interpretation of the terms employed. *Grassham v. Robertson*, 126 S.W.2d 1063, 1064 (Ky. 1939); *Otting*, 172 S.W.2d at 556; and

4. A covenant or agreement by the landlord not to lease retained property for the purpose of conducting any business in competition with the tenant must be positively expressed (*Keyes v. Carrick*, 268 S.W.2d 397, 402 (Ky. 1954)), and if so expressed such restriction shall be binding upon the landlord and upon any subsequent tenants with actual knowledge of such restriction. *Buckaway v. J-Town Center, Inc.*, 475 S.W.2d 642, 645. (Ky. 1972).

D. [20.23] Suggested Lease Provisions Regarding Use of Demised Premises

Given the foregoing principles, it is evident that the granting by the landlord, in a multiple tenant development, of a single right to an exclusive use by an individual tenant or the entering into of a single covenant not to permit certain uses by other tenants, has a direct impact on all past and future leasing of the development in question. Accordingly, if any exclusive rights or specific limitations are contemplated in a multi-tenant development, it is suggested that the following points be considered for inclusion in drafting each lease:

A. The inclusion of a specific statement as to the use for which the premises are to be leased by the tenant;

B. The inclusion of an express covenant by the tenant that the premises be used *only* for the permitted use and no other purpose;

C. The avoidance of any covenant by the landlord that other portions of the development will not be used for any purpose in competition with the tenant; and

D. If major tenants (*i.e.*, those with substantial economic clout), are able to insist upon and obtain exclusive use covenants, make certain that (i) the definition of competing business or exclusive use is written so as not to encompass the business activities of other smaller tenants such as specialty stores or restaurants, and (ii) all other leases either specifically acknowledge the exclusive rights granted or limit the use of the demised premises thereunder to uses not in conflict with the exclusive rights granted.

E. [20.24] Checklist for Lease Review Regarding Use of Demised Premises

In reviewing an existing set of commercial leases for a multi-tenant development, whether for a current owner in connection with drafting a new lease or for a prospective purchaser or lender, it is useful to make a checklist and ask the following questions, among others, as to each lease:

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(ii) If so, does the use to which the premises are restricted violate any exclusive rights which have been granted to another tenant?

(iii) If not, are exclusive rights which have been granted to other tenants expressly recognized?

(iv) Does the lease restrict the use of other portions of the development?

(v) Do all other leases conform to the restrictions imposed by the subject lease?

IV. [20.25] Rent and Additional Rent

The basic rental provisions of a lease are generally very simply, clearly, and specifically expressed. Provisions for percentage rent, rent during renewal periods, additional rent in the form of common area maintenance ("CAM") or operating costs, taxes, insurance, etc., may become substantially more complicated.

A. [20.26] Basic Legal Concepts

1. [20.27] Requirement of Definiteness

As stated in *Walker v. Keith*, 382 S.W.2d 198, 202 (Ky. 1964), the stipulated rental is the essence of the lease agreement. In order to create an enforceable lease agreement, the rental to be paid must be sufficiently specific or capable of determination in order to provide "an adequate key to a mutual agreement." *Id.* at 203. In *Walker*, the rental during the renewal term was to be fixed by agreement of the lessor and lessee based upon "comparative basis of rental values as of the date of the renewal with rental values at this time reflected by the comparative business conditions of the two periods." In finding that the lessee's option to extend was illusory by reason of failing to specify either an agreed rental or an agreed method by which it could be fixed with certainty, the court noted two aspects of the lease agreement which prevented the renewal option from becoming a binding contract. The court noted that "it should be obvious that an agreement to agree cannot constitute a binding contract." *Id.* at 201. Further, the standard of "comparative business conditions" was found to be lacking in the required substantial certainty as to the material terms upon which the minds of the parties have met. Lacking such "substantial certainty" the court refused to actually fix the rent for the parties.

2. [20.28] Calculation by Reference to Extrinsic Matters

Although an "adequate key to a mutual agreement" is required, the law does not require that a specific dollar amount be fixed by the lease agreement nor

does the rental amount have to be determinable as of the date of executing the lease agreement. For example, the rental may be determined by the amount of income derived from the premises. *Jackson v. Pepper Gasoline Co.*, 133 S.W.2d 91, 93 (Ky. 1939). In *Jackson*, the rent was to be determined by an amount equal to one cent per gallon for each gallon of gasoline delivered to the service station which was the subject of the lease. In upholding the lease, the court held that "...the lease sufficiently specifies the rent to be paid, and prescribes a proper measure for definitely determining its amount." *Id.* Also, it should be noted that a provision for referring the determination of rent to a panel of arbitrators has been approved by the courts of Kentucky. *Ehlenberger v. Dalbey,* 234 S.W.2d 735, 737 (Ky. 1950).

3. [20.29] Rent as Covenant Running with Premises

Assuming the stipulated rental is stated with the required "substantial certainty," the obligation to pay the specified rental is a covenant which runs with the land, which inures to the benefit of the lessor, and its assigns, and binds the lessee, and its assigns. *Webber v. C & C Dry Goods Co.*, 69 S.W.2d 731, 735 (Ky. 1934); *Motch's Administrator v. Portner*, 34 S.W.2d 744, 745 (Ky. 1931). *See also*, KRS 383.010(2) (stating that if an owner or holder alienates or assigns his estate, the alienee or assignee may recover the rent that falls due thereafter). In *Motch's Administrator*, the court further specifically held that the assignment of a lease by the lessee "...does not relieve the lessee from his covenant to pay rent, even though rent be accepted from the assignee." In order to relieve a tenant from further liability to pay upon an assignment of its interest in the lease, the acceptance of the surrender of the demised premises by the landlord "...must be evidenced by an express agreement or an unequivocal act" on the part of the landlord. *Motch's Administrator*, 34 S.W.2d at 745.

4. [20.30] Waiver or Modification of Rent

Even though fixed by the terms of the lease, the amount of rental due to the landlord may be waived or modified by the landlord's acceptance of a reduced amount. *See Venters v. Reynolds*, 354 S.W.2d 521, 524 (Ky. 1961) (finding that landlord who accepted rent from lessees with knowledge that sublease covenant had been violated constituted waiver of the landlord's right to forfeit); *Ma-Beha Co., Inc. v. Acme Realty Co., Inc.*, 150 S.W.2d 1, 3 (Ky. 1941) (holding that a landlord who had accepted payment of rent at a reduced rate, thereby waiving the right to demand amount stipulated in original lease, could not argue that because of want of consideration, payment of a debtor and receipt by a creditor of a part of a liquidated demand is not satisfaction of the whole although the landlord agrees to accept it as such).

5. [20.31] Relief from Obligation to Pay Rent

The agreed rental or other obligations to be performed by the tenant will not be excused simply because the lease has become onerous or unprofitable. *Fra-*

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zier v. Collins, 187 S.W.2d 816, 817-818 (Ky. 1945). The obligor will be excused, however, where a governmental act makes unlawful the obligation assumed, prohibits its performance, or otherwise renders performance impossible. *Id.* at 818.

B. [20.32] Increased or Additional Rents

1. [20.33] Generally

Lease agreements often provide for periodic increases and/or for additional sums to be paid by the tenant in addition to the base rent. Increased rent and additional rent would appear to be subject to the same legal requirements as basic rent as set forth in the preceding section. However, due to the tremendous variations in the methods for determining increased or additional rent, a review of some of the more common methods may be helpful.

2. [20.34] Common Methods of Providing for Rent Increases

Common methods for providing for increases in base rent include predetermined step-ups in rent, indexed rent, and increases determined by appraisal. For stepped-up rent, rent is simply graduated periodically over the lease term in predetermined amounts. For indexed rent, the base rent fluctuates (or only increases) as a function of an external standard or index. A common index is the Consumer Price Index ("CPI"), although other indexes may be used. When using CPI for adjustments in the rental payment, it is important to specify which index is to be used, *e.g.*, the index for "Urban Wage Earners" or the one for "All Urban Consumers." One must also designate whether the nationwide index or that for a specific major urban area is to be used. For increases based on appraisal, the method of appraisal and the method for selecting appraisers must be carefully drafted. The major shortcomings of determining increases based upon appraisal would appear to be the expense and the amount of time required.

3. [20.35] Percentage Rent

In certain commercial leases such as those involving shopping centers, base rent or additional rent is frequently determined by a percentage of sales. By this method, the landlord shares in the success and fruits of the tenant's labors. Percentage rent is generally based on a specified percentage of the tenant's "gross sales" and is often calculated only on the percentage of "gross sales" in excess of a designated base dollar amount. Key elements in any formula for determining percentage rent payments are:

(i) The percentage of gross sales to which landlord is entitled;

(ii) The definition of gross sales;

(iii) The base amount of gross sales, if any, which must be reached before percentage rent is payable;

(iv) The installment provisions designating when percentage rent payments are to be calculated and made; and

(v) The record keeping system for receipts.

In a United States District Court case in the Eastern District of Kentucky, a lease providing for percentage rent was construed to imply a covenant of continuous operation. *See Lagrew v. Hooks-SuperX, Inc.*, 905 F. Supp. 401, 405-406 (E.D. Ky. 1995).

a. [20.36] Landlord's Desired Inclusions

In defining gross sales for purposes of percentage rent, a landlord will want to clearly include the selling price of all goods and services sold from the premises regardless of by whom made, whether the tenant, sublessee, concessionaire, from vending machines, etc., and may further wish to include items leased, licensed, or delivered from the premises; credit and lay-a-way sales; and revenues from orders taken on the premises although filled elsewhere. From the landlord's standpoint, it is difficult to define "gross sales" broadly enough and the term "gross income" may more accurately reflect the landlord's intention.

b. [20.37] Tenant's Desired Exclusions

The tenant will normally insist that a number of items be excluded from the gross sales, including, but not limited to, the following: the selling price of merchandise which has been returned and accepted for a full credit or allowances; cash refunds in the ordinary course of business; discounts paid to the issuers of credit cards; sales and use taxes or gross receipt taxes and other similar taxes imposed upon the sale of the merchandise or services; sales of fixtures; deductions for bad debts; and accommodation transfers of goods to other locations.

These suggestions as to possible exclusions and/or inclusions in "gross sales" are by no means exhaustive and are meant to be suggestive only.

4. [20.38] Landlord's Costs as Additional Rent

Certain of landlord's costs in connection with the ownership of the demised premises are frequently passed along to tenants in the form of "additional rents." Items most frequently included as additional rent are common area maintenance charges, property taxes, insurance, and utilities (to the extent not metered separately to and paid directly by tenant). Commercial leases which provide for the tenant to pay all expenses of landlord for maintenance, taxes and insurance are often referred to as "net" or "triple net" leases. In a properly drafted lease, failure to pay additional rentals when due will have the same effect (*i.e.,* default consequences) as a failure to pay base or percentage rents.

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a. [20.39] Allocation of Costs Between Multiple Tenants

In a multiple tenant development, each tenant's share of the expenses, which are the basis for additional rent, is most often expressed as a fraction of the landlord's actual cost for the expenses in question, the numerator of which is the square footage in the tenant's premises and the denominator of which is the total number of leasable square feet in the building or project of which the demised premises are a part. Tenants must beware of provisions which base calculations of proportionate share on the total number of leased or occupied square feet in the project. Such provisions would enable the landlord to pass through the expenses for unleased space to the actual tenants in place. However, it is not uncommon for commercial leases to contain "gross up" provisions which permit the landlord to calculate the landlord's expenses as if the building or development were occupied to a specified level, (*e.g.*, ninety percent (90%) occupied), for purposes of determining the amount of expenses to be charged to a tenant.

b. [20.40] Suggested Lease Provisions Regarding Additional Rent

In drafting additional rent provisions based upon a tenant's proportionate share of space, several items should be considered and clearly expressed, for example:

(i) The method for determining square footage of the leased premises and for the remaining property;

(ii) The method to be employed in calculating the tenant's proportionate share;

(iii) If the tenant is to be responsible only for the increased cost of certain items such as taxes or insurance, the base amount or base year for which the tenant is not to be charged;

(iv) The definition of the items to be included in additional rent; and

(v) Provisions for verification of the amounts and payment of the additional rents.

c. [20.41] Common Area Maintenance

Significant challenges in drafting additional rent provisions for CAM are providing the proper definitions for "common areas" and for the costs of the landlord which are to be included (or, from the standpoint of the tenant, excluded).

"Common area" definitions frequently include hallways, stairways, elevators, lobbies, enclosed mall areas, landscaped areas, sidewalks, parking lots, and even wiring, plumbing, heating and air conditioning equipment. Some landlords may even seek to include roofs and structural components such as walls and foundations. Common area "expense" definitions frequently include all costs and expenses

of the landlord with respect to the operation, cleaning, repair, management, security and maintenance of the common areas of the building or project. The definition may further include all labor, costs, materials and supplies, replacement costs of worn out or obsolete tools and equipment, repair and maintenance of building systems, professional and management fees, janitorial services, and utility charges to the extent not otherwise provided for by the lease.

Some items which a tenant may seek to have excluded from common area "expenses" are costs of correcting initial construction defects, costs of repairs caused by the landlord's negligence, salaries of employees above the grade of building manager, advertising, brokerage fees, legal fees for leasing and enforcement, cost of any item reimbursed by insurance, management fees in excess of those agreed upon, and capital expenditures.

d. [20.42] "Net Lease" Provisions

In a "net" or "triple net" lease, the landlord typically seeks to impose upon the tenant the responsibility to pay all taxes, insurance, and other expenses associated with the operation, maintenance, or repair of the demised premises, irrespective of whether expressly covered by the lease agreement, to the end that the rentals shall be "absolutely net" to the landlord. Such "net lease" provisions are frequently used in connection with ground leases where the tenant is the sole occupant of the entire property to be leased. However, few leases are truly "net" to the landlord and the tenant may seek to add the words "except as otherwise set out in the lease" to any sweeping net lease provision. Further, a tenant may wish to specifically exclude certain matters from net lease provisions, for example:

(i) Income, inheritance, estate or other taxes personal to the landlord;

(ii) Any carrying charges relating to the financing of the leased premises;

(iii) Repairs due to faulty construction, improper materials or poor workmanship to the extent any improvements were erected by the landlord;

(iv) Any costs arising out of any act, omission, or fault of landlord; and

(v) Any capital expenditures which are not specifically contemplated to be the obligation of the tenant.

V. [20.43] Lease Term

The term of the lease, as well as any options to extend the term, are of vital legal and economic consequences to both landlord and tenant. The agreed

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upon rental, coupled with the term of the lease, constitute two factors of primary importance to both lenders and purchasers in determining the value of the landlord's interest in the property.

A. [20.44] Basic Legal Concepts

1. [20.45] In Absence of Lease Term

In the absence of specific provisions as to the term of the lease, the presumption is that the tenancy is one at sufferance or at will. *Krisch v. Wolfson*, 234 S.W.2d 966, 969 (Ky. 1950). KRS 383.140, which was repealed in 1974, provided that, "[a] tenancy at will or by sufferance may be terminated by the landlord giving one (1) month's notice, in writing, to the tenant requiring him to remove." KRS 383.195, enacted in 1984, provides that, "[i]n those jurisdictions where the Uniform Residential Landlord and Tenant Act is not in effect, a tenancy at will or by sufferance may be terminated by the landlord giving one (1) month's notice, in writing, to the tenant requiring him to remove." Of course, the Uniform Residential Landlord and Tenant Act by its terms applies only to residential lease agreements. Nevertheless, it would appear that leases of commercial property which are deemed to be at will or by sufferance should still be terminable by the giving of not less than one (1) month's notice, in writing, unless otherwise provided by the terms of the lease agreement. *See, e.g.*, *Morgan v. Morgan*, 218 S.W.2d 410, 412 (Ky. 1949) (finding that where lease provided for termination on sixty (60) days notice but did not fix an expiration date, the lease was a tenancy at will and could be terminated on sixty (60) days notice).

2. [20.46] By Reference to Stated Event

Although it is generally desirable that the lease term be fixed in terms of a specified length of time by reference to stated dates, there appears to be no reason why the lease term may not be fixed by reference to some other event. *See Hite v. Carmon*, 486 S.W.2d 715 (Ky. 1972). In finding that the lease under consideration in *Hite* was limited to a period measured by the commercial activity of the lessee on the property, however, the court emphasized the extent to which perpetual leases are disfavored and the extent to which the courts will search for some indication of an intent of the parties not to create a lease in perpetuity. The court stated:

> The law does not favor perpetual leases. The mere use in the original lease of the words "from year to year," "yearly," or words of substantially the same meaning, does not, in and of itself, obligate the lessor to renew the lease perpetually, particularly where such provision is considered together with others tending to show that such was not the intention of the parties.

Id. at 717.

The Kentucky Court of Appeals reaffirmed that perpetual leases are disfavored in *Farris v. Laurel Explosives, Inc.*, 797 S.W.2d 487, 489-490 (Ky. Ct. App. 1990). In that case, the lease provided for successive three (3) year renewal options upon the same terms, except that rent increased to 110% of that in effect during the preceding term "until $5,000.00 per year is reached, and then remain constant." In finding the lease term not to be perpetual, the court stated: "The lease does not utilize such terminology as 'perpetual lease,' 'perpetual successive renewals' or 'forever' which is more descriptive of the actual legal significance imposed, and which may place an ordinary person on notice." *Id.* at 490.

3. [20.47] Holding Over; Implied Extension

If, following expiration of the term, a tenant under a lease for a term of a year or more remains in possession of the leased premises for more than ninety (90) days in the absence of an express contract, without proceedings for possession having been instituted by landlord, the lease is deemed extended for a period of one (1) year pursuant to KRS 383.160. At the end of that year, if the tenant does not abandon the premises, he shall stand in the same relation to his landlord as at the expiration of the lease term, and "...so from year to year, until he abandons the premises, is turned out of possession, or makes a new contract." KRS 383.160(1); *see also, Masterson v. DeHart Paint and Varnish Co.*, 843 S.W.2d 332, 334 (Ky. 1992) (holding that KRS 383.160(1) created a one-year tenancy between parties to a commercial lease, even though the lease provided for successive two-year extension options and tenant had not extended lease under its terms through required written notice). Pursuant to KRS 383.160(2), a similar rule applies to leases for a term of less than one (1) year, except that if no action is brought within thirty (30) days, no proceedings shall be instituted until the expiration of sixty (60) days. Where a lease is extended by operation of law pursuant to KRS 383.160, it is presumed that the terms of the original lease are carried over. *Cass v. Home Tobacco Warehouse Co.*, 223 S.W.2d 569, 571 (Ky. 1949).

4. [20.48] Renewal or Extension Options

Many leases provide options for renewal or extension terms following the expiration of the initial lease term. The provisions of renewal or extension options must be strictly complied with (*i.e.*, any notice required must be given at the time and in the manner specified). *Deane v. Mitchell*, 227 S.W.2d 893, 894 (Ky. 1950). Time is of the essence under the lease agreement both with respect to exercises of renewal or extension options and with respect to any options given to purchase the demised premises. *See Good v. Evans*, 178 S.W.2d 600, 601 (Ky. 1944) (holding that lessee who did not attempt to exercise option to purchase land at end of lease term until several months after expiration of the term lost the right); *Rounds v. Owensboro Ferry Co.*, 69 S.W.2d 350, 355-356 (Ky. 1934) (finding that equitable rule that time is not necessarily of the essence does not include contracts creating options to lease property). As noted above, the law does not favor per-

petual leases and accordingly the terms of all renewal or extension options should be clearly expressed.

a. [20.49] Renewals Versus Extensions

There is a technical legal distinction between the terms "renew" and "extend." The term "renew" has the connotation of requiring a new formal agreement or other positive act in order to effectuate the renewal. However, the courts of Kentucky have held that the word "renew" will not be given its strict legal interpretation unless it is evident from the terms of the lease or the conduct of the parties that the word was not used as a synonym for the word "extend." *Lexington Flying Service, Inc. v. Anderson's Ex'r.*, 239 S.W.2d 945, 947 (Ky. 1951).

b. [20.50] Lease Terms During Extension Periods

In the absence of a clearly expressed intention of the parties to modify the terms of the lease during a renewal or extension option period, it appears that the terms and conditions applicable to the renewal or extension period are the same as those applicable to the original lease term. *Id.* However, where continued occupancy of the leased premises upon expiration of the lease term is accomplished by the execution and delivery of a new lease agreement, the terms set forth in the new agreement are controlling and the parties will not be bound by any terms or waivers of terms in connection with the original lease. *McHugh v. Knippert*, 243 S.W.2d 654, 656 (Ky. 1951).

c. [20.51] Invocation of Extensions

If the lease agreement does not require any specific act or notice in order to exercise a renewal or extension privilege, the continued occupancy of the premises and payment of the required rent by the tenant is sufficient to invoke the option and bind the tenant for the renewal or extension term. *Weber v. C & C Dry Goods Co.*, 69 S.W.2d 731, 734 (Ky. 1934); *Cain v. Lawrence Drug Co.*, 29 S.W.2d 550, 552 (Ky. 1930). However, where specific actions to invoke the renewal or extension option are required, the continued possession of the premises by the tenant and the acceptance by the landlord of the rental will not necessarily be deemed to constitute an effective extension of the lease for the full renewal term. *Electronic Sales Engineers, Inc. v. Urban Renewal and Community Development Agency of Paducah*, 477 S.W.2d 814, 816 (Ky. 1972); *Cass*, 223 S.W.2d at 98-99. Where specific action which is required for extension is not taken, KRS 383.160 is applicable. *See* Section [20.47], *supra*; *Masterson v. DeHart Paint & Varnish Co.*, 843 S.W.2d 332, 334 (Ky. 1992) (holding that KRS 383.160 created a one-year tenancy between the parties to a commercial lease where the tenant had not extended the lease under the lease terms through the required written notice).

B. [20.52] Practice Considerations

In drafting or reviewing the commercial lease, several practical matters should be considered in connection with the lease term and any renewal or extension options. In many cases, the commencement date under a commercial lease will be a date other than the date upon which the lease is executed, *e.g.*, upon completion of leasehold improvements by the landlord. In such cases, an objective standard for determining the commencement date is appropriate. Two possible standards are (1) substantial completion of the improvements in accordance with the plans and specifications as evidenced by the certificate of a designated architect or (2) the issuance of a certificate of occupancy by appropriate governmental authorities. If the commencement date is to be established upon completion of improvements or the satisfaction of some other condition precedent, an outside date for commencement and the effect of the failure of the parties to comply with the conditions precedent should be specifically addressed. Further, some mechanism for documenting the commencement date is strongly suggested, such as the execution of a certificate of commencement date which should be attached as a supplement to the lease.

With respect to renewal or extension options, a clear expression as to the number and duration of permissible extension periods should be included. The means for exercising renewal or extension options should be set forth whether automatic, after notice or upon execution of a new lease agreement, and if notice is required, the time and manner for giving notice should be clearly stated. The lease agreement should provide for any modification of terms which will be effective during the renewal period, such as increased rents or other changes. Further, a tenant's right to renew will often be specifically conditioned upon the absence of any existing default by the tenant.

VI. [20.53] Default Provisions

So long as both landlord and tenant perform their respective obligations under the lease agreement, default provisions are generally of little concern. However, upon any failure of one of the parties to perform as agreed, the default provisions become matters of considerable consequence and concern to the parties.

A. [20.54] Basic Legal Concepts

1. [20.55] Forfeiture or Right of Reentry

A provision in a lease agreement providing for forfeiture or right to reenter upon non-payment of rent or default in the performance of other portions of the agreement is valid and enforceable. *Stoll Oil Refining Co. v. Pierce*, 337 S.W.2d 263, 264 (Ky. 1960); *Dean v. Stillwell*, 145 S.W.2d 830, 832 (Ky. 1940). In fact, it

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appears that a landlord may not recover possession of the premises upon violation of lease provisions unless the lease agreement contains a forfeiture or right of reentry clause, even though the landlord may have a valid claim for past due rentals or the performance of other obligations by the tenant. *Adams v. Shoopman*, 316 S.W.2d 840 (Ky. 1958); *Estes v. Gatliff*, 163 S.W.2d 273, 276 (Ky. 1942); *Morgan v. Chamberlain*, 160 S.W. 1066, 1067 (Ky. 1913).

2. [20.56] General Disfavor of Forfeitures

Despite the general rule that forfeiture provisions are enforceable, courts do not favor forfeitures, and such language will be interpreted against the one claiming the forfeiture. *Hogg v. Forsythe*, 248 S.W. 1008, 1011 (Ky. 1923). A forfeiture will not be declared except under the strict and literal terms of the lease. *Id.* It will not be decreed when upon equitable principles it works an injustice. *Roberts v. Babb*, 137 S.W.2d 1112, 1116 (Ky. 1940). Kentucky courts have also declined to decree termination of a lease where to do so would harm the tenant without benefit to the landlord. *Crawford v. Braden*, 112 S.W.2d 673, 674 (Ky. 1938).

3. [20.57] Enforcement of Forfeiture Provisions

Absent circumstances justifying relief, courts do not alter contracts entered into by the parties freely and knowingly, even when forfeiture provisions are harsh. *Miller Dairy Products v. Puryear*, 310 S.W.2d 518, 521 (Ky. 1957); *see also, Orion Investments, LLC v. McBride & Son Homes Land Development*, No. 3:06-CV-657-R, 2009 U.S. Dist. LEXIS (W.D. Ky. Aug. 27, 2009) (quoting *Miller* for the proposition that "[i]n tha absence of circumstances justifying relief, courts do not make contracts different from those that the parties make for themselves, even when the forfeiture provisions are harsh"). For example, equity will not relieve against a forfeiture on account of non-payment of rent where circumstances do not justify the intervention. *Blue Ridge Coal Co. v. Hurst*, 244 S.W. 892, 893 (Ky. 1922); *Wender Blue Gem Coal Co. v. Louisville Property Co.*, 125 S.W. 732 (Ky. 1910). Nor will a court of equity allow a tenant to place the landlord in a position of peril and then prevent the landlord from declaring a forfeiture for noncompliance with the lease. *Schwartz Amusement Co. v. Independent Order of Odd Fellows*, 128 S.W.2d 965, 969 (Ky. 1939).

4. [20.58] Equitable Estoppel

A landlord will be equitably estopped from enforcing a forfeiture if he, by words or conduct, leads his tenant to believe he will not enforce the forfeiture provided in the lease. *Specht v. Stoker*, 237 S.W.2d 78, 79 (Ky. 1951); *Hogg*, 248 S.W. at 1011; *Sale v. Smith & Nixon Co.*, 143 S.W. 737, 739 (Ky. 1912).

5. [20.59] Waiver of Rights

Whether acceptance of rental payments will constitute a waiver by the landlord of the right to declare a forfeiture is dependent on the surrounding circumstances. It has been held that it will act as a waiver where the breach is non-payment of the rent (*Bridges v. Jeffrey*, 437 S.W.2d 732, 733 (Ky. 1968); *Rich v. Rose*, 99 S.W. 953, 955 (Ky. 1907)), unless the rent accepted accrued prior to the effective date of the forfeiture. *Sherill v. Harlan Theater Co., Inc.*, 75 S.W.2d 775, 778 (Ky. 1934). *See also, Schwartz Amusement Co.*, 128 S.W.2d at 739 (acceptance of past due rental was coupled with unequivocal statement that lease had been cancelled).

Courts have also held that acceptance of rent with knowledge that a lease covenant against subleasing has been violated will operate as a waiver of the lessor's right of forfeiture by reason of the subletting. *Venters v. Reynolds*, 354 S.W.2d 521, 524 (Ky. 1961); *Citizens Fidelity Bank & Trust Co. v. Norfleet*, 252 S.W.2d 54, 55 (Ky. 1952). An exception appears to arise when the acceptance is conditional and the lessor has no knowledge of the terms of the sublease. *Miller v. Tutt*, 264 S.W.2d 649, 651 (Ky. 1954). Further, it has been stated that the acceptance of rent by the landlord is not a waiver of the right to declare a forfeiture where the default is a continuing one, such as a failure to make repairs, the commission of waste, or the maintaining of a nuisance. *Sherill*, 75 S.W.2d at 777.

6. [20.60] Forfeiture Provisions Not Reciprocal

A provision for forfeiture upon non-payment of rent will not authorize the tenant to terminate the lease by non-payment without incurring liability. *Moore v. Rogers*, 43 S.W.2d 31, 32 (Ky. 1931). This premise can apparently be extended to a blanket statement that provisions under a lease for a specific term giving a landlord rights to terminate a lease do not apply reciprocally to the lessee. *Southeastern Land Co. v. Clem*, 39 S.W.2d 674, 675 (Ky. 1931).

7. [20.61] Violation of Subleasing or Assignment Provision

In addition to non-payment of rent, there are many forfeiture cases which involve subleasing or assignment where the tenant has not obtained the landlord's permission as required by the lease agreement. Forfeiture provisions under these circumstances are also valid, and a tenant ordinarily will not have a valid complaint based on the landlord's refusal to give permission. *Hill v. Rudd*, 35 S.W. 270, 271 (Ky. 1896). Assignment or subleasing of a lease in violation of a covenant does not automatically terminate the lease, but gives the landlord the option to terminate (provided that the lease agreement specifically authorizes such a remedy) or to waive the option and continue the leasehold. *Setzer's Steel Systems, Inc. v. Chenault Development Corp.*, 725 S.W.2d 22, 24 (Ky. Ct. App. 1987); *Cities Service Oil Co. v. Taylor*, 45 S.W.2d 1039, 1041 (Ky. 1932).

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8. [20.62] Dual Actions for Rent and Possession

The Kentucky courts have held that a landlord may not maintain an action for possession by reason of a default and a separate action for rentals not then due. *Rich*, 99 S.W. at 954. Such actions have been held to be radically inconsistent, and "...manifestly unreasonable and unfair to permit the landlord to resort to both at the same time." *Id.* Even where the landlord is entitled to continue collecting the rent, as where the tenant has abandoned the premises and ceased paying rent, it has been held that the rents may be collected only as they become due and not by acceleration. *Jordan v. Nickell*, 253 S.W.2d 237, 239 (Ky. 1952).

Notwithstanding the *Rich v. Rose* case, which follows the prevailing authority that, "[w]hen a lease ends, the tenant's liability for rent ends," (FRIEDMAN ON LEASES, § 16.3 (4th ed. 1997) at page 1090), it is common to provide for a "survival clause" in drafting leases which imposes an obligation on the tenant to pay and the right of the landlord to receive rentals agreed to be paid during the term or damages following any termination of the lease or reentry by the landlord by reason of a default by the tenant under the lease. It may also be helpful to the effort to continue collecting rent to provide for and to exercise a right of reentry upon a default without declaring a "forfeiture" of the lease.

9. [20.63] Reletting After Termination

Whether the landlord has a duty to mitigate damages by reletting appears to depend upon whether the tenant has abandoned the leased premises or whether there has been a forfeiture of the lease and reentry by the lessor because of a breach of covenant by the lessee. *Jordan*, 253 S.W.2d at 238. Failure of the lessee to occupy the leased premises does not impose on his lessor a duty to procure another tenant, and the lessor can recover rent due under the lease. *Id.*; *G.D. Holding, Inc. v. Baker Energy, Inc.*, 501 F. Supp. 2d 914, 923-24 (W.D. Ky. 2007) (applying Kentucky law and noting that "[t]he Plaintiff correctly points out that where a tenant abandons a lease and the possibility to minimize damages is foreclosed, the landlord is under no obligation to mitigate his/her damages" (citations omitted).), *aff'd* 291 F. App'x 690 (6th Cir. 2008) (unpublished); *Dulworth v. Hyman*, 246 S.W.2d 993, 996 (Ky. 1952); *Ideal Furniture Co. v. Mazer*, 28 S.W.2d 974, 975 (Ky. 1930); *Abraham v. Gheens*, 265 S.W. 778, 780 (Ky. 1924).

10. [20.64] Default by Lessor

When the lessor refuses to place and keep the lessee in possession according to the terms of the lease, the lessee's measure of damages for the breach of contract is the difference between the price he agreed to pay and the actual rental value of the property, together with such special damages as may be authorized by the facts. *Lawrence v. Fielder*, 216 S.W. 1068, 1070 (Ky. 1919); *Devers v. May*, 99 S.W. 255, 257 (Ky. 1907). Specific performance may also be available to the lessee. *See* Section [20.7], *supra*.

B. [20.65] Provisions for Defaults by Tenants

1. [20.66] Typical Events of Default

The events or occurrences constituting a default by a tenant should include failure to pay base rent, percentage rent, or any additional rents called for under the lease when due or within a specified grace period; and the breach of any covenant or agreement of the tenant provided for by the lease, generally within a specified period after notice from the landlord.

Additional events constituting a default might include suffering or permitting liens or encumbrances on the leased premises, specifically including mechanics' liens, and the bankruptcy or insolvency of the tenant. Although a provision for default by reason of a bankruptcy filing or the failure of a tenant to satisfy certain financial covenants are not enforceable in bankruptcy court, (*see* Section [20.83], *infra*), such provisions may be useful if the bankruptcy stay is lifted and proceedings are commenced or continued in state court. Default provisions may also include such other matters as may be of particular significance to the landlord.

2. [20.67] Remedies Upon Default

The lease agreement typically includes the various remedy provisions which the landlord might wish to pursue in the event of a default, including:

(i) reentry of the leased premises by landlord and/or forfeiture of the tenant's leasehold estate;

(ii) dispossession of the tenant and its property from the leased premises;

(iii) collection of the rentals remaining to be paid under the lease (either presently by acceleration[1] or as they become due);

(iv) suit for damages against the defaulting tenant; and

(v) all other remedies available to the landlord at law or in equity.

For a detailed form of default and remedy provision, *see* FRIEDMAN ON LEASES, § 16.4 (4th ed. 1997).

[1] *See Moore v. Ford Motor Credit Co.*, 778 S.W.2d 657, 659 (Ky. Ct. App. 1989), where, in connection with an automobile lease, it was held that "...the failure of the default provision to discount the accelerated rent to its present value constitutes an unlawful penalty." *See also,* Section [20.62], *supra*, and cases cited therein which bring into question the ability of a landlord to maintain an action for possession and for rentals not then due, or to accelerate rents before they become due.

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C. [20.68] Provisions for Defaults by Landlord

Default provisions relating to the obligations of the landlord under a lease agreement are much less common than those relating to tenants. One reason may be that there are often fewer affirmative obligations imposed upon a landlord by lease agreements which require future action by the landlord. A second reason may simply be the greater economic bargaining position which most landlords possess.

If a landlord default clause is to be negotiated for a particular lease, it is suggested that the landlord should be very cautious in permitting a tenant to terminate the lease upon a default, or to offset claims against the landlord against rentals due under the lease. Either type of provision may adversely affect the landlord's ability to obtain necessary financing inasmuch as such provisions have an adverse impact on the income stream which is a focus of commercial lenders. If a specific tenant's remedy is to be provided for, a provision for specific performance or damages may be preferable after adequate notice and opportunity to cure have been afforded to the landlord.

VII. [20.69] Assignment and Subletting

Landlords are often very concerned about the ability of a tenant to assign or sublet to other parties. The ability to freely assign or sublet prevents the landlord from exercising control over the selection of parties occupying the leased premises. Such control is often very important to a landlord in selecting financially stable tenants or in maintaining a desirable tenant mix.

A. [20.70] Basic Legal Concepts

1. [20.71] Generally

At common law, a tenant may freely assign its lease without the landlord's consent in the absence of an express prohibition to the contrary. *Cities Service Oil Co. v. Taylor*, 45 S.W.2d 1039, 1040 (Ky. 1932). The common law appears to be somewhat modified by KRS 383.180(2), which provides that, unless the landlord consents thereto in writing, every assignment, or transfer of a tenant's term or interest in the premises, or any portion thereof, by a tenant at will or by sufferance, or by a tenant who has a term less than two (2) years, shall operate as a forfeiture to the landlord.

2. [20.72] Distinction Between Assignment and Subletting

The distinction between an *assignment* of lease and a *subletting* of the premises depends on the quantity of interest that passes, and not on the extent of

the premises. *Cities Service*, 45 S.W.2d at 1040. An assignment transfers the tenant's entire interest in the leasehold or, if assignment *pro tanto*, the tenant's entire interest in a part of the demised premises. A subletting constitutes a grant by a tenant of a portion of its term, with some reversionary interest remaining in the sublessor. *Ventors v. Reynolds*, 354 S.W.2d 521, 523 (Ky. 1961) (citing *Cities Service* 45 S.W.2d at 1040)). Due to the distinction between an "assignment" and a "sublease," the prohibition of one by the terms of a lease will not extend to include the prohibition of the other. *Cities Service,* 45 S.W.2d at 1040.

There is also a distinction between an "assignment" and a "sublease" regarding who is bound to the landlord. As stated in *Venters*, "[a]n assignee in whole or in part under a lease is liable to the landlord for the payment of rent, while a sublessee is liable only to the lessee." *Venters*, 354 S.W.2d at 523.

3. [20.73] Effect of Assignment of Landlord's Interest

A transfer or assignment of a landlord's reversionary interest carries with it the benefit of leasehold covenants which run with the land and the right to receive rents under an existing lease, unless specifically reserved. *Anderson v. Island Creek Coal Company*, 297 F. Supp. 283, 285 (W.D. Ky. 1969). Pursuant to KRS 383.100(2), a conveyance of the landlord's interest is valid without an attornment by the tenant, but no tenant who pays the rent to the original landlord before notice of the conveyance shall suffer any damage thereby.

B. [20.74] Provisions Regarding Assignment and Subleasing

Most landlords will find it desirable to expressly prohibit all assignments or subleases without the landlord's prior written consent. Tenants, on the other hand, will find it desirable to obtain the agreement of the landlord that consent will not be unreasonably withheld or, preferably, to expressly set forth objective standards, the satisfaction of which will require the landlord to consent to an assignment or sublease. As noted in FRIEDMAN ON LEASES, "...there is a rapidly growing minority to the effect that if the lease states 'tenant may assign only with landlord's consent' or 'tenant may not assign without landlord's consent' there is engrafted on this language by implication the phrase 'which consent shall not be unreasonably withheld.'" FRIEDMAN ON LEASES, § 7.304a (4th ed. 1997) at page 325.

Landlords may want to provide for the payment of the landlord's expenses, including attorney fees, for reviewing and documenting any requested assignment or sublease, irrespective of whether or not the landlord consents thereto. Landlords may also wish to expressly provide that the tenants shall remain liable for all obligations to the landlord in the event of an assignment or sublease, unless the original tenant is released, in writing, at the time any consent is given, even though it appears at common law that the original tenant is not released by reason of such assignment. *Alexander v. Theatre Realty Corp.*, 70 S.W.2d 380, 387 (Ky. 1934); *Motch's Administrator v. Portner*, 34 S.W.2d 744, 745 (Ky. 1931). *See* Section

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[20.83], *infra*, for the effect of bankruptcy upon the liability of a tenant for a lease that has been assigned.

VIII. [20.75] Subordination, Non-Disturbance, and Estoppel

Provisions regarding subordination and non-disturbance and those requiring a tenant to execute estoppel certificates are generally of little concern to landlords until they seek to finance or sell a parcel of real estate subject to existing leases. At that time, lenders will generally require that tenants execute subordination agreements and sign estoppel certificates. Purchasers also typically require estoppel certificates. Faced with such a requirement by a lender or a purchaser, it is helpful if the existing leases require the tenant to comply.

A. [20.76] Subordination

A lease may be subordinate to a lender's mortgage either because it is later in time, or by specific agreement. Due to the usual requirements of commercial lenders regarding specific subordination agreements, consideration should be given to obligating the tenant to execute and deliver a subordination agreement to a mortgage lender upon request of the landlord.

B. [20.77] Non-Disturbance

Closely related to subordination agreements are non-disturbance provisions, which tenants should insist upon in exchange for agreeing to be subordinate to a mortgage. If having the lease terminated by an existing lender would subject a tenant to significant loss, a non-disturbance agreement should also be required by a tenant from existing lenders upon execution of the lease. In simple terms, a non-disturbance agreement provides that so long as the tenant is not in default of its obligations under the lease, neither the mortgagee to whose mortgage the lease is subordinate or its successors will disturb the tenant in its possession of the premises, irrespective of any default under the mortgage by the landlord. In the absence of such a non-disturbance provision, a tenant might find its lease subject to extinguishment by a foreclosure proceeding as with any other matter which is subordinate to the lien of the mortgage being foreclosed.

C. [20.78] Estoppel Certificates

In addition to requiring subordination agreements, many commercial lenders also require that existing tenants sign estoppel certificates verifying that the leases are valid and binding, that they are currently in force and effect, and that there are no defaults existing under the leases. Such certificates are also typically required by purchasers of leased property. In drafting a commercial lease, consideration should be given to including a provision which requires the tenant

to deliver an estoppel certificate at the request of the landlord, certifying, among other things, the existence and terms of the lease, any amendments to the lease, the status of rental payments, and the absence of any defaults under the lease (or, if there are any defaults in existence, the nature of the defaults).

IX. [20.79] Selected Bankruptcy Issues

The many ramifications of the United States Bankruptcy Code, Title 11 of the United States Code ("Bankruptcy Code"), on commercial leases are beyond the scope of this chapter. Nevertheless, some basic concepts will be reviewed as a starting point for more detailed research and consideration by the practitioner.

A. [20.80] Automatic Stay

Section 362 of the Bankruptcy Code imposes a broad automatic stay of actions against a debtor or property of the debtor's estate with respect to matters that arose before the commencement of a bankruptcy case. The stay reaches to actions against a tenant for non-payment of rent or other breaches of a lease which occurred prior to commencement of the bankruptcy case. A notable exception to the automatic stay, however, is provided by subsection (b)(10) of Section 362 of the Bankruptcy Code, which provides that the filing of a bankruptcy petition does not operate as a stay:

> [U]nder subsection (a) of this section, of any act by a lessor to the debtor under a lease of non-residential real property that has terminated by the expiration of the stated term of the lease before the commencement of or during a case under this title to obtain possession of such property.

If an issue arises as to whether a lease has terminated, state law will govern. *See, e.g. In re Depoy*, 29 B.R. 466 (Bankr. N.D. Ind. 1983).

B. [20.81] Assumption or Rejection of Lease

Section 365 of the Bankruptcy Code gives to a trustee (or a debtor in possession), subject to the court's approval, the right to "assume or reject any...unexpired lease of the debtor." However, subsection (c)(3) of Section 365 specifically excludes leases of non-residential real property which have been terminated under applicable non-bankruptcy law prior to the order for relief. Other than as set forth in Section 365(b)(3), with respect to shopping center leases, the Bankruptcy Code contains no special requirements for assuming a lease which is not in default other than court approval. If the debtor is in default (for reasons other than violation of bankruptcy or financial clauses described in Section 365(b)(2)), then in order to assume the lease, the trustee or debtor in possession must (1) cure the default or

provide adequate assurances of a prompt cure, (2) compensate the other party to the lease for any actual pecuniary loss resulting form the default or provide adequate assurances of prompt compensation, and (3) provide adequate assurances of future performance. Subsection (b)(3) of Section 365 further imposes specific standards which must be satisfied for purposes of providing adequate assurances of future performance with respect to shopping center leases.

The Bankruptcy Abuse Prevention and Consumer Protection Act of 2005 ("BAPCPA") expanded Bankruptcy Code Section 365(b)(1)(A) and modified Section 365(b)(2)(D) to clarify the requirements with respect to curing defaults of nonmonetary obligations. Pre-BAPCPA it was unclear whether non-monetary defaults must be cured prior to assumption. Under the BAPCPA amendment to Section 365(b)(2)(D), non-monetary defaults must be cured prior to assumption unless the default requires a penalty payment. However, Section 365(b)(1)(A) carves out an exception for non-monetary defaults under unexpired leases of residential real property where "it is impossible for the trustee to cure such default by performing non-monetary acts at and after the time of assumption." Defaults arising from a failure to operate in accordance with a non-residential real property lease are specifically excluded from the carve out and must be cured at and after the time of assumption. The carve out then implicitly includes impossible default cures of *non-operational* obligations in a non-residential real property lease.

The BAPCPA also eliminated special provisions under Bankruptcy Code Section 365 for assumption or assignment of non-residential real property leases related to the airline industry.

Section 365(d)(3) of the Bankruptcy Code provides in relevant part:

> The trustee shall timely perform all the obligations of debtor, except those specified in Section 365(b)(2), arising from and after the order for relief under any unexpired lease of non-residential real property, until such lease is assumed or rejected, notwithstanding Section 503(b)(1) of this title.

The effect of this provision is that rent and most other charges continue in accordance with the terms of the lease until assumption or rejection. If a lease is rejected, however, and the tenant nonetheless holds over, rent would thereafter accrue at the fair use and occupancy rate as long as the holdover does not prevent a new tenant from entering into possession. *See, e.g., In re Cardinal Industries, Inc.*, 109 B.R. 738 (Bankr. S.D. Ohio 1989) and *In re Rare Coin Galleries of America, Inc.*, 72 B.R. 415 (D. Mass 1987). Additionally, even when the "fair use and occupancy rate" applies, a presumption may arise that the reasonable value for use of the premises is the rent under the lease, unless the rate is proved unreasonable. *In re Rare Coin Galleries of America, Inc.*, 72 B.R. at 417.

By reason of Section 365(d)(3) of the Bankruptcy Code, the landlord has an administrative claim against a debtor-tenant for post-petition rent accruing

prior to acceptance or rejection of the lease. If ultimately rejected without having been first assumed, the rejection creates a pre-petition general unsecured claim pursuant to Section 365(g)(1) of the Bankruptcy Code. Section 502(b)(6) of the Bankruptcy Code provides a formula for determining the ceiling on an allowed claim for a lease termination. The BAPCPA added a new provision to Bankruptcy Code Section 503(b), subsection (7), dealing specifically with non-residential real property leases assumed under Section 365, then later rejected:

> [W]ith respect to a non-residential real property lease previously assumed under Section 365, and subsequently rejected, a sum equal to all monetary obligations due, excluding those arising from or relating to a failure to operate or a penalty provision, for the period of 2 years following the later of the rejection date or the date of actual turnover of the premises, without reduction or setoff for any reason whatsoever except for sums actually received or to be received from an entity other than the debtor, and the claim for remaining sums due for the balance of the term of the lease shall be a claim under Section 502(b)(6)[.]

This new subsection prevents a landlord from potentially receiving an administrative claim for the full value of a lease first assumed, then rejected, by limiting the administrative portion of the claim to amounts due for a two (2) year period following the later of rejection or turnover of the property.

The BAPCPA amended Bankruptcy Code Section 365(d)(4) to provide that leases of non-residential real property, under which the debtor is the lessee, are deemed rejected and the non-residential real property surrendered to the lessor, unless affirmatively assumed or rejected by (1) the earlier of 120 days after the date of the order for relief, or (2) the date of the entry of an order confirming a plan. The court may extend this period "prior to the expiration of the 120 day period, for 90 days on the motion of the trustee or lessor for cause." No subsequent extension may be granted without the prior written consent of the lessor. This change extended the time for assuming or rejecting an unexpired lease of non-residential real property from 60 days under the prior law to 120 days. The discretion of the court, however, to grant an extension of time under the amended provision is strictly limited. By reason of this provision, the burden is upon the debtor/trustee to obtain an order for an extension within the 120 day period in order to avoid the lease being deemed rejected. There is some authority under pre-BAPCPA law to the effect that filing a motion for an extension or for approval of assumption within such time period is sufficient.

C. [20.82] Rejection by Landlord

Rejection of a lease by a landlord in bankruptcy highlights the unique nature of a lease which consists of both an executory agreement and a present conveyance of an interest in real estate. *See* Section [20.7], *supra*. Pursuant to

Section 365(h)(1)(A) of the Bankruptcy Code, the lessee has the right upon rejection of its lease by the landlord/debtor to stay in possession of the leased premises in accordance with the terms of its lease or to terminate the lease if the rejection of the lease would entitle the tenant "to treat such lease as terminated by virtue of its terms, applicable non-bankruptcy law, or any agreement made by the lessee...." If the lessee chooses to remain in possession, it may reduce its rent by the amount of damages it suffers from the rejection pursuant to Bankruptcy Code Section 365(h)(1)(B). One potential exception to Section 365(h) has been recognized where a Section 363(f) sale of the leased property occurs. The Seventh Circuit Court of Appeals, noting a split of authority among lower courts, held that the lessee's post-rejection possessory rights under Section 365(h) were not preserved in a sale of the leased property pursuant to Section 363(f), under which property is sold "free and clear of any interest in such property...." *Precision Industries, Inc. v. Qualitech Steel SBQ, LLC*, 327 F.3d 537 (7th Cir. 2003). Notably, the lessee did not object to the Section 363(f) sale and failed to protect its rights. Lessee's should actively assert available protections when faced with a Section 363(f) sale of the leased property. *Compare In re Haskell L.P.*, 321 B.R. 1 (Bankr. D. Mass. 2005) (denying Chapter 11 debtor's motion to sell real property free and clear of liens and encumbrances because it could not demonstrate that its affected tenant could be compelled to accept monetary satisfaction of its interest in the debtor-landlord's property pursuant to Section 363(f)(5)); *see also, In re Samaritan Alliance, LLC*, 2007 Bankr. Lexis 3896 (Nov. 21, 2007) (concluding that the reasoning in *Haskell* was "instructive" and holding that lessee's post-rejection possessory rights were preserved).

D. [20.83] Unenforceable Provisions in Bankruptcy

Assumption of a lease does not mean that all of the terms of the lease are thereafter enforceable in accordance with their terms. The Bankruptcy Code serves to modify or render unenforceable in bankruptcy court several provisions of unexpired leases. An example of modification is contained in Section 108(b) of the Bankruptcy Code, which extends the debtor's time to take various actions for up to sixty (60) days, the time for performance of which was fixed by the lease, if such period has not expired before the date of filing of the petition.

Section 365(e)(1) of the Bankruptcy Code specifically renders unenforceable provisions in leases conditioned on:

> (A) [T]he insolvency or financial condition of the debtor at any time before the closing of the case; (B) the commencement of a case under this title; or (C) the appointment of or taking possession by a trustee in a case under this title or a custodian before such commencement.

Anti-assignment clauses are also rendered unenforceable by Section 365(f)(1) of the Bankruptcy Code. Notwithstanding provisions prohibiting assignment, an unexpired lease may be assigned, provided the lease has been assumed and

adequate assurance of future performance by the assignee of the lease is provided. Pursuant to Section 365(k), the debtor is released from any further liability for any breach of the lease occurring after the lease has been assigned.

X. [20.84] Other Miscellaneous Provisions

A. [20.85] Covenant of Quiet Enjoyment

Although the general rule is that the use of the words "demise, grant, let or lease" have the effect of an "implied covenant that the lessee shall have the quiet and peaceable possession and enjoyment of the leased premises, so far as regards the lessor, or anyone lawfully claiming through or under him...," (*Evans v. Williams*, 165 S.W.2d 52, 55 (Ky. 1942) (citing 62 ALR 1262, *Breach of Covenant for Quiet Enjoyment in Lease*)), the inclusion of a specific covenant of quiet enjoyment is common. Although such covenants are generally very simple in nature and often follow the language cited from *Evans*, the covenant of quiet enjoyment may be qualified by agreement. A common qualification is that the covenant is applicable only so long as the tenant has fully performed its obligations under the lease. Where the lease contains an express covenant of quiet enjoyment, although restricted, the law will not imply a general covenant. 51 CJS *Landlord and Tenant* § 323(1).

B. [20.86] Taxes, Insurance, and Utilities

Although each of these matters has been discussed in connection with broader topics, such as additional rent or maintenance and care of the improvements, *supra*, these topics are mentioned separately at this point in order to highlight the importance of having some explicit agreement as to each of these matters in the commercial lease agreement.

C. [20.87] Environmental Matters

Due to the increasing importance of environmental statutes and regulations in the day-to-day ownership, operation, and use of all types of real property, environmental provisions are becoming more and more prevalent in the standard commercial lease agreement. A cursory review of one of the more significant environmental statutes affecting all types of real property, the Comprehensive Environmental Response, Compensation, and Liability Act ("CERCLA"), 42 USC §§ 9601, *et seq.*, quickly reveals an important reason for considering environmental matters in the commercial lease setting. Under CERCLA, and under various other environmental enactments, liability for correcting violations of environmental regulations may be imposed upon owners and other parties in possession or control of a parcel of real estate, irrespective of fault. *See* **Chapter 24**, *infra*, for further detail as to the nature and scope of liabilities incident to environmental hazards.

In addressing environmental hazards in the lease setting, representations and warranties from both landlord and tenant should be considered as to prior and future uses of the premises in question, respectively. Indemnification provisions as to matters for which each party is responsible should also be considered.

D. [20.88] Indemnification and Exculpation

Although indemnification provisions are in no way essential to the lease agreement, such provisions are frequently included. Such provisions tend to make the party giving same virtually an insurer and should be approached with caution. *See* FRIEDMAN ON LEASES, § 9.10 (4th ed. 1997).

Closely related to indemnification is the concept of exculpation. In an indemnification agreement, one party agrees to hold the other harmless from loss or damage as the result of the occurrence of certain identified risks or events. Exculpation provisions act as a release of one party from liability to the other as the result of certain acts or events. Exculpation provisions in the landlord/tenant context related to loss of property have been upheld by the Kentucky Court of Appeals. In *Jones v. Hanna*, 814 S.W.2d 287, 289 (Ky. Ct. App. 1991), the court approved the concept that, "one may contract away future negligence if such is not willful and wanton, and not resultant in personal injury."

E. [20.89] Notice

In order to establish an acceptable standard for any required notices to the parties, a notice provision in the commercial lease would appear to be appropriate. Notice provisions should require that all notices be in writing, and frequently specify the manner in which notices shall be given, whether personally, by certified or registered mail, or by other recognized courier. Notice provisions also frequently specify a particular individual or officer to whom notices should be directed.

F. [20.90] Recording of Lease or Short Form

Although the parties to a detailed commercial lease often do not want all of its terms to become public information, a tenant will frequently desire to have the lease or a short form of the lease recorded in order to place third parties on notice of the tenant's interest in the demised premises. If the tenant desires or has need of a recorded instrument in order to evidence its interest in the property, either the lease or the short form to be recorded must be in recordable form. *See* **Chapter 16**, *supra*, on recordation of instruments affecting real property.

Kentucky does not have a statutory form of memorandum or short form of lease. Language sufficient to create the leasehold interest to be memorialized by the recorded document would therefore seem to be appropriate in the recorded document, along with the names and addresses of the parties, the description of the

property, the term of the lease, and any other matters of which the tenant desires to place third parties on notice.

G. [20.91] Miscellaneous Contractual "Boilerplate"

Because the lease agreement is essentially contractual in nature, there are any number of standard contractual provisions which are properly included within the lease agreement. Because most lease forms include such provisions, there will be no attempt to enumerate or discuss such provisions herein. A short list would include provisions binding successors and assigns, reciting that the lease sets forth the entire agreement of the parties, stating that the lease provisions are severable, stating that all rights and remedies are cumulative, addressing the effect of one or more waivers of rights, etc.

XI. [20.92] Conclusion

This chapter is not, nor is it intended to be, a comprehensive discussion of all aspects of commercial leasing. The topic is of such a complicated and ever-evolving nature that reference to current forms of leases and detailed commentaries are suggested. Sources for forms and more detailed commentary are attached to this chapter as Appendix B. It is hoped, however, that the foregoing discussion, with emphasis on controlling Kentucky authorities, will be beneficial to the practitioner in the drafting, review, and evaluation of the various forms of commercial lease agreements.

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XII. [20.93] Appendix

A. [20.94] Checklist for Drafting or Reviewing Commercial Leases

This checklist is not, nor is it intended to be, exhaustive of potential concerns or provisions, but, rather, is intended to be suggestive only of the matters which may be appropriate for consideration.

1. Parties-Landlord and Tenant

__ Entity (individual, corporation, limited liability company, partnership, unincorporated association, trust, personal representative)

__ Capacity (minority, incompetency, due authorization, scope of authority, court approval required)

__ Status (due organization, good standing, duly appointed, marital [as to landlord])

2. Premises Demised

__ Grant of Premises (is there an appropriate granting and demising clause)

__ Adequacy of Description (legal description of tract or parcel; if less than entire tract, is record plat required; if legal description not used, is property otherwise adequately described or appropriate drawing attached)

__ Common Areas (are areas other than demised premises to be available for tenant's use; if so, what areas and what use is permitted)

__ Landlord's Control (if rights are granted in common areas, does landlord reserve sufficient control over use and alteration so as to provide for use by others and for some flexibility for the future)

__ Appurtenant Rights (are easements, rights-of-way, parking facilities, sidewalks, etc., necessary to use of demised premises; if so, are necessary rights to use same included)

3. Construction or Improvement of Demised Premises

__ Current State of Improvements (are additional improvements required; if so, who is to construct same, at whose expense)

__ Nature of Additional Improvements (is there a clear understanding of type and nature of improvements to be erected; are plans and specifications attached)

__ Conditions Precedent (must contractor or plans and specifications be approved; are payment and performance bonds required)

__ Time for Completion (when is construction to begin; when is it to be complete; what is effect on lease of failure to timely complete)

4. Lease Term

__ Length of term

__ When does term commence

__ If lease is to begin at a later time, is there an outside date for commencement

__ What contingencies are there to commencement

__ What is the effect of failure of term to commence within a specified time

__ If commencement of lease is not a specific date, is there a mechanism for documenting the commencement date

__ What is the lease termination date

__ Are there options to renew or extend; if so, how many, how long, and upon what terms

__ What actions, if any, are necessary to renew or extend

5. Rental

__ What is the base rent due under the lease

__ If rental not a fixed sum, is the lease sufficiently specific to provide "an adequate key to a mutual agreement"

__ When is rent payable

__ Where is rent payable

__ Is there a penalty for late payment

__ Is the rent to be adjusted during the term; if so, when and how

__ Is the tenant to receive any free rent; if so, how much and for how long

__ Is the landlord to receive any advance rent; if so, how much, how is it to be held and how is it to be applied

__ Is rent to be adjusted in the event a renewal or extension option is exercised; if so, how is adjustment to be determined

6. Percentage Rental

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___ How is percentage rent to be determined (percentage of gross sales, what percentage, is there a floor for sales which must be exceeded before percentage rent is payable)

___ To what sales is percentage rent applicable, (*i.e.,* what receipts of tenant are excluded-sales taxes, returned goods, lottery tickets, sales to employees, sales of fixtures or equipment, etc.; what receipts of tenant are included-all sales of goods or services from the demised premises, sales from vending machines, sales by subtenants, assignees, concessionaires, etc.)

___ How and when are percentage rents payable; how are sales records to be maintained; what access is landlord to be given

___ Are records to be audited; if so, by whom, and at whose expense

___ Is there a penalty for under reporting; do lease provisions obligate tenant to adequately staff and stock demised premises

7. Additional Rentals

___ What is included in additional rentals (utilities, taxes, insurance, common area maintenance ("CAM"))

___ Is tenant to pay any of the above charges directly

___ If more than one tenant, what portion is tenant to pay

___ How is tenant's share determined (*e.g.,* by a ratio the numerator of which is number of leasable square feet in the demised premises and the denominator of which is the total number of leasable square feet in the building or center of which the demised premises are a part)

___ What is included in CAM (janitorial, maintenance and repair of driveways, parking and sidewalks; snow removal, management fees, security, etc.)

___ What is excluded from CAM (capital improvements, taxes personal to landlord, depreciation, structural repairs not caused by tenant, etc.)

___ When is additional rent payable

___ What supporting documentation must landlord supply to tenant or vice versa if tenant is to pay any such charges directly

8. Security Deposit

___ Is security deposit required; if so, in what amount

___ How is security deposit to be held and if interest is earned, for whose benefit

___ What happens to deposit in the event of default, in the event of failure to leave demised premises in required state, and if tenant discharges all of its obligations

9. Use of Premises

___ Is tenant required to comply with all applicable laws and regulations and to obtain any necessary permits

___ Are demised premises limited to a particular use

___ If so, does the use to which the demised premises are limited violate any exclusive right which has been granted to another tenant in the development; if not, are any exclusive rights which have been granted to other tenants, or which are contemplated for the future, expressly recognized

___ Does the lease restrict the use of any other portions of the development

___ Do all leases in the development conform to the restrictions imposed by the subject lease

___ Is tenant required to conduct the permitted use on the demised premises continuously during the lease term

10. Maintenance, Repair, and Alterations

___ Does lease specifically assign responsibility for maintenance and repair (roof, walls, floors, foundations, heating and cooling, electrical, plumbing, sidewalks, parking lot, etc.)

___ Are "major" repairs treated any differently than "minor" repairs

___ Must any alteration be approved by landlord

___ Who must provide any improvements required to comply with any changes in applicable laws

___ Must tenant keep the improvements free of any liens or encumbrances resulting from labor or materials supplied to or contracted for by tenant

11. Insurance

___ Who is required to insure the demised premises against casualty loss

___ What types and amounts of insurance are required

___ If tenant is to provide insurance against casualty loss, is landlord named insured

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___ Must tenant insure and bear risk of loss for its inventory, trade fixtures, equipment, and other personal property

___ Must tenant obtain and maintain liability insurance, with specific limits, naming landlord as additional insured

___ Does landlord have any right to approve insurance carriers

___ How are insurance proceeds to be paid and applied

___ Must tenant provide landlord with copies of insurance policies and provide proof of payment of renewal premiums or a new policy prior to expiration thereof

___ Is there a waiver of subrogation as to casualty losses (make sure this is permitted by insurance contract)

12. Rebuilding of Demised Premises After Loss

___ Is either party obligated to rebuild in the event of casualty loss

___ Within what period of time must demised premises be rebuilt

___ Under what conditions may rebuilding be excused

___ Is there an abatement of rent during period of reconstruction

___ Is abatement of rent affected by degree of loss

___ Under what conditions may landlord or tenant terminate the lease

13. Condemnation

___ What is effect on lease of a total taking, of a partial taking

___ What obligation do the parties have to restore the remaining premises

___ What interest, if any, is tenant to have in condemnation proceeds

___ If lease continues in effect, how is rental obligation affected

14. Advances by Lessor

___ Does lease permit landlord to advance any funds necessary to discharge obligations of tenant in the event tenant fails to discharge same

___ If so, how and when is landlord to be reimbursed and is there any penalty provision

___ May landlord declare default whether or not landlord chooses to discharge obligation of tenant

15. Subletting and Assignment

___ Does lease prohibit assignment or sublease without consent of landlord

__ May landlord arbitrarily withhold consent or is there an objective standard

__ Is tenant to be relieved from liability upon approval of assignment

__ Are there certain affiliated entities for which approval of landlord should not be required

16. Default and Remedies

__ What constitutes a default (failure to pay base rental, percentage rental, additional rentals, breach of or failure to observe any covenant, agreement, or undertaking set forth in the lease, bankruptcy or insolvency, etc.)

__ Are there any provisions for notice and opportunity to cure

__ Are there any provisions for landlord's default

__ What remedies are provided for (reentry by landlord, dispossession of tenant and its property, collection of rentals due or to become due, suit for damages, all other remedies at law or in equity)

__ Does lease provide that remedies are cumulative

__ Does lease require landlord to mitigate its damages

17. Mortgaging of Landlord's Reversion (Fee)

__ Is tenant required to subordinate its leasehold interest to any mortgagee of landlord

__ If so, is obligation to subordinate contingent upon a non-disturbance agreement from mortgagee

__ Is tenant required to attorn to lender or any purchaser at foreclosure

__ Is tenant required to execute and deliver estoppel certificates at request of landlord

__ Is a non-disturbance agreement from existing lenders required in order to adequately protect tenant's leasehold interest

18. Mortgage of Leasehold

__ Are such mortgages permitted; if so, under what conditions

__ Is landlord required to notify tenant's mortgagee of any default and to permit such mortgagee to cure

19. Environmental Concerns

__ Does landlord make representations and warranties about present status of demised premises vis à vis environmental regulations

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___ Is tenant required to comply with all present and future environmental rules and regulations affecting demised premises

___ Do parties agree to indemnify and hold the other harmless from environmental problems for which each is responsible.

___ Do covenants of tenant survive termination of leasehold

20. Termination

___ What condition are the demised premises to be in upon return of same to landlord

___ What property (*e.g.,* trade fixtures, leasehold improvements, personal property, etc.) is tenant permitted or required to remove upon termination of lease

___ What is effect of holding over by tenant following expiration of the term (month to month, increased rental, hold landlord harmless from liability to succeeding tenant, etc.)

___ Are there events other than expiration of the term or a default under lease which will permit one of the parties to terminate lease

21. Miscellaneous Provisions

___ Indemnification Are there provisions for indemnification of landlord or tenant from various claims or liabilities which may arise during lease term

___ Entry of Landlord Has landlord reserved rights to enter upon demised premises at reasonable times or in the event of an emergency to inspect or protect the demised premises or to discharge its obligations under the lease

___ Additional Expense of Tenant If not treated as additional rent, are responsibilities for utilities, taxes, etc., properly allocated between the parties

___ Successors and Assigns Subject to any limitations on transferability, are the parties, their heirs, successors, and assigns, bound to the lease

___ Rights of Set-Off Are there any circumstances under which tenant may be permitted to offset the rents against obligations of landlord

___ Waiver What is effect of failure to enforce rights or express waiver upon any subsequently occurring breach, default or occurrence

___ Entire Agreement Does lease set forth the entire agreement of the parties and supersede any prior agreements or understandings

___ Severability Does or should lease contain a severability provision as to any invalid, illegal, or unenforceable provision

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