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Property Lease Dangers Part II ©

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Insurance

Commercial leases always require tenants to maintain general liability insurance and casualty insurance covering tenant's furnishings, equipment and other property. Sometimes the lease mandates that the tenant keep business interruption insurance sufficient to pay the rent for a year (or more). The lease usually provides that tenant's insurance must fulfill certain requirements as to the insurer's financial strength, and policy scope of coverage and limits. Tenant must also have the policies name landlord as additional insured, and include various other provisions to protect landlord. Tenant must also maintain fire and other casualty insurance on the facility itself in single tenant facilities, whereas multiple tenant facility landlords insure themselves and pass the costs thereof to tenant via Common Area Maintenance "CAM".

When Bad Things Happen: Premises Destruction & Condemnation

If the premises are destroyed or damaged by fire or other casualty, the lease provides that if the premises repairs can be completed within a certain time period specified in the contract, landlord uses the casualty insurance proceeds to repair same, and rent is abated while until the repairs are completed. (Please note in passing that the lease usually provides that landlord's casualty repair obligation is limited to spending insurance proceeds, not its own funds.) If the premises can't be repaired within the specified deadline, then the lease can be terminated. The critical issue for the lease parties is whether only the landlord can terminate the lease in this instance, or if tenant may also do so. If only landlord, then tenant may be stuck paying rent for premises it can't use until lengthy repairs are completed. The same issue arises when only a portion of the premises are condemned or a public authority exercises eminent domain over part of the premises.

Time for Improvements.

The general rule is that all tenant improvements require landlord's prior consent and are

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at tenant's sole expense. (Tenants can try to soften this requirement by requesting that the lease add that landlord's consent can be neither unreasonably withheld nor delayed, but we wonder if that's an efficient use of precious tenant negotiating capital.) The main issue regarding tenant improvements is whether tenant can elect to remove its improvements when the lease ends. Some leases do not provide for this option, which means that all tenant improvements revert to landlord upon lease termination.

Splitting Up & Moving On: Lease Assignment & Subletting.

Almost all leases provide that tenants can't assign their lease, or sublet space without landlord's consent. As with tenant improvements discussed above, tenants can try to prohibit landlord from unreasonably withholding or delaying its consent. Tenants with foresight will try to get more freedom to assign the lease if tenant is also selling the practice, but landlords will need to get comfortable with the new tenant's creditworthiness, so there's not much room for compromise here.

Keeping Landlord Safe: Indemnification & Liability Limits.

Leases almost always require tenant to indemnify and hold landlord harmless from any injury or damage suffered by landlord resulting from the acts and omissions of tenant (and also those of tenant's owners, managers, employees, contractors, agents, patients, clients and invitees). Clearly tenant must indemnify landlord for tenant's negligent or unlawful acts or tenant's failure to honor its lease obligations, for instance if a practice patient bit landlord; or if the environmental authorities sue landlord because tenant failed to comply with hazardous waste disposal rules.

Leases also invariably include clauses stipulating that landlord will not be responsible for any injury or damage suffered by tenant resulting from the premises being defective or out of repair. So if the agreement requires landlord to maintain and repair the roof—and the roof starts leaking, tenant's sole recourse is to go to court to force landlord to do the repairs. *But tenant may still be required to pay rent.* Tenant is not entitled to seek compensation from landlord for the damage caused by the leaking roof. (Hopefully, tenant's insurance will cover tenant's losses.) Savvy tenants (with leverage) will try to add lease language limiting the adverse impact of these landlord liability disclaimers by stipulating that the disclaimer doesn't apply to the extent landlord was negligent or breached the lease.

Breach & Punishment: Default, Termination, Remedies & Set Off.

Commercial leases usually include long provisions detailing: (a) the events which trigger a tenant default; (b) how much notice landlord must give before declaring a default; and (c) the various remedies available to landlord if tenant defaults. Landlord's remedies usually include accelerating rent, terminating the lease, evicting the tenant and suing tenant for damages. The critical thing for tenant to understand is that *lease termination and eviction do not suspend tenant's obligation to pay rent and CAM for the remaining term of the lease.* Tenant's rent payment obligation is reduced to the extent landlord re-rents the premises to a new tenant, but

landlord is not required to do so. Landlords won't tie their hands by agreeing to a lease provision forcing them to relet. Tenants can improve their position by trying to insert a general clause requiring landlord to mitigate its damages.

Lease Guarantees, Owners on the Hook.

Landlords regularly demand that tenant's owners guarantee tenant's lease obligations. Tenant owners should resist this of course, because the main purpose of conducting the practice through a company is to avoid personal liability. If tenant lacks the leverage to "just say no," tenant can propose various ways to limit the guarantee. The owners will also need to address what happens to the guarantees when an owner leaves the practice.

There is one important guarantee point that tenant owners should watch for. Many leases frequently stipulate that a *guarantor's* bankruptcy triggers a *tenant* default under the lease, which then allows landlord to evict tenant. This is too harsh because an owner's bankruptcy does not necessarily affect tenant's ability to pay the rent. So tenants may want to try to eliminate or soften this provision.

Commercial leases, even the rare properly drafted one are heavy going. Hopefully this road map will make the trip less daunting.