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Key Considerations for Terminating Commercial Leases

A Practical Guidance® Practice Note by
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This practice note provides an overview of key legal and practical considerations for commercial owners and tenants when navigating potential lease termination scenarios. It discusses common lease provisions, legal principles, and strategic questions that confront parties to commercial lease disputes, as well as factors beyond the parties' control that affect their relative leverage in settlement negotiations.

For a full listing of key content on commercial leasing, see Office Leasing Resource Kit, Retail Leasing Resource Kit, Industrial Leasing Resource Kit, and Restaurant Leasing Resource Kit.

Overview

Commercial leases, and the rents paid pursuant to those leases, are the backbone of commercial real estate values. Properties with strong rent rolls and long-term income streams are highly valued and sought after by real estate investors. But commercial real estate is not always that easy. While owners dread the prospect, income streams do not always last and tenants' businesses can falter. Sometimes this is due to events beyond the parties' control, such as changes in technology or society more generally. For instance, Blockbuster Video was a once sought-after strip-mall tenant, but no matter how well run its business operations were, changes in the way consumers watched movies at home eventually rendered its business obsolete. Changes in Americans' shopping habits caused by online retailers have shuttered countless malls and darkened many a ground-floor storefront. And pandemic-induced changes in work habits did not justify many companies' maintenance of large commercial office footprints. Instead, those changes have markedly decreased the values of office properties in the United States and around the world.

Commercial tenants also run into trouble for myriad other reasons: a new restaurant concept that failed to catch on or received poor online reviews; a fledging business owner who got in too deep, with expenses outstripping revenue; a partnership dispute that erupted, resulting in no one paying close enough attention to the underlying business; and other situations that are too numerous to recite or even conceive of here.

The bottom line is this: while a stable commercial property with a consistent, predictable income stream is highly valuable, owners sometimes have no choice but to take action against a tenant that is not meeting its leasehold obligations. But in order to preserve its income stream, the owner's imperative—depending on the situation—must be to either

minimize rental losses and relet the space at market rents as expeditiously as possible, or to avoid lease termination altogether and negotiate a lease modification that works for both sides.

On the other side of the coin, tenants stuck in money-losing leases face their own unenviable set of possible circumstances, including bankruptcy and significant monetary liability under personal or corporate lease guaranties. They, too, would often like nothing more than a restructuring of their lease obligations and the opportunity to stay above water financially.

If you represent an owner or a commercial tenant in a lease dispute, whether relating to unpaid rent or an alleged nonmonetary default, there is no one-size-fits-all approach to how to best navigate the situation. As is commonly said about real estate itself, every situation—like every parcel of real estate—is unique. Nevertheless, while no precise instruction manual exists or is even possible when confronting a possible commercial lease termination scenario, experience dictates that certain factors should be considered and weighed against one another in ascertaining the leverage between the parties and charting a potential path forward.

From the Owner's Perspective

What Does the Default Provision Actually Say, and Is It Enforceable?

The starting point for any analysis concerning a potential lease termination is the lease's default provision. It is extremely important to review this provision carefully, and not to simply assume that it provides for the remedies to which you may be accustomed.

Let us take unpaid rent, for example, which is the most frequent source of dispute between owners and tenants.

The monetary damages under a commercial lease will often consist not only of the past due rent, which likely prompted the termination of possession, but also future rent for the balance of what would have been the remaining lease term. Conceptually, a future rent award is intended to compensate an owner for the rent it would have received for the entirety of the lease term, discounted to a net present value. The award also assumes that the tenant would have occupied the premises and paid rent during this period. This is where the concern of a double recovery may get triggered, because the owner (1) could be compensated as if the tenant were staying in possession and the lease were in effect (recovery one), while it (2) maintains the ability to collect rent from a new tenant during that same period, or to utilize the space for its own uses such as storage or as offices for its own employees (the second, double recovery).

Some jurisdictions will not permit an owner to recover future rent following a lease termination unless the lease expressly so provides—and even if it does, courts may not enforce the future rent clause if enforcement of it will result in the owner obtaining a double recovery.

For instance, courts in some states will not permit an owner to collect a judgment for accelerated rent after a lease termination while retaining the proceeds of reletting. See, e.g., Elk 33 E. 33rd LLC v. Sticky's Corporate LLC, 228 A.D.3d 455, 456 (N.Y. App. Div. 2024) (citations omitted) ("While landlord was permitted to accelerate the entire rent, it is not permitted to an acceleration pursuant to Article 70.11.1(I) *and* to relet the premises under subsection (II)"). Thus, many New York commercial leases (to use one example) provide that the owner may exercise one of two mutually exclusive damages remedies upon the lease's termination: (1) accelerate and discount to present value the rent due for the remainder of the term, with the owner entitled to any excess of that amount over the then-current fair market rental value of the space; or (2) the owner will be entitled to the rent at the time it would have come due had the lease not been terminated, set off against any proceeds of reletting during what would have been the balance of the lease's term.

Other states do not focus on the clause itself, but on how the owner actually uses the leased space following recapture. In these states, so long as the future rent award does not equate to a double recovery, then a court may enforce it subject to certain conditions, including that (1) the award regarding the future rent will be discounted to a net present value; (2) the owner will not be permitted to use the leased premises for its own use following recapture if it was awarded future rent and instead must attempt to relet the premises to regenerate rent; and/or (3) the judgment will reserve jurisdiction to permit the prior tenant to request an accounting of all rents received in the future that will act as an offset to the judgment. This way, the owner will not obtain the double recovery courts fear, where the owner is essentially getting two rental payments for the same month from the prior tenant and new tenant.

Other states, however, may potentially allow a double recovery. For example, in California, upon lease termination the owner is entitled to collect the present value of future rent, and the tenant bears the burden of proving that the future rent award should be reduced because the owner did not adequately mitigate its damages by placing a new tenant in the space.

If you are unsure whether a double recovery is permissible, or if your client wishes to avoid the prospect of litigation over the question, it can avoid the issue entirely by proactively crediting the terminated tenant for the reletting proceeds—whether (as applicable) for the proceeds reasonably anticipated at the time

of termination, or for those received during what would have been the terminated lease's term.

For a full listing of key content on commercial leasing, see Office Leasing Resource Kit, Retail Leasing Resource Kit, Industrial Leasing Resource Kit, and Restaurant Leasing Resource Kit.

Must the Owner Mitigate Damages?

Relatedly, owners must consider whether their jurisdiction imposes an obligation to mitigate rental losses, or whether the default rule permits the owner to collect the rent for the entirety of the term without reletting.

While contract law generally requires nonbreaching parties to make reasonable attempts to mitigate damages, many states limit or dispense with that obligation when it comes to commercial leases. For example, in California, Civil Code Section 1951.4 provides that if the lease contains certain language and permits the tenant to reasonably assign its interest in the lease, then a defaulting tenant that abandons the premises prematurely may be held liable for the full amount of future rent notwithstanding a failure on the part of the owner to mitigate damages. And in New York, it is well settled that commercial owners have no obligation to mitigate damages upon an early lease termination unless the lease expressly so provides. See, e.g., Holy Properties Ltd., L.P. v. Kenneth Cole Prods., 87 N.Y.2d 130, 134 (N.Y. 1995).

On the other hand, some jurisdictions impose a mitigation requirement on commercial owners. For example, Florida imposes a duty to mitigate losses by reletting the premises, but notably this duty is not triggered until the owner actually recovers possession of the premises. In these jurisdictions, even if the owner prevails by obtaining a ruling that the tenant defaulted and is liable for damages, the owner may not be able to recover all future rent. Rather, the owner must demonstrate reasonable efforts to mitigate its damages, and if it is determined that the owner did not adequately exercise its efforts to mitigate damages, then the owner will not be able to recover the full amount of future rent over the balance of the term. Mitigation of damages, in short, can be a powerful defense for a tenant. But this impact can be limited if the lease expressly prescribes the steps that, if taken, would be considered a reasonable effort to relet.

Thus, if you represent an owner in a state that requires mitigation of damages upon a lease termination, or if the lease requires mitigation, it is crucial to document reletting efforts in order to avoid the reduction of a future rent award. The key is for the owner to treat the reletting as it would any other vacancy, to make sure all efforts (or as many as are practically possible) are in writing, and to avoid acting in a way that will give credence to tenant arguments that the owner dragged its feet as a way to increase the tenant's liability.

And if you represent the tenant resisting a future rent damages claim, your chief aim will be to demonstrate how the owner's efforts departed from what was commercially reasonable under the circumstances.

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Is There a Lease Guaranty?

Of course, if the tenant cannot pay monthly rent as it comes due, any remedy nominally afforded to an owner may be meaningless in the absence of a lease guaranty executed by a principal or solvent corporate parent of the tenant.

In ascertaining the parties' rights, obligations, and relative leverage, the guaranty's provisions must be examined closely. Some guaranties guarantee all of the tenant's monetary obligations under the lease, but others are limited in some respect. Some guaranties will only guarantee up to a certain amount due under the lease, or for a finite period of time. Other guaranties are what is known as "good guy" guaranties, in which so long as certain conditions are met and the tenant gives back the keys and surrenders possession of the space, the tenant's rental obligation will end and only the guarantor will be on the hook.

But even if a guarantor is liable for some or all of the obligations under the lease, the owner must consider whether the guarantor has sufficient assets to satisfy a money judgment and whether the amount of a potential judgment may induce the guarantor to file for bankruptcy—and with unsecured creditors being in an unfavorable position in bankruptcy court, the owner may be relegated to recovering pennies on the dollar, if that.

For lease guaranty templates, see Guaranty (Personal Guaranty, Office Lease), Limited Guaranty of Lease (Retail Lease), and Guaranty (Personal Guaranty, Industrial Lease).

Your Lease Has a Prevailing Party Attorney's Fees Clause, but Will It Help You?

Prevailing party attorney's fees clauses have become standard terms in commercial leases. And on initial thought, they seem like a good idea. If an owner must sue the tenant due to a breach of the lease, then it can recover the unpaid rent as well as its attorney's fees and costs in order to be made whole. Right?

But the owner should also consider how it got into this position. If it was because the tenant had insufficient funds to pay rent, then the tenant likely will not have enough money to pay attorney's fees and costs either. So, the notion of the

tenant being liable for the owner's fees and costs in the event it falls behind in rent may not confer the expected leverage.

Consider also that some jurisdictions, like Florida and California, have statutes that automatically treat one-way attorney's fees clauses as applying to both parties. For example, if a lease governed by Florida or California law purports to award only the owner attorney's fees if it prevails in a lease enforcement lawsuit, then that clause will be treated as meaning that the tenant can also recover its fees upon prevailing in the lawsuit. Why is that important? Because it should give owners pause on pulling the trigger on every potential tenant breach and force them to evaluate the strength of their claims. In other words, depending on the law in your jurisdiction, what may appear on its face to be an advantageous attorney's fees clause may in fact provide leverage to the tenant in the event of a dispute. And if the lease does not contain a prevailing party attorney's fees clause, then the tenant may be less likely to contest disputes under the lease if it knows there is no ability to recover fees.

That being said, on balance, it is still best practice to include the prevailing party attorney's fees in the lease as a default term—especially in a state like New York that does not imply a reciprocal attorney's fees right in commercial leases.

Prevailing party attorney's fees are also recommended in lease guaranties. There, the guarantor, usually either the individual principal or a parent company, likely was selected due to its creditworthiness, and, in theory, should have the resources to cover both the past due rent and attorney's fees and costs—thus putting the guarantor at a greater risk of loss than a potentially judgment-proof tenant.

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Where Do You Want to Litigate?

If the owner decides to move forward with an eviction proceeding, several strategic factors should be considered, including the venue of the action and whether to sue for both eviction and damages in the same lawsuit. When making these determinations, the number one goal is to ensure that your selection aligns with your client's goals.

First, consider the local court system where an eviction proceeding can be commenced in your jurisdiction. In most states, there are multiple courts in which the case can be brought. For example, in New York, eviction cases can be brought in either a local town, city, or county court (the usual preferred forum for eviction cases), or the state Supreme Court (i.e., New York's court of general jurisdiction). In each forum, you should consider a number of factors, including, without limitation:

1. The pace of how cases usually progress; do they proceed relatively quickly, or are the courts backed up?
2. Are the judges generally regarded as even-handed, or do they have a propensity to be pro-owner or pro-tenant?
3. Is discovery—which can significantly bog a case down—permitted as of right (as is the case in New York State Supreme Court), or is it only available on motion (as is the case in the New York City Civil Court)?

Relatedly, you should consider whether you can and should split causes of action for eviction and unpaid rent. Some jurisdictions, like Florida and California, permit a commercial owner to split its cause of action by filing one lawsuit for eviction only, and then a subsequent lawsuit for damages. If your client's goal is to recover the premises as quickly as possible, then your recommendation may be to file a lawsuit only for eviction so that you can bring the claim in a court (such as Florida's County Court) which tends to handle eviction claims more expeditiously than a court of general jurisdiction (like Florida's Circuit Court). But if your client wants to sue at the same time for both eviction and damages, then depending upon the amount in controversy, you may have no choice but to bring the entire action in Florida's Circuit Court or the court of general jurisdiction in your state.

Similarly, California handles evictions through a summary unlawful detainer proceeding, which is on an expedited track. If the owner seeks to obtain future rent, it will not benefit from the summary proceeding. For this reason, in California, many owners first choose to obtain possession and then sue separately for future rent. This is why you must make sure your litigation strategy aligns with your client's goals.

Another consideration is whether the claims can be brought in federal court. If there is complete diversity of citizenship between the owner and tenant and the claim is over $75,000, then diversity jurisdiction may apply and the case can be commenced in federal court. This may be a good option in certain instances, such as if (1) as in New York since the COVID-19 pandemic, the administration of state- and city-court eviction proceedings has slowed significantly; (2) you are concerned that the local forum is the tenant's home turf or may otherwise be favorable to the tenant; and/or (3) you are agreeable with the majority of the issues being decided purely on the papers, since hearings in federal court tend to be rarer than state court. There are potential downsides to federal court, however. State courts are more familiar with eviction proceedings and the issues that typically arise in those proceedings, which may expedite the consideration and disposition of the claims. Some federal courts, however, will refuse to exercise jurisdiction over eviction proceedings; it is vital to check the local case law on this issue to determine

whether federal court is an available option. Moreover, federal court diversity cases will almost always take longer than state court eviction cases due to the absence of an expedited or summary track. For that reason, owners should be mindful that even if they opt to bring an eviction proceeding in state court, the tenant may seek to remove the case to federal court if diversity exists as a way to slow down the process and increase their negotiating leverage.

Finally, the owner should consider whether it needs to bring an eviction case at all and whether a self-help remedy is available. For example, in New York, self-help is permitted upon a commercial lease termination if it is authorized by the lease and can be effected without "breaching the peace" (i.e., causing a disturbance or altercation with the tenant). If a tenant has ceased conducting business and the premises are vacant, self-help (if permitted) can be a quick and inexpensive way to recover possession and install a new tenant while avoiding months of lost rent and attorney's fees expended in litigation. On the other hand, some states, like Florida, do not permit self-help evictions even if purportedly authorized by the lease. Moreover, other states do not allow self-help in the event of abandonment. For example, California requires owners to follow a statutory notice procedure in the event of abandonment to legally terminate the lease and recover possession.

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Should You Credit the Security Deposit Now, or Wait?

Most leases require that the tenant post a security deposit or letter of credit (collectively, security) to act as a collateral source that the owner can use for payment of rent or to cover other monetary defaults under the lease. And most leases will generally state that an owner "may" (but is not required to) apply the security against any missed rental payment. So, if a tenant misses a rental payment, should you apply the security to the arrears, and subsequently serve a notice to replenish the security followed by a default notice upon the tenant's failure to do so? It depends on your client's goals.

If your client is seeking to recapture the premises as quickly as possible, then utilizing the security may not be the best decision because the owner will have essentially cured the tenant's breach and then there would be no pending default to serve as the basis for an eviction claim. While the lease may require the tenant to replenish the security, leases generally provide tenants with a reasonable amount of time to replenish before the owner can declare a default. Thus, if the client's goal is to recapture the premises quickly, it may be better to refrain from utilizing the security to cover the missed rental payment so that the owner can act upon that default immediately. Then, if and when the lease is terminated and the premises are recaptured, the owner can apply the security to make itself whole. Alternatively, if the tenant cures the default, then the owner can keep the security intact and ready to be applied at the lease's expiration or in the event of another default down the road.

Another concern is whether the tenant is on the verge of bankruptcy, in which case you may want to apply the security as quickly as possible to preserve your rights to it in a bankruptcy estate. But suppose that the security is in the form of a letter of credit (LC) rather than a cash deposit. The bankruptcy courts generally view an LC as being an asset outside of the bankruptcy estate that can be drawn down after a tenant's bankruptcy filing. See, e.g., In re Compton Corp., 831 F.2d 586, 589 (5th Cir. 1987). Other forms of security may not be treated in the same way and can potentially become inaccessible following a bankruptcy filing.

For a state law survey on security deposits, see Security Deposit (Residential and Commercial Leases) State Law Survey.

Getting Ready to Litigate—To-do List before Commencing Litigation

Taking the necessary steps before litigation is essential because, in the landlord-tenant context, one misstep can lead to a jurisdictional or other procedural defect that results in dismissal. Any owner thinking of commencing litigation should (1) ensure that all notices are given in strict compliance with the lease's requirements (e.g., by the required method of mailing or other mode of service); (2) issue default notices even if waived under the lease; and (3) provide notices not only to all addresses required by the lease, but also the tenant's registered agent, principal place of business, and any other known address. Preparation on the front end prior to filing a lawsuit will save time and countless thousands of dollars in attorney's fees in preempting arguments by a tenant on a motion to dismiss or other dispositive motion.

For example, to set up an eviction lawsuit, the tenant generally needs to be considered "in default" per the terms of the lease. Generally, a tenant is held to be in default when the owner serves a default notice pursuant to the lease and/or applicable state statute, followed by a subsequent notice of termination and/or any other notice that may be required under the law of your jurisdiction. Notably, subtenants in possession may also be entitled to the predicate notices pursuant to the lease and/or statute. Once the required notices are served, the owner may commence an eviction proceeding. While some states may permit the parties to waive these notices under the lease, the best practice is

usually to issue the notices anyway, because the owner will avoid the necessity of litigating whether the waiver under the lease was valid.

Along those lines, when you are giving the required predicate notices to set up an eviction lawsuit (as may be required under the lease and/or statute), make sure you are giving the notices to all known addresses under the lease, and also to any address registered with your state's secretary of state, department of corporations, or similar state office. The latter will generally include an address for a registered agent and principal mailing address for the tenant. The rationale here is, again, to preempt a motion to dismiss (or loss during trial) on the basis of failure to notify the tenant of the default. If you can show the court that you properly issued the predicate notices in compliance with the lease and/or statute to any and all available addresses for the tenant, a court will have little-to-no sympathy for a tenant claiming lack of notice as a defense.

Another important front-end consideration for owners prior to commencing an action is to ensure that all documents necessary to establish their *prima facie* case in court are lined up. For example, if the case goes to trial, the owner will likely need to submit the original lease as evidence of the tenant's obligations, as well as ledgers or other business records establishing that the tenant is in arrears. And if the owner is a corporation or other business entity such as an LLC, most states require the entity to be in good standing and to have been properly formed under state law in order to recover affirmative relief in court. Therefore, certified copies of the entity's corporate records should be retrieved from the relevant state office (such as the secretary of state or the division of corporations) for examination and, if in order, submission at trial as evidence of the entity's authority to commence suit. If any entity formation defects are identified, they obviously need to be corrected as soon as possible; notably, depending on the state, these defects can sometimes be corrected *nunc pro tunc*, which allows you to proceed with a lawsuit while simultaneously remedying the defects.

Also be sure to review the lease for any mediation or arbitration requirements. Some leases require arbitration of some or all disputes in lieu of court proceedings, and a failure to heed such a requirement can result in a tenant's successful motion to dismiss and lost time and expense on the owner's part. And the failure to undertake any pre-suit mediation prior to filing a lawsuit may trigger a stay pending mediation that slows down your lawsuit.

For a full listing of key content on commercial leasing, see Office Leasing Resource Kit, Retail Leasing Resource Kit, Industrial Leasing Resource Kit, and Restaurant Leasing Resource Kit.

What Are Some Potential Downfalls to Commencing Litigation?

Of course, any lease dispute will not occur in a vacuum. The real estate market in which a property is located often has a significant effect on the parties' bargaining power.

Litigation is both risky and frustrating—risky because you cannot guarantee the result of your case (even where you believe it is a "slam dunk"), and frustrating because you are incurring significant attorney's fees litigating against a tenant that broke a promise under the lease. In short, the expense and uncertainty of litigation must always be taken into account. Owners new to litigation often experience shock at how expensive it can be to engage in necessary tasks such as document review, deposition preparation, litigating discovery objections, and taking employees away from their normal duties to assist outside counsel in obtaining documents for discovery. Motion practice and its attendant cost and expense are also often unwelcome surprises to owners' bottom lines. And the necessary fees must be incurred without any guarantee that the tenant will have any assets to pay a money judgment or your attorney's fees if you prevail.

Moreover, depending on your goals, litigation may not always be the best answer.

For instance, suppose that four years into a 10-year lease, a retail tenant runs into financial trouble and falls behind in the payment of rent. Suppose further that during those four years, retail rents have increased 30% over the rent reserved under the lease.

In that instance, it often makes sense for both parties to reach an accommodation on the rental arrears and allow the tenant to vacate, and for the owner to sign a new lease with a different tenant for a higher rent. Another common strategy for defaulting tenants in a strong rental market is for the tenant to seek a new tenant who might benefit from the low rents under the lease, and then assign the lease to that tenant. Assuming that the lease permits an assignment, the owner will usually be required to consent to the assignment (or, at the very least, not unreasonably withhold consent), provided that the proposed assignment complies with the lease's requirements. Or, if the parties are unable to reach agreement on a lease termination or assignment, the owner is incentivized to bring an eviction proceeding seeking to force the tenant's hand and obtain possession for a more profitable re-rental.

On the other hand, suppose instead that the market has stagnated or that rents are now lower than when the lease was executed—a very common scenario, for example, for troubled leases executed in the period leading up to the COVID-19 pandemic. In this situation, the tenant potentially holds significant bargaining power because the tenant knows that even with inconsistent and late rental payments, the

owner's alternative is a new tenant with a lower rent—if the space can be re-rented at all. In other words, litigating an eviction action may not be the best long-term strategy; after all, paying to litigate a case only to obtain an uncollectible paper judgment is the quintessential example of "throwing good money after bad." Instead, hard realities may encourage the owner to work with the tenant on a lease modification at a lower rental, since *some* money in the door is better than none.

The tenant's bargaining power, however, is not limitless. For instance, if a tenant is not paying rent at all, the owner may still seek possession because lower rent from a new tenant is better than no rent at all. But, if the tenant can pay a lower rent rather than the amount reserved in the lease, the owner may be incentivized to take such a deal for an in-place tenant instead of engaging a broker and undertaking the other expenses attendant to a re-rental (e.g., buildout costs, free rent periods) only to realize a similar rental from a new tenant.

And, if the tenant is on the verge of bankruptcy, the better long-term strategy would be to help the tenant stay out of bankruptcy so it can generate income and then pay the owner, even if it is less than what is owed under the lease. But if the tenant is on the verge of a bankruptcy that cannot be avoided, then you may want to push to terminate the lease entirely (with the understanding that this may cut off the ability to recover future rent), because otherwise you will be stuck in the bankruptcy proceeding waiting for a determination whether the lease will be rejected, and you may not be able to mitigate your losses in the meantime.

Nevertheless, the owner should not lose sight of its leverage points. A common refrain from owners when transferring new cases to their attorneys is that they have been trying to negotiate a new deal at the tenant's request, but the tenant is not getting back to them or taking a recalcitrant negotiating position. This is almost always because the owner is not properly exerting leverage over the tenant; a tenant in financial trouble will not prioritize rental payments and will seek to satisfy other pressing obligations unless and until the owner exercises its rights and places the tenancy at risk.

Thus, in order to maximize negotiating power, the owner should not negotiate a lease modification without placing the tenant at risk of lease termination and the consequences that could flow therefrom—for example, by serving a default notice or a security deposit replenishment notice (assuming that the owner has applied the security deposit to rental arrears) or taking steps toward enforcing personal guaranties. The tenant should also be reminded about any lease clauses awarding the owner attorney's fees in the event of eviction proceedings or other litigation. Taking one or more of these steps will act as a "sword of Damocles" over the tenant and hasten a new deal because the tenant knows that if a lease modification is not finalized, it can be evicted and significant financial liability can be imposed on the tenant and any guarantor. All the while, however, the owner should use its leverage wisely and negotiate a new deal that will permit the tenant to remain profitable and able to operate in the space for the long term.

Consider also whether your filing of a claim against the tenant for eviction or damages will trigger any counterclaims against the owner. Common counterclaims that a tenant may file could include, but are not limited to: the owner's failure to timely build out the premises, the owner's failure to maintain the common areas or building structure, or the owner's failure to timely approve requests by the tenant. If the tenant has any grounds to raise those claims, you are forcing them to do that by filing a lawsuit. This is why the owner should also consider whether there is a path to resolving outstanding issues without litigation.

In sum, think of litigation like rolling a snowball. Once it is rolling, you may not be able to stop it, and you certainly will not be able to steer where it goes. So before you jump into litigation, consider all pros and cons because a lease amendment, assignment, or other arm's-length agreement may be better in the long run for all parties involved.

For a full listing of key content on commercial leasing, see Office Leasing Resource Kit, Retail Leasing Resource Kit, Industrial Leasing Resource Kit, and Restaurant Leasing Resource Kit.

What Are Some Common Non-Monetary Breaches to Look out For?

A tenant's failure to pay rent will be the most common default you encounter under a lease. But what are "non-monetary" breaches that can lead to the tenant's eviction or lease termination?

Some of the most common ones we have seen include the following:

- Tenant's failure to comply with noise restrictions, which causes other tenants to request offsets in rent due to the nuisance
- Failure to remain open for business during the days and hours required by the lease, which decreases foot traffic in a mall or shopping center
- Failure to timely complete a buildout and open for business, which may give rise to issues regarding whether the rent commencement date was triggered
- Failure to maintain or provide copies of liability insurance policies, which may lead to liability on the owner if a slip and fall occurs on the premises; in some states like New York, the failure to maintain insurance is an incurable default, since it is virtually impossible to obtain insurance retroactively

- Failure to abide by local signage requirements, which may result in daily fines to owner as owner of the premises– and–
- Tenant's failure to abide by an anti-assignment clause requiring owner's approval for any subleases or assignments, which may result in a business of which the owner is unaware attempting to claim possessory rights in and to the premises

Because non-monetary breaches may be more difficult to establish than a straightforward failure to pay rent, it is vital that you contemporaneously document all non-monetary breaches and all communications in relation thereto as part of the owner's routine course of business. That paper trail will usually serve as evidence establishing the non-monetary breach and any resulting damages to the owner. So, make sure that any telephone conversations are followed up with confirmatory letters or emails that help establish a written record in your favor should the matter go to litigation—and that written record, in turn, may be the key to a favorable settlement.

From the Tenant's Perspective

Tenants Often Have Limited Termination Rights, with the Exception of Leases Involving Construction

In most commercial leases, owners have much broader termination rights than tenants, with tenants having few to no such rights. One exception often exists in commercial leases involving construction of the premises (e.g., a "build-to-suit lease"). In leases involving construction, there often is a period during which the tenant may not pay any rent or may obtain "free rent" from the owner. During that period, the tenant may not be considered in "possession," as the owner or its agents are performing construction of the premises according to the tenant's preferences (often defined in a statement of work). Generally, it is common to see provisions that will allow the tenant to terminate the lease prior to delivery of possession if there are delays in the construction that are not due to tenant's actions or inactions. In those situations, the lease carefully lays out the obligations of the owner and the tenant, and may provide a cure period for the owner prior to termination.

Similarly, if the tenant is in control of construction, the lease may also contain provisions allowing the tenant to terminate if, for example, completion of the premises is dependent on the approvals of a governmental entity. In those situations, the written lease may provide "outs" for the tenant if the governmental entity fails to act on or disapproves of the project. Additionally, some leases give tenants a due diligence period during which they need to obtain necessary construction permits or, alternatively, determine whether they anticipate obtaining such permits. The tenant can terminate before the end of that period, but if it does not do so, it cannot terminate later even if construction is delayed.

In leases involving construction, you should carefully review the termination provisions, as well as all exhibits and attachments to the lease, which often include important data regarding milestones that the parties must meet in order to avoid lease termination.

For additional information on tenant remedies in a commercial leasing context, see Remedies Available to a Tenant after a Default by the Landlord: State Law Comparison Tool Report [August 2024].

Eminent Domain

Another situation where a tenant may terminate involves a taking under eminent domain law (i.e., where a governmental authority condemns the premises or takes the premises for public use). Leases often contain provisions allowing the tenant to terminate or cancel the lease upon a taking by eminent domain. Even in partial taking situations, if a substantial portion of the leased premises is taken by eminent domain, then the tenant may be able to cancel the lease in its entirety.

A contested issue that often arises in eminent domain situations is whether the owner or tenant gets to keep the reasonable compensation provided by the government as a result of the taking. The lease itself often lays out the process for the tenant to claim an interest in the eminent domain proceeds. Separately, even where provisions are lacking in the lease, many states (e.g., California) have bodies of law allowing the tenant to obtain the compensation if the taking occurred after the lease was entered into and the taking interferes with the tenant's possessory rights. Without lease provisions clearly delineating the parties' rights and obligations in a taking (full or partial) situation, litigation is likely to ensue.

For additional information on tenant remedies in a commercial leasing context, see Remedies Available to a Tenant after a Default by the Landlord: State Law Comparison Tool Report [August 2024].

Force Majeure and Related Principles

Another doctrine that may allow a tenant to at least suspend its obligations under a lease—if not terminate the lease—is the doctrine of force majeure. Force majeure means that an unforeseen circumstance, outside the control of the tenant, has occurred that prevents performance under the terms of the lease (e.g., preventing the tenant from occupying or using the premises). Traditionally, a force majeure event involves a so-called "act of God," such as a major weather event or earthquake.

Most commercial leases have a force majeure clause. In practice, courts will often narrowly construe the force majeure provision, confining it to only those events defined by the clause itself. This became an issue during the COVID-19 pandemic, when many tenants sought relief due to governmental shutdowns that prevented their operations. Generally, the courts held that if the force majeure clause did not include reference to a pandemic or a government shutdown, it did not provide relief to the tenant. Additionally, many courts have held that an increased cost or inability to pay rent is insufficient to invoke relief under a force majeure clause. Indeed, many force majeure clauses specify that inability to pay rent or other economic hardships do not constitute a force majeure event.

Similarly, most courts around the country rejected impossibility of performance and frustration of purpose defenses raised by commercial tenants in response to governmental shutdowns and drastically decreased business operations resulting from the pandemic. Insofar as commercial tenants are generally presumed to be sophisticated and able to negotiate protections for unforeseen business interruptions, courts generally have been unwilling to step in and, essentially, rewrite leases for the tenants' benefit.

It is a rare occasion where force majeure will allow for a lease termination. At best, force majeure typically will allow for only a temporary suspension of specific obligations under the lease, rather than an outright ability to terminate the lease. Accordingly, tenants seeking to invoke force majeure are encouraged to study the clause as well as the body of case law in their local jurisdiction to understand how readily a court will hold that the alleged unforeseen event excuses leasehold obligations, including rental obligations.

For additional information on tenant remedies in a commercial leasing context, see Remedies Available to a Tenant after a Default by the Landlord: State Law Comparison Tool Report [August 2024].

Destruction of the Premises/ Hazardous Substances

If the leased premises is destroyed, and the lease does not provide otherwise, the tenant may terminate the lease. Moreover, in many states, if there is a partial destruction that materially interferes with possession by the tenant, then the tenant may be able to terminate.

Of course, the lease's terms may supersede the common law right of a tenant to allow for termination. It is common, for example, for a commercial lease to require the owner to perform repairs to the premises in the event of a partial destruction. Such provisions are generally enforceable and may impede a tenant's ability to terminate, depending on the severity of the damage. Many leases state that the owner must undertake repairs if the damage can be remedied within a stated number of days, but that the tenant may terminate the lease if the repair work will take longer.

Similarly, if hazardous substances are found on the property, close attention must be paid to the terms of the lease. If the tenant caused the substances to appear on the premises, then the lease often provides that the tenant must undertake abatement efforts and cannot terminate. If, however, a third party or owner is the cause, the tenant may be able to terminate the lease, or alternatively require the owner to abate and remediate the premises and indemnify the tenant against liability relating to the hazardous materials.

As a practical matter, even where the lease provides that the tenant has some obligation to continue in the premises or remediate hazardous substances, the owner should consider whether a negotiated resolution in which the owner takes control of the situation would be a preferred solution. For example, if the tenant is not capable of working with government authorities to abate the hazardous substances, the owner may choose to take matters into its own hands in order to minimize liability and further harm to the premises and third parties. Similarly, even where the owner has an obligation to rebuild or repair the premises, if that process will take substantial time, it may be best to agree to a negotiated termination to minimize costs and allow the owner to focus on rebuilding efforts.

In situations where the termination resulting from a partial destruction or hazardous substance release is not automatic, owners and their counsel should consider the following issues:

1. Is it more feasible/advantageous for the owner to take control of any remediation or repair?
2. Is it cheaper and more efficient to negotiate a termination?
3. Does it make sense to rebuild following destruction based on the long-term use of the property –and–
4. Could a negotiated termination allow for full releases of the owner to avoid liability due to business interruption or loss of personal property by the tenant?

In all of these situations, the owner is advised to carefully consider owner's and tenant's insurance policies, and act quickly with respect to noticing insurers of the loss to avoid waivers of coverage. For a discussion of insurance policies in the context of commercial leasing, see Insurance Considerations in Commercial Leasing (Tenant).

For additional information on tenant remedies in a commercial leasing context, see Remedies Available to a Tenant after a Default by the Landlord: State Law Comparison Tool Report [August 2024].

Constructive Eviction

A common law theory that may allow a tenant to terminate is constructive eviction. Constructive eviction occurs where the owner breaches a covenant—such as the covenant of quiet enjoyment—which interferes with the tenant's use, enjoyment, and possession of the premises, and the tenant actually vacates the premises as a result of the breach. For example, if the owner fails to deliver material services (e.g., electricity or HVAC) that makes the tenant's use of the premises untenable, and the tenant is forced to vacate, the tenant may have a constructive eviction claim allowing the tenant to vacate, terminate the lease, and seek damages arising from the constructive eviction.

Tenants should pay close attention to the language of the lease, however. Many states allow owners and tenants in a commercial lease to waive implied covenants (e.g., the covenant of fitness for a particular purpose, or the quiet enjoyment covenant), which may preclude relief under a constructive eviction theory. Additionally, many states require that before a tenant terminates the lease, it actually vacates the premises in order to benefit from the law of constructive eviction.

Furthermore, unlike the usual eviction proceedings commenced by owners due to a tenant's failure to pay rent, constructive eviction claims generally are not subject to summary proceedings. Instead, they will usually require a lengthier court process in a state's court of general jurisdiction to declare the lease terminated. Since a summary proceeding may not be available, close attention should be paid to the costs of litigating these often fact-intensive theories that may involve discovery and a trial.

For additional information on tenant remedies in a commercial leasing context, see Remedies Available to a Tenant after a Default by the Landlord: State Law Comparison Tool Report [August 2024].

Common Defenses to Owner's Attempted Lease Termination

Where an owner attempts to terminate the lease, the tenant may have many defenses to preclude lease termination. Some common tenant defenses include the following:

1 **No breach; immaterial breach.** The breach did not occur or was not material, and therefore, the owner should not be entitled to obtain repossession of the premises. Certain courts have excused more minor breaches by the tenant (e.g., breach of a non-monetary covenant) to allow the lease to continue. In certain states, eviction is considered a special remedy that should only be awarded upon material, uncured defaults.

2 **First breach; the owner breached first.** Tenants may be successful in arguing that the owner breached first by, for example, failing to maintain the premises or provide some essential service. In those situations, the tenant may seek to argue that the owner's first breach caused tenant's breach or made it more likely. Nevertheless, extra care must be exercised before invoking this defense. Many states do not allow a tenant to stop paying rent merely because the owner did not fully perform on the lease by engaging in a maintenance failure. Thus, in those states, the tenant must continue to pay rent to avoid an eviction by the owner and must instead sue the owner for damages while continuing to perform under the lease.

3. **Waiver.** If the owner fails to take action on a default and then later tries to terminate the lease, and substantial time has passed, some court may consider the default waived. Indeed, some states require that any eviction proceeding based upon a monetary default be brought within a specified period in order to benefit from summary proceedings. Older defaults may be enforced until the conclusion of the statute of limitations period, but may not be a basis for eviction. However, waiver may not be available as a defense if the lease contains a no-waiver clause providing, for example, that no provision of the lease or default by the tenant may be waived unless such waiver is contained in a writing executed by the owner.

4 **Lack of compliance with notice and other procedural nuances**. Many states have notice requirements that must be strictly followed to avoid dismissal of an eviction proceeding. If a tenant is successfully able to argue that an irregularity existed in noticing the default or commencing an eviction proceeding, the tenant may successfully obtain a dismissal of the eviction proceeding on a procedural ground. This would require the owner to start the process all over again to correct the procedural default—an event that would provide the tenant with substantial leverage either in negotiations or a second action by the owner seeking termination.

In short, although the owner's rights to terminate the lease are typically much broader than a tenant's rights, there are limited exceptions that allow a tenant to terminate the lease either under the common law or lease language. Additionally, even where an owner seeks to terminate, many defenses to termination

provide tools for a tenant disputing the termination or seeking to slow down the process to obtain a more favorable negotiated resolution.

Conclusion

While usually not ideal for any party involved, from time to time both commercial owners and tenants are forced to grapple with potential lease termination scenarios. Whether the prospective termination is the result of a tenant default, the owner's wrongdoing, or an outside event out of either party's control, the parties to the lease must take many different considerations into account when charting a path forward. No two situations are exactly alike and there is no instruction manual to guide exactly how the parties should proceed in a given situation. The bottom line is that each side must take full stock of its legal rights and potential remedies pursuant to the lease and applicable law, determine where they want to end up, and then carefully craft and execute a strategy to relegate the dispute to their rearview mirrors.

Related Content

Resource Kits

- Industrial Leasing Resource Kit
- Office Leasing Resource Kit
- Restaurant Leasing Resource Kit
- Retail Leasing Resource Kit

Practice Notes

- Insurance Considerations in Commercial Leasing (Tenant)
- Lease Assignments
- Remedies Available to a Tenant after a Default by the Landlord: State Law Comparison Tool Report [August 2024]

State Law Survey

- Security Deposit (Residential and Commercial Leases) State Law Survey

Templates

- Guaranty (Personal Guaranty, Industrial Lease)
- Guaranty (Personal Guaranty, Office Lease)
- Limited Guaranty of Lease (Retail Lease)

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Alexander Lycoyannis is a real estate attorney in Holland & Knight's New York office and represents owners, developers, landlords and commercial tenants in all phases of litigation and appellate matters in New York and throughout the country.

Mr. Lycoyannis is a prominent legal strategist and a go-to practitioner for real estate-related litigation. His writing and oral argument abilities frequently result in victories for his clients at the lower court and appellate levels. In addition, his keen business sense and negotiation skills have consistently led to favorable settlements for his clients, including the resolutions of many seemingly intractable stalemates that have freed clients from the inherent expense and uncertainty of a trial.

With broad knowledge and wide-ranging experience in an array of real estate and complex commercial matters, Mr. Lycoyannis has represented a wide variety of clients in his two decade-plus career, including some of the country's largest real estate developers and national commercial tenants. He has successfully litigated disputes and handled matters arising out of commercial leases and contracts for the purchase and sale of real property; commercial and residential landlord/tenant litigation; New York City rent regulation; applications for Yellowstone and preliminary injunctions; corporate, partnership and limited liability company disputes; condominium and cooperative disputes; construction litigation; adjacent landowner disputes; Uniform Commercial Code (UCC) and mortgage foreclosures; homestay vacation and short-term rental disputes; and the enforcement of guaranties and promissory notes. Mr. Lycoyannis also has negotiated purchase and sale agreements, buyout agreements, real estate brokerage agreements, occupancy agreements, and residential and commercial leases and amendments.

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