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Noneconomic defaults: Robust protections, remedies

EDITOR'S NOTE: This is the second in a two-part series. Part 1 was published May 15, 2024.

With tenants increasingly focused on protecting themselves from defaulting landlords, part one of this series addressed doing diligence on potential landlords and protecting the tenant's economic bargain, but a tenant should also protect against the landlord's defaults in noneconomic obligations. Leases significantly limit and waive tenant remedies for landlord defaults. Although these concepts are rarely completely, or even substantially, modified, tenants can negotiate for more favorable terms.

■ **Specific landlord default parameters.** Tenants should negotiate specific time frames for landlords and their mortgagees to cure landlord defaults (with reasonable extensions as necessary under the circumstances, subject to a cap). This provides security as to how quickly a situation will be remedied, or if it is not, when a tenant can seek remedies.

■ **Self-help right.** Tenants can request a self-help right for landlord defaults, with reimbursement from the landlord for the costs of performance (and for leveraged tenants, an offset right if the landlord does not timely reimburse them). Although landlords often limit self-help to defaults that directly affect the tenant, this is a practical way that a tenant can resolve impactful defaults.

■ **Avoiding limitations to scope of remedies.** Leases customarily limit a tenant's remedies for landlord defaults



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to an injunction or damages suit, with tenants waiving termination rights. Although tenants almost never get a blanket default terminate right, tenants can sometimes

get a terminate right for defaults that materially affect the tenant's use of the premises for an extended time or have a significant economic impact on the tenant. Tenants should also try to carve out the landlord's negligence (or at least gross negligence) and willful misconduct from waivers of landlord liability. Where a lease limits the tenant's recovery to the landlord's interest in the building, tenants should state that this includes the rents and proceeds derived from a sale, condemnation or casualty.

■ **Service interruption abatements.** Many tenants can negotiate for a rent abatement if a service or utility interruption caused by a landlord makes some portion of the premises unusable after a notice and cure period. Tenants should try to expand this to also cover other disruptions of the tenant's ability to operate in the premises caused by the landlord's default, performance of work or (gross or simple) negligence and willful misconduct. Larger tenants with leverage occasionally also get a termination right if the issue persists for an extended period.

■ **Late delivery penalties.**



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Especially in new construction leases, but also in leases for existing buildings where the landlord performs substantial build-outs, where there will be a significant time gap

between lease signing and delivering the space to the tenant, tenants often request late delivery penalties to incentivize landlords to deliver on time and to defray the tenant's potential costs if the landlord fails to do so. The customary penalty is a day-for-day (sometimes two days per day) rent abatement for each day the landlord does not deliver the space after an agreed upon outside date. Some tenants might also get a termination right if the landlord does not deliver by some later outside date, but landlords may be resistant to this, and it is not an ideal solution for tenants anyway. Tenants should also tie rent commencement to delivery of the premises in the required condition to avoid risking a late delivery eating into its free rent period or resulting in the tenant paying for space it cannot use. In very limited cases, landlords may also indemnify tenants for the holdover damages the tenant is responsible for under its existing lease if the new landlord delivers the space late, but that is customarily only for leveraged tenants signing leases prior to a

building being constructed, where there is significant risk of substantial construction and delivery delays.

■ **Customarily casualty/condemnation rights.** Tenants should ensure they have customary rights to terminate the lease for major issues and to receive a rent abatement for unusable space. Otherwise, the tenant can be locked into a lease without usable space for an extended time, even if a landlord is not timely performing its restoration obligations.

■ **Completion guaranty.** In rare cases, if significant work is required to be completed by the landlord, tenants may ask for a completion guaranty to ensure that the building and the tenant's premises will actually be completed.

Tenants should also negotiate a subordination, nondisturbance and attornment agreement with the landlord's lender. An SNDA ensures (and should expressly state) that a tenant will not be removed after the lender forecloses on the property provided the tenant is not in default beyond notice and cure periods. A lender's SNDA form will disclaim the lender's liability for preexisting defaults or recognition of offset rights, or performing a landlord's construction or allowance obligations, but tenants can sometimes get a lender to recognize their specific build-out, allowance and offset rights, and require a lender to cure preexisting defaults if they continue after foreclosure and are curable by the lender. An SNDA from all superior lienholders such as a ground lessor would

be even better. However, some lienholders might not provide an SNDA for smaller tenants, and depending on the size and leverage of a tenant, landlords may only agree to try to get an SNDA, without guaranteeing receipt or making it a condition to subordination.

Despite situational differences, the above considerations are also conceptually applicable to subtenants to protect against master landlord defaults (including assurance that the sublandlord will help obtain the master landlord's performance given the lack of privity of contract between a subtenant and master landlord), and also from sublandlord defaults, including affirmation that the subtenant will not be removed due to the master landlord's exercise of its remedies for sublandlord defaults.

Landlords and tenants want a positive, long-lasting relationship, but neither is immune to the effects of economic cycles that may cause their relationships to suffer. In order to protect themselves, tenants should do diligence on a potential landlord, and although a tenant should not expect to get every item detailed in this series, tenants should negotiate for those protections that are important under their particular circumstances so that they do not get locked into a lease with a nonperforming landlord or lose their lease due to a landlord's financial distress. ▲

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