

**NEGOTIATING COMMERCIAL REAL ESTATE  
ACQUISITIONS AND LEASING TRANSACTIONS  
IN TEXAS**

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## I. COMMERCIAL REAL ESTATE PURCHASE AND SALE TRANSACTIONS

### A. Four Important Issues in Commercial Real Estate Purchase and Sale Transactions

#### 1. “AS IS, WHERE IS”

“AS IS, WHERE IS” clauses have become very common in commercial purchase and sale contracts. In a commercial real estate transaction, “AS IS” clauses may be enforced by Texas courts if certain requirements are met. A plaintiff in a lawsuit alleging a seller’s breach of a representation or warranty concerning the condition of the real property being sold must prove that the breach *caused* the plaintiff’s damages. The Texas Supreme Court, in Prudential Insurance Company of America v. Jefferson Associates, 896 S.W.2d 156, (Tex. 1995) reversing 839 S.W.2d 866 (Tex. App.--Austin 1992), ruled that an “AS IS” agreement in a purchase contract negates the causation element for breach of contract and tort claims.<sup>1</sup> A plaintiff’s inability to prove causation will prevent them from recovering damages from the seller.

In Prudential Insurance Company of America, Prudential sold a building to Goldman in 1976. Goldman inspected the property before purchasing it. Goldman purchased the property “AS IS.” Two years later Goldman discovered that the building contained asbestos. Goldman sued Prudential alleging DTPA claims, fraudulent concealment and other causes of action relating to Prudential’s failure to disclose the existence of asbestos. Before Goldman purchased the building, Prudential’s on-site manager made statements to Goldman stating that the building had “no defects,” was a “superb, super fine building,” and was “one of the finest little properties in the City of Austin.”<sup>2</sup> Based on these statements, the trial court awarded Goldman \$6,023,933.03 in actual damages and \$14,300,000.00 in exemplary damages. The trial court’s decision was affirmed on appeal. The Texas Supreme Court, however, reversed the decision, stating that the on-site manager’s statements to Goldman were mere “puffing,” and not fraudulent misrepresentations, and that Goldman had not relied on the on-site manager’s statements in deciding to buy the \$7 million building.<sup>3</sup> In this case, the “AS IS” language was upheld.

The Prudential court also held, however, that “AS IS” clauses will not be binding and will not negate causation if the buyer was induced into the

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<sup>1</sup> Prudential Insurance Company of America v. Jefferson Association, 896 S.W.2d 156, 160-62 (Tex. 1995), reversing 839 S.W.2d 866 (Tex. App.--Austin 1992).

<sup>2</sup> Id. at 163.

<sup>3</sup>Id.

“AS IS” agreement by fraudulent representation or concealment of information (also known as “fraudulent inducement”).<sup>4</sup> Other aspects of the transaction may make an “as is” agreement unenforceable. For example, if the “AS IS” provision is deemed to be boilerplate contract language, the provision is suspect.<sup>5</sup> The relative sophistication of the parties will also be a factor.<sup>6</sup> The Court held that the “totality of the circumstances” surrounding the agreement must be considered to determine if the agreement is enforceable and negates causation. “AS IS” language similar to that quoted in the Prudential case has become very common in Texas commercial real estate contracts. The Prudential court did not specifically address residential real estate contracts.

In another Texas case, Schlumberger Technology Corporation v. Swanson, 959 S.W.2d 171 (Tex. 1997), the Texas Supreme Court held that contract language stating one party was not relying on the representations of another party was enforceable and precluded an action for fraudulent inducement. The Schlumberger case was not a real estate case, but its language is significant because it suggests that the protection from “AS IS” language in real estate sales contracts can be extended by indicating in the contract that the buyer is not relying on any representation made by the seller or its agents. In Schlumberger, Schlumberger was negotiating with Swanson, a joint venture partner, in an attempt to buy out Swanson’s interest in a sea diamond mining project in South Africa. During the negotiations, Schlumberger informed Swanson that the project was not technologically feasible or commercially viable.<sup>7</sup> Swanson agreed to sell its interest to Schlumberger. The sale contract contained “AS IS” language and a statement that Swanson was not relying on any representations or warranties made by Schlumberger.<sup>8</sup> Schlumberger then sold its interest and Swanson’s interest to DeBeers, the third joint venture party, at a premium.

Swanson alleged that Schlumberger fraudulently induced him into entering the contract. Swanson alleged fraudulent inducement because, under the holding in Prudential, the “AS IS” clause prevented Swanson from recovering damages unless there was an exception to its enforceability. Prudential held that fraudulent inducement was such an exception. The Texas Supreme Court denied Swanson’s claim, however. One of the elements of fraudulent inducement is proof of *reliance* on the

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<sup>4</sup> Id. at 162.

<sup>5</sup> Id.

<sup>6</sup> Id.

<sup>7</sup> Schlumberger, 959 S.W.2d at 174.

<sup>8</sup> Id.

statements that “induced” the injured party.<sup>9</sup> The Court held that the contract language reciting that Swanson did not rely on any statements made by Schlumberger during negotiations was enforceable and specifically negated the reliance element.<sup>10</sup> In making its holding, the Court considered the facts that both parties were sophisticated and were represented by counsel.<sup>11</sup>

The reasoning of Prudential and Schlumberger has been consistently followed since the holdings in those cases. In reported cases concerning breaches of representations or warranties in commercial real estate transactions, courts almost uniformly find in favor of the seller when the purchase contract contains an “AS IS” clause that also negates the element of reliance on sellers’ representations and warranties; no specific language is required.<sup>12</sup> In two recent cases, however, Texas courts decided not to enforce an AS IS clause against a purchaser.

In SMB Partners v. Osloub, the court held that the seller’s provision of a faulty survey constituted a misrepresentation that fraudulently induced the buyer to purchase the property.<sup>13</sup> The court stated that the AS IS clause in the earnest money contract was effective but that it explicitly excluded the seller’s representations regarding the title of the property.<sup>14</sup> Because the incorrect survey misidentified the location of an easement, the court held that the fraudulent representation (that is, the survey) related to the status of the seller’s title, which was not covered by the AS IS clause.<sup>15</sup> It was not clear in this case whether the AS IS clause included the Schlumberger non-reliance language.

In Nelson v. Najm, the purchaser had a contract to purchase a gas station. The seller informed the purchaser that, with regard to soil contamination: “Look, you don't have to make no test. This is a gas station. I'm selling gas. You see the people buying gas, selling gas, and that's it. And I have been here 30 years. I don't have any problem. I selling gas. Everything is

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<sup>9</sup> Id.

<sup>10</sup> Id. at 179-80.

<sup>11</sup> Id.

<sup>12</sup> See, e.g. United Enterprises, Inc. v. Erick Racing Enterprises, Inc., 2002 Tex. App. LEXIS 9271 (Tex. App.—Amarillo, 2002) (unpublished opinion); Starlight, L.P. v. Xarin/Austin I, Ltd., 1999 Tex. App. LEXIS 159 (Tex. App.—Austin 1999) (unpublished opinion); 1900 SJ, Inc. v. Washington Nat’l Ins. Co., 1998 Tex. App. LEXIS 1059 (Tex. App.—Houston [1<sup>st</sup> Dist] 1998) (unpublished opinion).

<sup>13</sup> SMB Partners v. Osloub, 4 S.W.3d 368, 372 (Tex. App.—Houston [1<sup>st</sup> Dist.] 1999, no pet.).

<sup>14</sup> Id. at 371.

<sup>15</sup> Id. at 371-72.

fine.”<sup>16</sup> The seller also failed to inform the purchaser of the existence of underground storage tanks.<sup>17</sup> Months after the transaction closed, soil contamination from a leaking underground tank was discovered, and the purchaser was prevented from operating the site as a gas station.<sup>18</sup> The seller refused to pay for the clean-up and repairs and argued that the AS IS clause in the contract and deed prevented the buyer from recovering from him. The court discussed the Prudential case and held that the AS IS clause did not protect the seller because the seller’s statements constituted fraudulent misrepresentations that formed the basis of a fraudulent inducement claim.<sup>19</sup> It was not clear in this case whether the AS IS clause included the Schlumberger non-reliance language that might have defeated the purchaser’s fraudulent inducement claim. The court also relied on the fact that the seller had a statutory duty to disclose the existence of the underground storage tanks for its holding that failing to disclose the tanks constituted the fraudulent concealment of a material fact.<sup>20</sup>

Texas courts’ application of the Prudential/Schlumberger doctrine in residential real estate cases has been less consistent. In residential cases, the courts have focused on Prudential’s requirement that the totality of the circumstances of the transaction be reviewed. In reviewing the totality of the circumstances, the courts have cited the sophistication of the parties and the boilerplate nature of “AS IS” provisions to allow the recovery of damages.

In The Woodlands Land Development Company, L.P. v. Jenkins, the court held that an “AS IS” provision was not enforceable against the buyer. In this case, the buyer purchased a home in which numerous defects were eventually discovered (including improperly graded landscaping, warped boards, roof leaks, improperly sealed floors, cracks in the walls and mortar, and a bee infestation).<sup>21</sup> Even though the contract contained “AS IS” language that also negated reliance on representations and warranties, the court declined to enforce the disclaimer of reliance.<sup>22</sup> The court held that the contract language was boilerplate, which was supported by the evidence that the real estate broker told the buyer that the contract could

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<sup>16</sup> Nelson, 2003 Tex. App. LEXIS 9038 at \*4 (Tex. App.—Houston [1<sup>st</sup> Dist] 2003, no pet. h.)

<sup>17</sup> Id.

<sup>18</sup> Nelson, 2000 Tex. App. LEXIS 9038 at \*5-\*6.

<sup>19</sup> Nelson, 2000 Tex. App. LEXIS 9038 at \*12-\*13.

<sup>20</sup> Nelson, 2000 Tex. App. LEXIS 9038 at \*12.

<sup>21</sup> The Woodlands, 48 S.W.3d 415, 419 (Tex. App.—Beaumont 2001, no pet.).

<sup>22</sup> Id. at 422.

not be altered and that another buyer was waiting to purchase the house. The court also noted that the buyer was not a knowledgeable purchaser of real estate, as contracted with the buyer in Prudential.<sup>23</sup> A different appellate court in a similar residential case, however, held that “AS IS” and disclaimer of reliance language was enforceable even though the transaction was the buyer’s first home purchase.<sup>24</sup>

Despite the inconsistency of the application of the doctrine in residential cases, sellers may continue to rely on the holdings in Prudential and Schlumberger to limit post-closing liability. Sellers should be more cautious in a residential transaction in order to avoid making false representations and/or failing to disclose major issues with the property because courts have been more willing to enforce exceptions to Prudential and Schlumberger in residential cases. In addition to tracking the language from Prudential and Schlumberger, a seller may want to require that the “AS IS” language be incorporated into the deed delivered at the closing and that the buyer execute the deed to certify its agreement to the “AS IS” language. This may give the seller additional assurance that a court will view the language as being specifically negotiated and not suspect boilerplate language. A sample “AS IS” provision follows:

PURCHASER HEREBY EXPRESSLY ACKNOWLEDGES THAT IT HAS OR WILL HAVE, PRIOR TO THE END OF THE INSPECTION PERIOD, THOROUGHLY INSPECTED AND EXAMINED THE PROJECT TO THE EXTENT DEEMED NECESSARY BY THE PURCHASER IN ORDER TO ENABLE THE PURCHASER TO EVALUATE THE PURCHASE OF THE PROJECT. PURCHASER REPRESENTS THAT IT IS A KNOWLEDGEABLE PURCHASER OF DEVELOPMENTS SUCH AS THE PROJECT AND THAT IT IS RELYING SOLELY ON ITS OWN EXPERTISE AND THAT OF PURCHASER'S CONSULTANTS, AND THAT PURCHASER WILL CONDUCT SUCH INSPECTIONS AND INVESTIGATIONS OF THE PROJECT, INCLUDING, BUT NOT LIMITED TO, THE PHYSICAL AND ENVIRONMENTAL CONDITIONS THEREOF, AND SHALL RELY UPON SAME, AND, UPON CLOSING, SHALL ASSUME THE RISK OF ANY ADVERSE MATTERS, INCLUDING, BUT NOT LIMITED TO, ADVERSE PHYSICAL AND ENVIRONMENTAL CONDITIONS, THAT MAY NOT HAVE BEEN REVEALED BY PURCHASER'S INSPECTIONS AND INVESTIGATIONS. PURCHASER FURTHER ACKNOWLEDGES AND AGREES THAT PURCHASER IS ACQUIRING THE PROJECT ON AN “AS IS, WHERE IS” AND WITH ALL FAULTS BASIS IN ITS PRESENT CONDITION WITH ALL KNOWN AND UNKNOWN DEFECTS, AND WITHOUT REPRESENTATIONS, WARRANTIES OR COVENANTS, EXPRESS OR IMPLIED, OF ANY KIND OR NATURE. PURCHASER DISCLAIMS RELIANCE UPON ALL ORAL REPRESENTATIONS AND WARRANTIES, EXPRESS OR IMPLIED, OF ANY KIND OR NATURE. THE

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<sup>23</sup> Id.

<sup>24</sup> See Alvarez v. Ward, 2002 Tex. App. LEXIS 7587 (Tex. App.—Houston [1<sup>st</sup> Dist.] 2002) (unpublished opinion).

PURCHASE PRICE IS A DISCOUNTED PURCHASE PRICE REPRESENTING THE FACT THAT THE PROJECT IS BEING PURCHASED BY PURCHASER ON AN AS IS, WHERE IS AND WITH ALL FAULTS BASIS. PURCHASER HEREBY WAIVES AND RELINQUISHES ALL RIGHTS AND PRIVILEGES ARISING OUT OF, OR WITH RESPECT OR IN RELATION TO, ANY REPRESENTATIONS, WARRANTIES OR COVENANTS, WHETHER EXPRESS OR IMPLIED, WHICH MAY HAVE BEEN MADE OR GIVEN, OR WHICH MAY HAVE BEEN DEEMED TO HAVE BEEN MADE OR GIVEN, BY THE SELLER. PURCHASER HEREBY ASSUMES ALL RISK AND LIABILITY (AND AGREES THAT SELLER SHALL NOT BE LIABLE FOR ANY SPECIAL, DIRECT, INDIRECT, CONSEQUENTIAL OR OTHER DAMAGES) RESULTING OR ARISING FROM OR RELATING TO THE OWNERSHIP, USE, CONDITION, LOCATION, MAINTENANCE, REPAIR OR OPERATION OF THE PROJECT. WITHOUT LIMITING THE GENERAL PROVISIONS OF THIS SECTION, IT IS UNDERSTOOD AND AGREED THAT SELLER IS NOT MAKING AND SPECIFICALLY DISCLAIMS ANY WARRANTIES OR REPRESENTATIONS OF ANY KIND OR CHARACTER, EXPRESS OR IMPLIED, AS TO (a) MATTERS OF TITLE, (b) ZONING, (c) TAX CONSEQUENCES, (d) PHYSICAL OR ENVIRONMENTAL CONDITIONS, (e) AVAILABILITY OF ACCESS, INGRESS OR EGRESS, (f) OPERATING HISTORY OR PROJECTIONS, (g) VALUATION, (h) GOVERNMENTAL APPROVALS, (i) GOVERNMENTAL REGULATIONS OR ANY OTHER MATTER OR THING RELATING TO OR AFFECTING THE PROJECT, INCLUDING, WITHOUT LIMITATION: (i) THE VALUE, CONDITION, MERCHANTABILITY, MARKETABILITY, PROFITABILITY, SUITABILITY OR FITNESS FOR A PARTICULAR USE OR PURPOSE OF THE PROJECT, (ii) THE MANNER OR QUALITY OF THE CONSTRUCTION OR MATERIALS INCORPORATED INTO ANY OF THE PROJECT, AND (iii) THE MANNER, QUALITY, STATE OF REPAIR OR LACK OF REPAIR OF THE PROJECT. PURCHASER FURTHER EXPRESSLY ACKNOWLEDGES AND AGREES THAT SELLER IS NOT REPRESENTING OR WARRANTING THAT ANYTHING CAN OR WILL BE ACCOMPLISHED THROUGH PURCHASER'S OR SELLER'S EFFORTS WITH REGARD TO THE PLANNING, PLATTING OR ZONING PROCESS OF THE CITY OF \_\_\_\_\_, \_\_\_\_\_ COUNTY, TEXAS, OR ANY OTHER GOVERNMENTAL OR MUNICIPAL AUTHORITIES, BOARDS OR ENTITIES. PURCHASER FURTHER ACKNOWLEDGES THAT SELLER HAS NOT WARRANTED, AND DOES NOT HEREBY WARRANT, THAT THE PROJECT NOW OR IN THE FUTURE WILL MEET OR COMPLY WITH THE REQUIREMENTS OF ANY SAFETY CODE, ENVIRONMENTAL LAW OR REGULATION OF THE STATE OF TEXAS, THE CITY OF \_\_\_\_\_, \_\_\_\_\_ COUNTY, TEXAS, OR ANY OTHER AUTHORITY OR JURISDICTION.

NOTWITHSTANDING ANY SEEMING CONTRADICTION, IT IS AGREED AND UNDERSTOOD THAT THE PROVISIONS OF THIS SECTION ARE LIMITED SO AS NOT TO BE CONSTRUED AS DIMINISHING OR NEGATING (a) SELLER'S RESPONSIBILITY FOR ANY REPRESENTATIONS PROVIDED IN THIS CONTRACT

(BUT ONLY TO THE EXTENT EXPRESSLY PROVIDED AND FOR THE DURATION STATED THEREIN), AND (b) ANY WARRANTY OF TITLE SET FORTH IN THE SPECIAL WARRANTY DEED TO BE DELIVERED BY SELLER TO PURCHASER AT CLOSING.

IT IS AGREED AND UNDERSTOOD THAT THE TERMS AND PROVISIONS OF THIS SECTION SHALL EXPRESSLY SURVIVE THE CLOSING AND NOT MERGE THEREIN AND SHALL BE INCORPORATED INTO THE SPECIAL WARRANTY DEED TO BE DELIVERED BY SELLER TO PURCHASER AT CLOSING.

## **2. Representations and Warranties**

The number and comprehensiveness of the representations and warranties given by a seller to a buyer are often driven by how much the parties intend for the buyer to rely on its own inspections of the property. It has become fairly common for sellers to make very few representations and warranties in commercial real estate contracts in Texas. Seller should, however, be willing make some limited warranties and representations – even in the commercial context. One basic representation a seller should be expected make is to represent and warrant that it owns good and indefeasible title (not “marketable” title). The buyer may request additional representations regarding compliance with applicable laws, rules, and ordinances; structural and physical condition of the property; environmental and hazardous materials issues; and other similar issues. The seller may agree to some of these representations, but softer their impact by requiring knowledge qualifiers (i.e., “to the best of seller’s actual knowledge and belief”). Many sellers, however, will resist giving such additional representations and warranties and will insist that the buyer to do its own inspections and due diligence and not rely on seller to promise anything about the condition of the real estate.

Some examples of representations and warranties that sellers will give, even in a hard negotiation, are set forth:

“(a) Seller shall at Closing be in a position to convey title to the Land and Improvements to Purchaser by execution of a Special Warranty Deed consistent with Article \_\_ herein.

(b) Seller is duly organized and validly existing under the laws of the state of its organization and has all requisite power and authority to enter into and perform this Contract. Each person executing this Contract on behalf of Seller warrants that he/she has all requisite authority to do so.

(c) Seller is not a "foreign person", as such term is defined in Section 1445 of the Internal Revenue Code of 1954, as amended, and the regulations promulgated thereunder ("Code"), and the sale of the Project is not subject to the federal income tax withholding requirements of such section of the Code.

(d) There are no leasing or other commission agreements with respect to the Tenant Leases which shall survive the Closing.

(e) There are no parties in possession of all or any portion of the Project other than those claiming under the Tenant Leases, the Miscellaneous Contracts or pursuant to any document which is filed in the Official Public Records of Real Property of \_\_\_\_\_ County, Texas.

(f) There are no actions, suits, claims, assessments, condemnation proceedings, or other proceedings pending or, to the knowledge of the Seller, threatened that could materially adversely affect the ownership, operation, or maintenance of the Project or Seller's ability to perform hereunder.

(g) Seller has not received actual notice, from any person or source, claiming that the location, operation or use of the Project, or any part thereof is in violation of any statute, ordinance, code, rule, or regulation of any governmental entity, or any restrictive covenant or deed restriction, including but not limited to zoning regulation and building codes, or flood, health, and environmental laws and regulations, or stating that any investigation has been commenced or is contemplated regarding any of the foregoing, and Seller has no knowledge that any of the foregoing is pending or threatened.”

### 3. **Internal Revenue Code Section 1031 —Basic Overview; Traps for the Unwary**

IRC § 1031 allows taxpayers to exchange real estate held for investment or used productively in the taxpayer's trade or business for a different tract that will also be held for investment or be used in the taxpayer's trade or business. This is called a nontaxable “like-kind” exchange. After the completion of the exchange, the newly acquired property will assume the tax basis and holding period of the transferred property, and no gain on the sale will be recognized. If consideration other than the like-kind tracts of real property is exchanged, it is considered “boot.” The parties will recognize gain or loss on the boot, and the amount of this gain or loss will adjust the basis of the real property received. The process and basic rules for conducting a like-kind exchange are described below.

**Qualifying Property.** The property transferred and the property received must both be qualifying properties for the transaction to be considered a like-kind exchange. To be considered a qualifying property, both the transferred property and the property received must be either held for productive use in a trade or business or held for investment. Real estate held for or acquired for personal use will not qualify. The following types of property cannot be qualifying property: stock in trade or other property held primarily for sale (including real estate owned as “inventory” by a “dealer” in real estate); stocks, bonds, or notes; other securities or evidences of indebtedness or interest; partnership interests; certificates of trust or beneficial interests, or choses in action.<sup>25</sup>

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<sup>25</sup> IRC § 1031(a)(1), (2).

The test for whether or not a property is held for productive business use or investment is applied at the time of the exchange without regard to the taxpayer's prior motives. For example, a taxpayer may have bought a tract of land on which to build his personal home, but later decided that she would rather hold the property, sell it, and realize its appreciation in value; in this instance, the property would be considered property held for investment.<sup>26</sup>

The words "held for" cause concern for taxpayers with regard to recently acquired property. If a taxpayer acquires property and then desires to immediately sell it in a tax-free exchange, does the property qualify as being "held for investment"? Probably not. Although the Tax Code and Regulations do not address this issue, many commentators agree that the IRS would likely argue that the property was never held for investment. At one time the Congress considered instituting a one-year required holding period, but then rejected the idea, thus leaving taxpayers with no guidance as to whether one year was too long or too short. If the buyer and seller in a transaction are "related parties" (meaning a familial relationship, a partnership and controlling partner, or partnership controlled by the same controlling partner), then the property must be held for two years in order to qualify as property held for investment.<sup>27</sup>

**Property Must Be Exchanged.** In order to meet the exchange requirement, qualifying like-kind properties must be part of a reciprocal exchange. The inclusion of non-qualifying property in the transaction will not invalidate the entire tax-free exchange. This non-qualifying property is referred to as "boot," and its treatment is discussed below.

**Property Must Be Like-Kind.** "Like-kind" refers to the nature or character of the properties and not their grade, quality, or fair market value.<sup>28</sup> The types of real estate considered like-kind are broad. The IRS has held in private letter rulings that all of the following may qualify as like-kind property: improved and unimproved real estate (the improvement is considered to enhance the grade or quality but not change the character of the real estate), undivided and tenant-in-common interests, urban and rural property, current possessory interests and indefeasible remainders that will become possessory, fee simple interests and leases with 30 years or more remaining on their term<sup>29</sup>.

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<sup>26</sup> Rev. Rule 57-244.

<sup>27</sup> IRC § 1031(f).

<sup>28</sup> IRC § 1031(a).

<sup>29</sup> See Treasury Regulation § 1.1031(a)-1(c).

**Multiple Party Delayed Exchanges.**<sup>30</sup> Although IRC § 1031 was originally interpreted by the IRS to permit only two-party simultaneous exchanges of property, court decisions and other factors led Congress to amend the statute to allow multiple party delayed exchanges; Section 1031 exchanges no longer need to be simultaneous. IRC § 1031(a)(3) permits delayed exchanges by providing that qualifying property will be treated as like-kind for purposes of the statute if: (1) the property is identified by the taxpayer on or before the day that is 45 days after the date on which the taxpayer transfers the property she sold during the exchange and (2) the property is received on or before the earlier of either (a) the day that is 180 days after the taxpayer sold the property relinquished or (b) the due date of the taxpayer's income tax return for the year in which she sold the relinquished property (including extensions). Therefore, in order for the taxpayer to meet the requirements of a delayed exchange she must meet these deadlines that begin to run on the date that she sells the first property in the exchange: (1) she must identify the replacement property within 45 days and (2) she must purchase the replacement property within 180 days or the date that year's income tax return is due. As a practical matter, if the income tax return due date is earlier than the 180-day date, the taxpayer may file extensions to push the due date up to at least day 180.

The taxpayer may identify multiple properties on or before the 45<sup>th</sup> day after she sells the relinquished property. The Treasury Regulations provide that a taxpayer may identify either three possible replacement properties or a larger number of properties if the cumulative fair market value of the identified properties does not exceed 200% of the fair market value of the relinquished property.<sup>31</sup> The identification must be made in writing and delivered to another unrelated party involved in the exchange.<sup>32</sup> The taxpayer may revoke her identification before the end of the 45-day period by delivering written notice to the same person(s) that the written notice of identification was delivered.<sup>33</sup> The property that the taxpayer purchases before the earlier of the 180-day deadline or her tax return due date must be substantially the same as one of the properties identified before the end of the 45-day period.<sup>34</sup>

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<sup>30</sup> These transactions are sometimes called "Starker" transactions. Starker was a party in a court case that involved a multiple party exchange.

<sup>31</sup> Treas. Reg. § 1.1031(k)-1(c)(4)(i).

<sup>32</sup> Treas. Reg. § 1.1031(k)-1(c)(2).

<sup>33</sup> Treas. Reg. § 1.1031(k)-1(c)(6).

<sup>34</sup> Treas. Reg. § 1.1031(k)-1(d)(1).

If the taxpayer actually or constructively receives money, property, or other consideration from her sale of the relinquished property before she receives the replacement property, then the benefit of the delayed exchange will be lost. In this situation, the transaction would be considered a sale rather than a like-kind exchange, and gain or loss would have to be immediately recognized even if the taxpayer eventually receives the replacement property. In order to provide clear rules to taxpayers, the Treasury Regulations establish four safe harbors for completing delayed like-kind exchanges without being deemed to have received consideration from the initial sale. These four safe harbors include: security or guaranty arrangements, qualified escrow accounts and trusts, qualified intermediaries, and interest and growth factors.<sup>35</sup> Most taxpayers participating in delayed exchanges prefer to use a qualified intermediary.

If the taxpayer uses a qualified intermediary in accordance with the provisions of the Treasury Regulations, the transaction will fall within a safe harbor. A qualified intermediary is a person who is not disqualified under the Treasury Regulations from acting as an intermediary<sup>36</sup> and enters into a written agreement with the taxpayer to (1) acquire the relinquished property from the taxpayer, (2) transfer the relinquished property to the taxpayer's purchaser, (3) acquire the replacement property from its owner, and (4) transfer the replacement property to the taxpayer.<sup>37</sup> The qualified intermediary does not need to acquire legal title to the relinquished property or replacement property before it transfers them; this allows the parties that have entered into the exchange agreement to deliver direct deeds to one another and bypass the intermediary for title purposes.<sup>38</sup> In order to utilize the qualified intermediary safe harbor, all parties must enter into the exchange agreement, and the taxpayer must not have the right to receive, pledge, borrow, or obtain any beneficial interest in the funds held by the intermediary on his behalf.<sup>39</sup> Because the completion of the exchange requires some cooperation from the other party in the immediate transaction, parties contemplating an exchange should always include a provision in the earnest money contract that requires the other party to cooperate (typically at no cost to the other party) in any possible section 1031 exchange.

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<sup>35</sup> Treas. Reg. § 1.1031(k)-1(g).

<sup>36</sup> See Treas. Reg. § 1.1031(k)-1(k) for a description of disqualified persons. Generally, persons or entities related to the taxpayer are disqualified from acting as a qualified intermediary for the taxpayer.

<sup>37</sup> Treas. Reg. § 1.1031(k)-1(g)(4)(iii).

<sup>38</sup> Treas. Reg. § 1.1031(k)-1(g)(4)(iv).

<sup>39</sup> Treas. Reg. § 1.1031(k)-1(g)(4)(v), (vi).

**Reversed Delayed Exchanges.**<sup>40</sup> Sometimes a taxpayer needs to obtain the replacement property before its buyer is able to purchase the relinquished property. The Treasury Regulations do not explicitly approve transactions following such a reverse order as falling within the safe harbor. In September 2000, however, the IRS issued a revenue procedure in which it stated that it would not challenge reverse delayed exchanges so long as they complied with the requirements in the ruling.<sup>41</sup> The rules established by the revenue procedure are complex; therefore, taxpayers are well-advised to use a seasoned intermediary to complete a reverse delayed exchange.

**Boot.** Giving or receiving “boot” in a like-kind exchange will not render the entire exchange taxable. The parties will instead recognize gain or loss for the fair market value of the boot. Boot may include cash, non-qualifying property, property that is not like-kind with the transferred property, or assumed liabilities.

If a party gives boot in an exchange, the party is deemed to have received an amount equal to the fair market value of the boot on the date of the exchange. The party will then recognize gain or loss on the transferred boot depending on how the fair market value relates to the taxpayer’s adjusted basis in the boot.<sup>42</sup> The party’s basis in the property received will be the aggregate basis of the transferred assets, as adjusted for any gain or loss recognized.<sup>43</sup>

If a party receives boot in an exchange, gain must be recognized in an amount equal to the fair market value of the boot received.<sup>44</sup> The taxpayer’s aggregate basis in the boot and the property received will be equal to his basis in the transferred property, with basis being first allocated to the boot to the extent of its fair market value.<sup>45</sup>

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<sup>40</sup> These transactions are sometimes called “Reverse Starker” transactions.

<sup>41</sup> See Rev. Proc. 2000-37. The revenue procedure states that reverse delayed like-kind exchanges will qualify for safe harbor protection so long as the property involved is held in a “qualified exchange accommodation arrangement.” The revenue procedure describes this complicated structure.

<sup>42</sup> Treas. Reg. § 1.1031(a)-1(a)(2).

<sup>43</sup> Rev. Rule 68-38.

<sup>44</sup> Treas. Reg. § 1.1031(b).

<sup>45</sup> Treas. Reg. § 1.1031(d)-1(e).

#### 4. Title Company Closing Instruction Letters and Insured Closing Letters

For transactions with a purchase price greater than \$250,000, the Buyer or Seller may request an Insured Closing Letter from the title insurance company underwriting the owner's title policy.<sup>46</sup> The letter may only be requested if the title company has issued a title commitment to the buyer prior to closing. The letter must also be requested in advance. The letter protects the requesting party from the loss of settlement funds due to the fraud or dishonesty of the local title agent. Careful buyers, sellers and lenders will request this letter from the national title insurance underwriter when the real estate sales price is greater than \$250,000. The underwriter does not charge any additional fee for an insured closing letter.

In addition to the protection given by an insured closing letter, buyers and sellers should consider utilizing instructions letters to the local closing agent and underwriter. A sample Seller's Closing Instruction Letter is printed below:

Via Hand Delivery

[ title company ]

Re: -G.F. # \_\_\_\_\_

-Contract for Purchase And Sale by and among \_\_\_\_\_, Ltd. ("Seller") and \_\_\_\_\_ ("Buyer"), as amended, for the sale and purchase of certain real property and all improvements situated thereon located in \_\_\_\_\_ County, Texas, known as the \_\_\_\_\_ Apartments (the "Property").

Dear \_\_\_\_\_:

We represent the Seller in the above-referenced transaction (hereinafter the "Purchase" or this "transaction"). We write this letter and deliver the enclosed documents to you in trust at the request of and on behalf of the Seller. We enclose the following original (unless otherwise indicated) documents that have been fully executed by the Seller:

1. Special Warranty Deed
2. Bill of Sale
3. Assignment of Tenant Leases and Assumption Agreement
4. Assignment of Service Contracts, Warranties, Government Approvals and Trade Name
5. Non-Foreign Affidavit
6. Resolution of \_\_\_\_\_, Inc. authorizing sale (copy)
7. Resolution of all partners authorizing sale (copy)
8. Letter to title company from Exchange Co.
9. Agreement of Exchange of Real Estate
10. Invoice from Exchange Co.
11. Notice of Assignment of Contract Pursuant to Exchange Agreement
12. W-9

Items 1 through 12 are sometimes hereinafter referred to as the "Seller Documents." Item 1 is sometimes hereinafter referred to as the "Deed." I also enclose the form of the following document which must be executed by the Buyer prior to closing this transaction:

13. Letter to Seller regarding notice to tenants

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<sup>46</sup> Tex. Ins. Code § 9.49 (2002). Amounts up to \$250,000 are covered under the Texas Title Insurance Guaranty Act. Tex. Ins. Code 9.48 (2002).

Each of items 1, 2, 3, 4 and 11 above must also be executed by the Buyer prior to closing.

You have informed us that you will dispose of all items listed on Schedule C of the Commitment (as defined below). Do not close this transaction unless you are in a position to dispose of all items listed on such Schedule C. Do not close this transaction unless you have collected the full amount necessary to pay all amounts on the settlement statement.

All of the Seller Documents and Item 13 must be fully executed by all required parties prior to closing this transaction and prior to delivering or recording any of the Seller Documents. Please complete the effective date information on all of the documents when you are in a position to close this transaction.

Please be certain that all of the above-listed documents are fully and properly executed and acknowledged by all requisite parties prior to closing this transaction and prior to delivering or recording any of the Seller Documents.

Buyer must cause funds sufficient to cover its closing costs (the "Funds") to be delivered to you for purposes of funding the Purchase prior to closing this transaction. Prior to closing this transaction, you must be in a position to cause the Funds to be delivered to Seller's Section 1031 Qualified Intermediary in the manner specified by Seller. Please contact \_\_\_\_\_ at the Exchange Co. at (512) \_\_\_\_\_ as soon as possible to arrange delivery of a cashier's check or a wire transfer of the Funds.

You must ensure that a settlement statement (the "Settlement Statement") has been executed on behalf of Buyer and Seller in the final form agreed to by me prior to closing this transaction.

After you are instructed by me to proceed with the closing of this transaction, but before you deliver or record any of the Seller Documents or otherwise advise Seller that this transaction has closed, you must be in a position to issue to Buyer an Owner Policy of Title Insurance (the "Policy") in the form prescribed by the State Board of Insurance of the State of Texas, and in accordance with the Commitment (the "Commitment") you issued \_\_\_\_\_, 2004, for \_\_\_\_\_ under G.F. No. \_\_\_\_\_ (such Commitment having an effective date of \_\_\_\_\_, 2004) except that all matters described on Schedule C of the Commitment must be disposed of to your complete satisfaction so that none of these matters will appear as exceptions in the Policy.

By disbursing the Funds, you will certify to Seller that all matters disclosed on Schedule C of the Commitment will be paid or disposed of to the satisfaction of the title insurer prior to the date of the issuance of the Policy, and that no exceptions for any item on said Schedule C shall be contained therein.

After closing, please deliver to me at Stahl & Bernal, L.L.P., 7320 N. MoPac, Suite 211, Austin, Texas 78731, **four copies** (along with fully executed originals of items 11 and 13 above), certified by you to be true and correct, of all of the fully executed documents connected with this transaction. Before closing this transaction you must be in a position to deliver to me such copies along with fully executed originals of items 11 and 13 specified above.

If, for any reason, you cannot comply strictly with these instructions, then immediately return to Seller all of the documents submitted with this letter and the other items deposited by Seller in connection with this transaction.

If you have any questions regarding any aspect of this transaction, please contact me. To further confirm your agreement to close this transaction in accordance with these instructions, please sign where indicated below and immediately return a signed copy of this letter to me via fax at 512-346-2712.

Sincerely,  
STAHL & BERNAL, L.L.P.  
By: \_\_\_\_\_  
Brent G. Stahl

Agreed and Accepted:  
\_\_\_\_\_ Title Insurance Co.  
By: \_\_\_\_\_  
Print Name: \_\_\_\_\_  
Print Title: \_\_\_\_\_

## **B. Five Common Mistakes in Commercial Real Estate Purchase and Sale Transactions**

### **1. Letters of Intent—Binding vs. Nonbinding**

Although formal and detailed letters of intent are more common in corporate transactions than in real estate transactions, parties do sometimes execute letters of intent in commercial real estate transactions. Parties should always be cautious when entering into a letter of intent. Letters of intent, if not drafted properly, can become binding contracts. If a written document contains all of the necessary business elements of a transaction, it can rise to the level of an enforceable contract under Texas law. In fact, in the famous Pennzoil vs. Texaco case, Texaco was found to be liable to Pennzoil because it interfered with Pennzoil's "contract" to purchase Getty Oil even though Texaco argued that the alleged contract was actually no more than the equivalent of a letter of intent or a term sheet. The jury in that case held that the letter of intent should be enforced as if it were the final contract for purchase despite the fact that all of the detailed legal terms had not yet been agreed on between the parties. Unless a party is willing to take the risk that its letter of intent will be enforced as a contract, the letter of intent should include strong, clear language stating that it is intended to be nonbinding, is not a contract, and that no binding agreement will exist until the parties execute final and detailed definitive contract documents. Some sample nonbinding letter of intent language follows:

"The proposed transaction will require further documentation and approvals, including the preparation of one or more definitive agreements setting forth in further detail the terms and conditions of our agreement ("Definitive Agreements"). This Letter of Intent is intended to be nonbinding on both parties and is merely a preliminary expression of our mutual understanding of the general terms under which Buyer and Seller are prepared to proceed to negotiate the terms of the Definitive Agreements and any related agreements consistent with this nonbinding Letter of Intent. None of the parties hereto shall be under any obligation to the other party (except for the confidentiality and exclusivity provisions) until the Definitive Agreements have been executed. Buyer may terminate this Letter of Intent at any time. Seller may terminate this Letter of Intent at any time after the expiration of the Exclusivity Period. Unless and until the Definitive Agreements are signed, it is understood that a party terminating discussions may do so, for any reason, without penalty of any type."

### **2. Proration Issues**

A few items that some sellers and buyers sometimes forget about in the proration section of earnest money contracts are discussed below.

a. Lump-sum contract payments

Sometimes property owners receive large lump sum payments upon the execution of long-term service contract for its property (e.g., long distance telephone or cable television contract or laundry lease contracts). If a buyer is being forced to assume or be otherwise be bound by the long-term service contract, it may want require the lump sum be prorated between buyer and seller over the full term of the service contract. Rents, fees or other royalties that the service provider may be paying over the life of the service contract are likely reduced if it paid a large lump sum at the outset of the service contract. It is this reduction in payments over the life of the service contract that may lead the buyer to insist on a proration from the seller for the lump sum payment.

b. Underlying tenant finish-out costs and Leasing Commissions

Sellers often pay for certain tenant finish out costs (in office buildings) or certain tenant “make-ready” costs (in apartment properties). Sellers are willing to incur these costs because the owner expects a rental stream over a long enough period of time to recoup the costs and earn a return. If a seller incurs such tenant finish costs after executing an earnest money contract and before the closing of such contract, the seller will receive very little of the rental income stream related to such costs. Many sellers in these circumstances will require that the tenant finish costs be prorated at closing, between buyer and seller, over the term of the underlying leases. In addition to finish out costs and make-ready costs, buyers and sellers will often agree to prorate related leasing commission or locator services costs.

**3. Inspection Period, Objection to Title, and Survey Date Coordination**

Several important dates must be coordinated during the buyer’s inspection period under an earnest money contract. First, the end of the inspection period must be established. This is the date by which the buyer should have completed all of its due diligence on the property and after which the buyer’s earnest money deposit may become nonrefundable. The closing date will typically be 10 to 30 days after the end of the inspection period.

Second, the deadlines for the survey and title review period must be established. The entire title and survey review process usually occurs during the inspection period, although savvy buyers may be able to extend such periods beyond the inspection period through the use of effective objection letters. Typically, the seller will have 10 to 20 days to provide the buyer with a title commitment (and sometimes a survey) for the

property. The buyer will then have a period of time to review the title commitment and survey and object to specific items shown on the title commitment and survey if it so desires. If the buyer does not deliver a list of specific objections before the expiration of its survey and title review period, then it waives its right to make title or survey objections. If the buyer does make specific objections, the earnest money contract should give the seller a time period during which to respond to the objections. The seller may respond by indicating that it will or will not remedy the specific objection or by stating how it might otherwise address the objection. Items that the seller agrees to remedy will usually become conditions to the closing of the contract so that the buyer may terminate the contract on the eve of closing if the remedial steps have not been completed.

If the seller refuses to take any remedial actions with regard to a specific buyer's title or survey objection, the earnest money contract should provide the buyer with a time period during which it may terminate the contract because of the objection. If the contract is not terminated during that period, then the survey or title objection is often deemed to be waived by the contract. This final deadline should coincide with the end of the inspection period. Sellers should carefully draft their earnest money contracts so that buyer's title/survey objections are not permitted to linger until closing. Some commonly used standard form earnest money contracts do not force title and survey objections to be resolved prior to the end of the inspection period under the contract; as a result, the buyer may still have a right to terminate the contract and receive a refund of its earnest money on the eve of the closing date even though the inspection period expired many weeks earlier. Careful drafting can avoid this problem.

#### **4. Survey Requirements—Specificity of Certification Language**

The buyer should require that the surveyor certify the survey of the property that the seller provides to the title company issuing the owner's title policy, to the buyer, and to the buyer's lender. The certification language should also reference the title company's file number. Although most buyers will seek to recover under their title insurance when a survey is in error, the proper certification of the survey to the buyer, coupled with a reference to the title company's file number, may provide the buyer with an avenue of recovery against the surveyor who made the error. Some title related encroachment defects may not be covered by title insurance and a buyer's only avenue of recourse may be against the surveyor. Carefully required survey certification language should help preserve buyer's remedies against the surveyor if the prior undiscovered defect should have been found by the surveyor. Some sample detailed survey certification instructions are printed below.

“All surveys delivered to Buyers must comply with the Texas Society of Professional Survey Standards and Specifications for a Category 1A, Condition IV survey and the following special requirements:

- (a) A plat of the subject property showing the following:
  - (i) The boundary line of the subject property and all appurtenant easements by courses and distances showing the area of the subject property, and each parcel thereof, in square feet. If the subject property is composed of all or portions of several lots or other legal subdivisions, the boundaries of each should be indicated by dotted lines and the proper lot number or legal subdivision designation shown. If the survey comprises more than one parcel, it should show interior lines and facts sufficient to insure contiguity. Points of beginning used in the description of the subject property should be identified.
  - (ii) The location and type of all buildings and other improvements comprising a portion of the wind energy project (the "Project Improvements") on the subject property, the dimensions and area thereof and the distances therefrom to the nearest facing exterior property lines of the subject property and to any buildings or improvements not a part of the Project Improvements that are located within 500 feet;
  - (iii) The location of all easements and rights-of-way affecting the subject property (each of which must be identified by reference to the volume and page where recorded).
  - (iv) The location of all required building set back lines on the subject property.
  - (v) All encroachments, conflicts or protrusions.
  - (vi) All roads and roadways located on or providing access to the subject property.
  - (vii) All fences (both perimeter and cross) and all walls and other improvements along the property lines with dimensions.
  - (viii) The location of any railroad tracks and boundaries of railway rights of way affecting the subject property.
  - (ix) All wires and cables crossing, entering or leaving the subject property, indicating the amount of cross arm or wire overhang and all anchors or guy wires affecting the subject property.
  - (x) The location of all utilities serving the subject property.
  - (xi) The scale, the north direction, the beginning point, the distance to the nearest intersecting street and point of reference from which the subject property is measured.
  - (xii) Substantial visible improvements.
  - (xiii) The flood zone designation (with proper annotation based on Federal Flood Insurance Rate Maps or the state or local equivalent, by sealed map location and graphic plotting only) and the location of any portion of the subject property situated in a Flood Hazard Area designation.
- (b) A legal description (metes and bounds) of the subject property, which must coincide with the boundaries shown on the plat and which must be identical with the description of the subject property as described in the title commitment furnished by Chicago Title Insurance Company.
- (c) The certification signed and sealed by the surveyor, which must be in substantially the following form:

"To: \_\_\_\_\_, \_\_\_\_\_,  
\_\_\_\_\_ and \_\_\_\_\_ Title Insurance Company.

I hereby certify that on the \_\_\_\_ day of \_\_\_\_\_, 200\_\_.

- (a) this survey was made on the ground as per the field notes shown on this survey and correctly shows (i) the boundaries and areas of the subject property and the size, location and type of buildings and improvements (including wind turbine towers and their foundations, footings and support structures) thereon and the distance therefrom to the nearest facing exterior property lines of the subject property and to any buildings and improvements not a part of the Project Improvements located within 500 feet of the subject property; (ii) the location of all rights-of-way, easements and any other matters of record (or of which I have knowledge or have been advised, whether or not of record) affecting the subject property; (iii) the flood zone designation (with proper annotation

based on Federal Flood Insurance Rate Maps or the state or local equivalent, by sealed map location and graphic plotting only); (iv) all roads and roadways located on or providing access to the subject property; and (v) all other significant items on the subject property;

(b) except as shown on the survey, there are no (i) encroachments upon the subject property by improvements on adjacent property, (ii) encroachments on adjacent property, streets or alleys by any improvements on the subject property, (iii) party walls, or (iv) conflicts or protrusions;

(c) all required building set back lines on the subject property are located as shown hereon;

(d) except as shown on the survey, no part of the subject property lies within a flood plain or flood prone area or flood way of any body of water;

(e) the transmission lines connecting the Project Improvements are uninterrupted and are located entirely on the subject property or other property leased to or owned by \_\_\_\_\_;

(f) the entire wind energy project consisting of a power substation and 80 wind turbines and towers with associated foundations, footings, support structures, transmission lines, guy wires and braces is located on the subject property and other property leased to or owned by \_\_\_\_\_; and

(g) the survey complies with the current Society of Professional Surveyors Standards and Specifications for a Category 1A, Condition IV survey and the same is true to the best of my knowledge and belief.”

## **5. General Warranty Deed vs. Special Warranty Deed**

Many sellers agree to convey the property to their buyers using a general warranty deed, and buyers may believe that the general warranty deed provides them with better title than a special warranty deed. This is simply not true. Buyers will receive identical rights under general and special warranty deeds. When delivering a general warranty deed, the seller is warranting that neither it nor any of the prior title holders created defects in title; when delivering a special warranty deed, a seller is warranting that the Seller itself did not create any title defects. Hence, there is not a great difference to the buyer between a general and special warranty deed. The seller on the other, hand, if it utilizes a general warranty deed is warranting the acts of others about whom it knows nothing. The seller should insist using a special warranty deed; this typically must be negotiated in the earnest money contract. The buyer should accept the special warranty deed because its title insurance should compensate him or her for any prior title defects.

## **II. BANKRUPTCY ISSUES INVOLVED IN COMMERCIAL REAL ESTATE TRANSACTIONS**

### **A. Buying Real Estate from a Bankruptcy Estate—Sales free and clear of liens- 11 U.S.C. section 363(f)**

When buying real estate from a bankruptcy estate, a buyer should insist on certain agreements from the bankruptcy debtor and on certain orders being issued by a bankruptcy court. A sale of assets in bankruptcy can take many different forms.

Some sample contract provisions that buyers may encounter in Section 363 sales involving auction procedures are set forth below:

“The Acquired Assets shall be sold, transferred and conveyed free and clear of all liens, claims and Encumbrances pursuant to Section 363(f) of the Bankruptcy Code.

This Agreement shall be deemed to be effective as of the date hereof, subject to the Approval Order not being subject to further stay or appeal; provided, however, that Buyer may elect to close the transactions contemplated hereby (despite a pending appeal if no stay thereof is in effect) pursuant to, and in accordance with, the protections afforded under Section 363(m) of the Bankruptcy Code.

(a) Court Orders. In connection with the transactions contemplated by this Agreement, Sellers shall file with the Court applications for the following orders, each of which shall have been entered by the Court prior to the Closing Date, and Sellers shall use their reasonable best efforts (which shall not require an appeal of the Court's decision) to obtain the following orders:

(i) Bidding Procedures Order. An order ("Bidding Procedures Order") providing for, among other things, that: (a) this Agreement is subject to higher or better offers (each, a "Higher or Better Offer"); (b) if Higher or Better Offer(s) are approved by the Court before entry by the Court of the Approval Order and Sellers consummate the sale of all or a substantial portion of the Acquired Assets to the maker(s) of such offer(s), Buyer shall be paid the Breakup Fee; (c) as a condition to making such offer(s), each interested party, other than Buyer, must tender to a Person to be specified in such order, at least one Business Day before the auction to be conducted pursuant to the Bidding Procedures Order to be held at or prior to the Sale Hearing, a bank check, teller's check or wire transfer payable to the Person specified in such order, in a sum of not less than the Breakup Fee to be held until the closing of such sale(s) (at which time such payment shall be credited against the purchase price for the Acquired Assets subject to such sale(s) if such offer(s) are accepted), or until the conclusion of the Sale Hearing (at which time such payment shall be returned if such offer(s) are rejected); (d) in order for any alternative proposal(s) to be approved by the Court as a Higher or Better Offer, (1) such proposal(s) must be to purchase all or a substantial portion of the Acquired Assets in both the Round Rock Market and the Austin Market and must provide for an aggregate purchase price for the Acquired Assets which exceeds the Purchase Price by at least an amount equal to the sum of the Breakup Fee plus \$1,000,000, (2) such proposal(s) must not be subject to financing, and (3) the competing offeror(s) must provide evidence, satisfactory to Sellers and approved by the Court, of their financial ability to perform in the event that the competing offer(s) are accepted as "higher or better" than the offer of Buyer and must demonstrate, and provide adequate assurance of, their ability to perform under the Assumed Contracts (collectively, the "Scheduling Provisions"); (e) Buyer and the maker or makers of any Higher or Better Offer(s) shall be given the opportunity to make further competitive bids to purchase the Acquired Assets in a fair and open auction to be conducted in such manner as the Court directs prior to the Sale Hearing, provided, that each further competitive bid will be at least \$1,000,000 higher than the last highest bid; and (f) such bidding process shall allow each bidder an opportunity at the time of such auction to respond to the last highest bid of any offeror. If Sellers accept any competing offer, Buyer retains the right to offer evidence before the Court approves such competing offer regarding whether a particular offer is indeed a Higher or Better Offer.

(ii) Approval Order. An order or orders (the "Approval Order") pursuant to Sections 363, 365 and other applicable provisions of the Bankruptcy Code, which Sellers shall seek by filing a motion with the Court within five Business Days after the earlier of \_\_\_\_\_, 2004 and the date on which Sellers receive written

notice from Buyer that Buyer has waived its right to terminate this Agreement pursuant to Section \_\_\_ (the "Motion") (which Motion Sellers will review with Buyer prior to filing such Motion with the Court), (A) authorizing and approving the sale to Buyer pursuant to this Agreement of the Acquired Assets, and approving the terms of this Agreement, (B) finding that Buyer is acting in good faith, and is entitled to the protections of a buyer under Section 363(m) of the Bankruptcy Code, and (C) containing such other findings and provisions as may be reasonably requested by Buyer (including a finding that notice of the transactions contemplated by this Agreement has been properly given to all required parties pursuant to Sections 2004, 6004 and 6006 of the Federal Rules of Bankruptcy Procedure) to assure that: (1) title to the Acquired Assets will be transferred to Buyer free and clear of all liens, claims and Encumbrances and any such liens, claims and Encumbrances shall attach solely to the Purchase Price; (2) Sellers will be duly authorized to execute and deliver all such instruments as Sellers are required to execute and deliver pursuant to the terms of this Agreement; and (3) upon Sellers' assuming and assigning to Buyer each of the Assumed Contracts which are Acquired Assets, (aa) Sellers will have properly assumed and assigned the same, (bb) there will be no defaults thereunder as of the Closing Date that are not cured or for which adequate assurance of prompt cure has not been provided by Sellers, except for defaults which are deemed cured by the Approval Order, (cc) all "cure" amounts necessary to cure monetary defaults under any such contract shall be made in the appropriate amounts by Sellers, and (dd) the Assumed Contracts which are Acquired Assets have been listed on a schedule annexed to such order or motion seeking entry of such order.

(b) Binding Nature. Notwithstanding the provisions of Section \_\_\_\_, the terms and provisions of Sections \_\_\_\_, \_\_\_\_, \_\_\_\_, and \_\_\_\_ shall be binding upon, and shall inure to the benefit of, the parties to this Agreement and their successors and permitted assigns.

(c) Certain Required Notices With Respect to All Bankruptcy Motions. All motions for the Bidding Procedures Order and the Approval Order must be sent to the following parties in the manner required by the Court, the Bankruptcy Code, and the local rules for the Court: (i) all taxing authorities (including without limitation local tax appraisal districts) for the Texas cities and Texas counties in which all or any of the Acquired Assets are located, including without limitation the Cities of Austin and Round Rock, and the Counties of Travis and Williamson. Seller shall notify Buyer within ten Business Days of all of the following to the extent they may negatively impact the Acquired Assets: (I) all written notices of litigation or threatened litigation received by Sellers, (II) all notices of breach or notices of default relating to any Lease, and (III) any event which constitutes a Material Adverse Effect.”

## **B. Bankruptcy-Specific Provisions for Commercial Real Estate Leases**

- 1. Perfection of contractual liens – 11 U.S.C. section 544 issues**
- 2. Ipso facto clauses not enforceable – 11 U.S.C. section 365**
- 3. Tax claim issues – 11 U.S.C. section 502 limitations**
- 4. Statutory landlord’s liens ineffective – 11 U.S.C. section 544**

**C. Bankruptcy Effects of Using a Letter of Credit as a Security Deposit for a Commercial Tenancy**

Landlords may not be able to apply a tenant's security deposit to past due rent after the tenant has filed for bankruptcy because the automatic bankruptcy stay will usually protect the security deposit as being property of the bankrupt. On the other hand, court cases have held that letters of credit obtained by a tenant on the landlord's behalf are not the property of the bankrupt tenant but, instead, a third party obligation of the issuing bank.<sup>47</sup> Therefore, landlords may be able to obtain funds from a tenant's letter of credit even after the tenant has filed for bankruptcy protection.

A sample form of lease provision requiring a letter of credit as security follows:

In lieu of the security deposit, Tenant shall deliver to Landlord an unconditional, clean, irrevocable letter of credit (the LOC) in the initial amount of \$\_\_\_\_\_, issued by a bank reasonably acceptable to Landlord that accepts deposits, maintains accounts, has a local \_\_\_\_\_ office, and negotiates letters of credit, and whose deposits are insured by the FDIC. The LOC will be in form and content reasonably acceptable to Landlord, and transferable without cost from time to time. Tenant will pay all charges to obtain the LOC. The LOC will be payable solely upon its presentation with a sight draft.

The LOC will be held by Landlord as security for the performance by Tenant of its obligations under this Lease. The LOC will not be mortgaged, assigned, or encumbered by Tenant without the prior written consent of Landlord. If an Event of Default occurs, or if Tenant fails to renew the LOC at least thirty (30) days before its expiration or replace it with a letter of credit satisfying the conditions of this Section, Landlord may, but will not be required to, draw upon all or any portion of the LOC for payment of any Rent. The use of the LOC or any part of it by Landlord will not prevent Landlord from exercising any other right or remedy provided by this Lease or by law. Landlord will not be required to proceed against the LOC. The LOC will not operate as a limitation on any recovery to which Landlord may be entitled. Any amount of the LOC that is drawn by Landlord, but is not used or applied by Landlord, will be held by Landlord and deemed a security deposit. If any portion of the LOC is drawn, Tenant will, within five (5) days after written demand, either (i) deposit cash with Landlord in an amount sufficient to cause the sum of the security deposit and the amount of the remaining LOC to equal the amount of the LOC then required under this Lease, or (ii) reinstate the LOC to the amount then required under this Lease. If Landlord transfers or mortgages the Building, Landlord may transfer the security deposit and the LOC to the transferee or mortgagee and Tenant will look solely to the transferee or mortgagee for the return of the security deposit. If Tenant performs its obligations under this Lease, the LOC and the security deposit will be returned to Tenant within thirty (30) days after the expiration of the Term.

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<sup>47</sup> See, e.g., In the Matter of Compton Corp., 831 F.2d 586 (5<sup>th</sup> Cir. 1987) (holding that "a bankruptcy trustee is not entitled to enjoin a post petition payment of funds under a letter of credit from the issuer to the beneficiary, because such a payment is not a transfer of the debtor's property. . . ."). See also In re Elegant Merchandising, Inc., 41 B.R. 398 (Bankr. S.D. N.Y. 1984); In re Illinois-California Exp., Inc., 50 B.R. 232 (Bankr. D. Colo. 1985).

### III. COMMERCIAL REAL ESTATE LEASES

*Authors' Note: This section of the paper contains some sample lease provisions. Anytime a lease provision is described as containing "alternative Landlord and Tenant provisions," we have used normal roman type to signify the neutral and/or Landlord-friendly portions of the provision, and we have added comments or alternative Tenant-friendly provisions in italicized, bracketed type.*

#### A. BASIC BUSINESS TERMS OF THE LEASE

##### 1. Defining the Leased Premises, Land, and Building

In order to describe the Leased Premises with adequate specificity, the Lease should define the three basic components of the property that encompass the Leased Premises—the real property on which the Leased Premises is constructed (the "Land"), the Building on the Land that contains the Leased Premises, and the portion of the Building comprising the Leased Premises itself. The Lease may also define the office or shopping complex of which the Building is a part (the "Project") The following provision adequately describes the Leased Premises:

The "Leased Premises" means Suite No. 100 located in the office building (the "Building") at 123 Drive Street, Austin, Texas 78701. The Building is located on the real property described on Exhibit A attached to this Lease (the "Land") which is part of the office complex located on the Land (the "Project"). The Leased Premises are more particularly described in the floor plan attached to this Lease as Exhibit B.

The Lease should state the square footage of the both the Leased Premises and the Building (and the Project if a portion of the common area expenses is derived from Project-related expenses). Most Landlords will want the stated measurements in the Lease to be deemed agreed to by the Tenant and not subject to remeasurement or amendment. Although the Tenant may be willing to accept the Landlord's stated measurement of the Building and the Project, Tenants commonly insist on a right to measure the Leased Premises after finish out is complete. The provisions below address measuring the square footage of the Leased Premises in two different ways.

##### No Remeasurement Provision

The Net Rentable Area of the Leased Premises has been calculated using commercially acceptable standards, and is stipulated and agreed to for all purposes to be as set forth in the Lease. The Net Rentable Area of the Leased Premises is not subject to remeasurement by Tenant.

##### Remeasurement Provision

At the request of either Tenant or Landlord, a third party space planner may recalculate the Net Rentable Area of the Leases Premises utilizing BOMA (Building Owners and Management Association) standards; such recalculated Net Rentable Area shall be documented in a writing signed by Landlord and Tenant. The expenses of the third party space planner associated with recalculating the rentable square footage of the Leased Premises shall be paid by the party making the request.

## 2. Lease Term

Since most Landlords and Tenants desire for the Lease to terminate on the last day of a month, the definition of the Lease Term should contain a provision to extend the Lease Term by the remaining portion of the month during which the Lease commences if the Lease does not commence on the first day of a month. The following is a sample definition for the Lease Term:

The period beginning on the Commencement Date and continuing for 60 calendar months thereafter; provided, however, if the Commencement Date occurs on a date other than the first day of a calendar month, the expiration date of the primary term shall be extended by the number of days remaining in the month during which the Commencement Date occurs.

A number of different events may be used to determine the Commencement Date. In the case of a “build-to-suit” lease, the Lease typically commences on either the date the Leased Premises are substantially complete or the date that the applicable local authority issues a Certificate of Occupancy. In a general office lease, the Commencement Date may be either the date the Tenant actually occupies the Leased Premises or the date that the Landlord has substantially completed the Tenant’s agreed finish-out. In either case, the actual Commencement Date negotiated by the parties is usually less important than making sure both parties and the Lease have a clear, unambiguous definition of when the Lease Term commences. To avoid future disputes, both the Landlord and the Tenant should consider executing an addendum to the Lease confirming the actual Commencement Date promptly after it occurs.

Lease renewal terms should describe: (1) the deadline by which the Tenant may elect to extend the Lease, (2) the length of the renewal period, and (3) the rent for the renewal period. Depending on the length of the initial Lease Term and market conditions, the Landlord, the Tenant, or both may be unwilling to agree in advance on a rental rate for the renewal period. In this case, Leases often contain a procedure for determining the renewal rent similar to the following:

Tenant shall have the right to renew this Lease for two five-year periods. The basic rental for each optional renewal period shall be the Market Rent, as determined by mutual agreement between Landlord and Tenant 60 days prior to the end of the then current lease term. If no rental figure has been agreed upon at that time, the Market Rent for the Leased Premises for each renewal term shall be determined by an M.A.I. appraiser or Texas-licensed real estate broker mutually chosen by Landlord and Tenant 30 days prior to the end of the Lease Term or first renewal term, as the case may be, with Landlord and Tenant each paying one-half of any cost of such broker or appraiser. If Landlord

and Tenant are unable to agree on such appraiser or broker, each shall select an M.A.I. appraiser or Texas-licensed real estate broker and such appraisers and/or brokers shall select a third M.A.I. appraiser or Texas-licensed real estate broker. If the selected appraisers or brokers cannot agree upon a third appraiser or Texas-licensed real estate broker, either party may petition a court of competent jurisdiction for appointment of a third appraiser or Texas-licensed real estate broker. The third appraiser or broker shall determine the Market Rent, which must be in between the Market Rent as determined by the other two appraisers or brokers. If "M.A.I." is no longer in common usage, the closest equivalent designation shall be utilized. Each party shall pay for the services of the appraiser or broker chosen by it, and each party shall pay one-half of the cost of the third appraiser or broker mutually chosen by such appraisers, brokers, or the court.

The Landlord may want to add a provision prohibiting the Base Rent in any renewal period from being less than either the rent payable under the final month of the initial term or some established amount. A sample of such a provision follows:

In no event shall the Market Rent for any renewal period be less than [the rent payable during the final month of the initial Lease Term / \$\_\_\_\_\_ per month].

### **3. Rent**

The Landlord and the Tenant will both want to ensure that the Lease specifically describes all rent and expenses payable by the Tenant. In most leases, the Rent is comprised of two amounts—a fixed rent amount (or, "Base Rent") and a pass-through expenses component.

A provision with alternating Landlord and Tenant language is included below.

In addition to the Base Rent payable by Tenant under this Lease, Tenant shall pay additional rent in the form of "Operating Expenses" determined as follows:

(1) The Operating Expenses attributable to the Leased Premises shall be computed by multiplying the "Basic Cost Per Square Foot of NRA" (as defined in and determined in accordance with Paragraph (3) below) by the Net Rentable Area of the Premises. The term "Basic Cost" shall mean any and all costs, expenses and disbursements of every kind and character (subject to the limitations set forth below), which Landlord shall incur, pay or become obligated to pay in connection with the ownership of any estate or interest in, operation, maintenance, repair, replacement and security of the Leased Premises, Building, Project, or Land, or any portion thereof, determined in accordance with accepted cash basis accounting principles consistently applied, including but not limited to the following:

(a) Wages, salaries and other benefits of all Landlord employees including any managing agent who are engaged in the operation, repair, replacement, maintenance and security of the Project (including without limitation, payroll, unemployment, social security and other taxes, insurance, vacation, holiday and sick pay and other fringe benefits, but excluding any profit sharing benefits), and management fees of any managing agent of the Project [*Tenant may want to either exclude management fees or limit payment of management fees to "management fees comparable to those paid in connection with similar Projects located in the Austin, Texas area*].

(b) All supplies, equipment and materials used in the operation, maintenance, repair, replacement and security of all or any portion of the Leased Premises, Building, Project, or Land.

(c) Annual cost of all capital improvements made to the Project (or any portion thereof) which although capital in nature can reasonably be expected to reduce the normal operating costs of the Project, as well as all capital improvements made in order to comply with any statutes, rules, regulations or directives hereafter promulgated by any governmental authority relating to energy, conservation, public safety or security or access for handicapped individuals, as amortized (with interest on the unamortized balance of the market rate then generally available for such improvements) over the useful life of such improvements by Landlord for federal income tax purposes.

*[Tenant's alternative paragraph (c): (c) Annual cost of all capital improvements made to the Project which although considered capital in nature by generally accepted accounting principles can reasonably be expected to reduce the normal operating costs of the Building, but only to the extent that the Landlord demonstrates an actual reduction.]*

(d) Cost of all utilities for the Building, but not including the cost of excess or individually metered utilities supplied to tenants of the Building which are actually reimbursed to Landlord by such tenants *[Tenant may want to replace last clause in this sentence with: "but not including the cost of excess or individually metered utilities supplied to tenants of the Building which are required to be reimbursed by other tenants, regardless of whether such cost is actually reimbursed to Landlord by such tenants].*

(e) Cost of all maintenance and service agreements on equipment for the Leased Premises, Building, Project, or Land, including alarm service, window cleaning, and elevator maintenance.

(f) Cost of casualty, rental abatement and liability insurance applicable to the Project and Landlord's personal property used in connection with the Project, together with any other insurance deemed necessary or desirable by Landlord or any holder of a lien secured by the Building, Project, or Land. *[Tenant may want to replace last clause in this sentence with "together with any other insurance required by any holder of a lien secured by the Building, Project, or Land".]*

(g) All taxes and assessments and governmental charges whether federal, state, county or municipal, and whether they be by taxing districts or authorities presently taxing or by others, subsequently created or otherwise, and any other taxes or assessments attributable to the Project and its operations (collectively, the "Taxes"), excluding, however, federal and state taxes on income (except as specifically permitted by this subparagraph (g)). If at any time during the Lease Term, the present method of taxation shall be changed so that in lieu of the whole or any part of the Taxes, there shall be levied, assessed or imposed on Landlord a capital levy or other tax directly on the rents received therefrom and/or a franchise tax, assessment, levy or charge measured by or based, in whole or in part, upon such rents or the Building or Project (or any future buildings on the Land), then all such taxes, assessments, levies or charges, or the part thereof so measured or based, shall be deemed to be included within the term "Taxes." *[Tenant may want to remove "and/or a franchise tax, assessment, levy or charge measured by or based, in whole or in part, upon such rents or the Building or Project (or any future buildings on the Land), then all such taxes, assessments, levies or charges, or the part thereof so measured or based,".]*

(h) Cost of repairs, replacements and general maintenance of the Project or any portion thereof.

(i) Cost of service or maintenance contracts with independent contractors for the operation, maintenance, repair, replacement or security of the Project or any portion thereof.

(j) Any costs incurred by reason of easements or restrictions affecting all or any portion of the Land and any costs incurred in the operation, maintenance, repair, replacement and security of the common and public areas on or serving the Project or any portion thereof, including, but not limited to, the parking garages or parking facilities serving the Project.

(2) There are specifically excluded from the definition of the term "Basic Cost" (i) expenses for capital

improvements made to the Building or Project, other than (A) capital improvements described in subparagraph (1)(c) above and (B) items which, though capital for accounting purposes, are properly considered maintenance and repair items (such as painting of common areas, replacement of carpet in elevator lobbies, and the like); (ii) expenses for repair, replacements and general maintenance paid by proceeds of insurance or by Tenant or other third parties, and alterations attributable solely to tenants of the Building other than Tenant; (iii) depreciation of the Building; (iv) leasing commissions; (v) legal expenses (other than legal expenses which are incurred to contest real estate taxes or assessments); (vi) income taxes imposed on the income of Landlord from the operation of the Property; and (vii) those costs (including costs for utilities), if any, for which Landlord is entitled to direct reimbursement from any tenant, to the extent Landlord actually receives such reimbursement.

*[Tenant's alternative paragraph (2): (2) There are specifically excluded from the definition of the term "Basic Cost" (i) expenses for capital improvements made to the Building or Project, other than (A) capital improvements described in subparagraph (1)(c) above and (B) items which, though capital for accounting purposes, are properly considered maintenance and repair items for the Building or common areas serving the Building (such as painting of common areas serving the Building, replacement of carpet in elevator lobbies of the Building, and the like); (ii) expenses for repair, replacements and general maintenance paid by proceeds of insurance or by Tenant or other third parties, and alterations attributable solely to tenants of the Building other than Tenant; (iii) depreciation of the Building; (iv) leasing commissions; (v) legal expenses; (vi) income taxes or state franchise taxes imposed on the income of Landlord from the operation of the Property; (vii) those costs, if any, for which Landlord is entitled to direct reimbursement from any tenant, regardless of whether Landlord actually receives such reimbursement; (viii) above-standard cleaning; (ix) costs of complying with any statutes, rules, regulations or directives hereafter promulgated by any governmental authority relating to energy, conservation, public safety or security or access for handicapped individuals; (x) advertising expenses; (xi) expenses for purchasing or maintaining artwork or sculptures; (xii) costs incurred by Landlord because another tenant at the Project breaches its lease or because Landlord breaches a lease to another tenant; (xiii) any Landlord cost reimbursed by insurance proceeds (or that would have been reimbursed by insurance proceeds if Landlord maintained the insurance required by this Lease and/or if tenants in the Project maintained the insurance required under their leases), any condemnation award, or an indemnification from a third party; (xiv) initial construction costs and costs to correct initial construction defects; (xv) charitable or political contributions made by Landlord; (xvi) amounts paid to any governmental body or community organization related to the development of the Land; (xvii) costs of testing for, handling, remediating, or abating asbestos and other hazardous materials or electromagnetic fields, or the cost to remove chlorofluorocarbons or accomplish other future retrofitting driven by as-yet-unknown future environmental concerns, or the cost to purchase environmental insurance; (xviii) management fees in excess of those charged in comparable buildings; (xix) salaries for officers above the level of building manager; (xx) fines and penalties Landlord must pay as a result of failure to comply with laws, ordinances, municipal codes, or other regulations; (xxi) costs related to food court tenants to the extent that they exceed normal costs; (xxii) holiday decorations or gifts; (xxiii) costs incurred as a result of the Landlord's negligence; (xxiv) Landlord's costs related to the ownership of the Land, Project, and Building, such as ground rent, mortgage interest, principal transaction costs, tenant build-out costs, construction clean-up, and general overhead; (xxv) fees and expenses paid to any affiliate of Landlord in excess of market rates (based on rates for similar services for similar Projects in the Austin, Texas area); (xxvi) professional fees paid by Landlord, including brokerage fees and commissions, legal fees, and accounting fees; and (xxvii) the cost of installing new telecommunications technologies at the Project.]*

(3) Landlord shall make a good faith estimate of the Operating Expenses for the upcoming calendar year and require that Tenant pay said estimated Operating Expenses in equal monthly installments in the manner and at the times set forth for payment of the Base Rent. On or before February 1 of each calendar year during the Lease Term (or of the calendar year immediately succeeding the termination of this Lease), or as soon thereafter as practical, Landlord shall furnish to Tenant a statement of the Basic Cost Per Square Foot of NRA for the previous calendar year. If Tenant's total payments of Operating Expenses for any calendar year (or portion thereof) during the Lease Term (based on Landlord's estimate of the Operating Expenses) exceed the Operating Expenses actually due during such year (or portion thereof), then Landlord, at Landlord's sole option, either shall credit to Tenant's account or shall refund to Tenant any overpayment. Likewise, Tenant shall pay to Landlord within ten (10) days after written demand, the amount by which the Operating Expenses for any calendar year (or portion thereof) during the Lease Term, exceed the Operating Expenses payments received by Landlord from Tenant for such calendar year (or portion thereof).

*Tenant and its agents will have the right to examine and copy Landlord's books and records relating to Basic Costs during normal business hours at Landlord's principal place of business according to this Lease Section so long as (a) there is no event of default by Tenant under the Lease at the time that the Tenant examines Landlord's books and records; (b) Tenant has fully and promptly paid the Rent; and (c) Tenant requests the examination of Landlord's books and records within twelve months after receipt of the statement of expenses with regard to which Tenant wishes to examine Landlord's books and records. If Tenant determines that an overcharge has occurred, Tenant shall advise Landlord in writing, setting forth with specificity the overcharge. If an aggregate overcharge of more than 5% occurred for a calendar year, then Landlord will reimburse Tenant's reasonable out-of-pocket expenses incurred in connection with Tenant's examination. If Tenant has overpaid its proportionate share of Operating Expenses (whether by more or less than 5%), then the amount of the overpayment (without interest) shall be credited to the next accruing Rent payment. If Tenant has underpaid its proportionate share of Operating Expenses, then the underpayment (without interest) shall be paid by Tenant to Landlord within thirty (30) days of the conclusion of the examination. Tenant's sole remedy in the event of an overpayment will be the credit (without interest) against its Rent payment and the reimbursement of its reasonable out-of-pocket expenses (if applicable under the provisions of this paragraph) or, if Landlord fails to credit such amount and reimburse such expenses (if applicable), an offset against its Rent payment for the amount of the credit and the expenses (if applicable). Landlord's sole remedy in the event of an underpayment shall be the payment of the amount (without interest) within thirty (30) days of the conclusion of the examination. Neither Landlord nor Tenant shall have the right to terminate the Lease because of an overpayment or underpayment of Operating Expenses. If an audit by another tenant at the Project discloses a discrepancy or error, the Landlord shall automatically give Tenant the benefit of any resulting adjustment to Operating Expenses—even if the Tenant does not request it.*

(4) The "Basic Cost Per Square Foot of NRA" shall be determined by adding the quotients of the following: (a) those amounts comprising the Basic Cost which are also Occupancy Independent Costs (hereinafter defined) divided by the Net Rentable Area of the Project, whether or not occupied, and (b) those amounts comprising the Basic Cost which are not Occupancy Independent Costs divided by the Net Rentable Area of the Project actually occupied or allocated to occupied portions of the Project. As used herein, the term "Occupancy Independent Costs" shall refer to those costs, expenses and disbursements which Landlord shall incur, pay or become obligated to pay in connection with the operation, maintenance, repair, replacement, security and ownership of any estate or interest in the Project, which costs, expenses and disbursements do not materially increase or decrease depending on the occupancy rate of the Project.

*[General author comment concerning pass-through rent: In a multiple-building Project, the Tenant may want to limit the pass-through expenses to only expenses related to the Building containing the Leased Premises and common areas related to the Project in general and not other buildings in the Project. Making this change will require revising many of the provisions in paragraph (1) above to refer to expenses related the "Building" as opposed to the "Project." The definition of "Basic Cost Per Square Foot of NRA" will also need to be revised to determine the Leased Premises' fraction of the Building's available square footage as opposed to the rentable square footage of the entire Project.]*

**Landlord and Tenant are knowledgeable and experienced in commercial transactions and agree that the provisions of the Lease for determining charges, amounts, and Operating Expenses payable by Tenant (including without limitation payments under Section 4.02 of the Lease) are commercially reasonable and valid even though the methods contained therein may not state a precise mathematical formula for determining all of such charges. ACCORDINGLY, TENANT VOLUNTARILY AND KNOWINGLY WAIVES ALL RIGHTS AND BENEFITS OF TENANT UNDER SECTION 93.004 OF THE TEXAS PROPERTY CODE, AS ENACTED BY HOUSE BILL 2186, 77<sup>TH</sup> LEGISLATURE, AS SUCH SECTION NOW EXISTS OR AS MAY BE HEREAFTER AMENDED OR SUCCEDED.**

*[Author comment: Although the Landlord's request for this wavier may not be unreasonable, the Tenant might want to resist its inclusion in the Lease.]*

Gross leases may contain an “expense stop” that limits pass-through expenses payable by Tenant to either: (1) amounts that exceed the expenses per square foot for the Project in a certain lease year (typically, the first year) or (2) expenses that exceed a certain amount per-square-foot. A sample expense stop provision follows:

During the Lease Term, Tenant shall pay only a component of the Operating Expenses—the Excess Operating Expenses. “Excess Operating Expenses” means the product of (i) the amount by which the Basic Cost Per Square Foot of NRA for any calendar year or portion thereof during the Lease Term exceeds the Basic Cost Per Square Foot of NRA during the Base Year (defined below), multiplied by (ii) the Net Rentable Area of the Leased Premises. The “Base Year” shall be 2004.

Or

During the Lease Term, Tenant shall pay only a component of the Operating Expenses—the Excess Operating Expenses. “Excess Operating Expenses” means the product of (i) the amount by which the Basic Cost Per Square Foot of NRA for any calendar year or portion thereof during the Lease Term exceeds \$ \_\_\_\_\_ per square foot of NRA, multiplied by (ii) the Net Rentable Area of the Leased Premises.

Leases may also contain an Operating Expenses “gross-up” provision. Paragraph (4) of the sample provision above contains a provision that accomplishes the same result as a typical gross-up provision without actually requiring a gross-up (it merely applies different Tenant percentages to Occupancy Independent Costs and non-Occupancy Independent Costs). Gross-up provisions generally operate to ensure that the amounts passed through to the Tenant fairly reflect the actual cost to the Landlord of maintaining the Tenant’s Leased Premises. Notice that only non-Occupancy Independent Costs, or “variable” costs, are grossed-up. Occupancy Independent Costs, or “fixed” costs, such as taxes and insurance, are not grossed up, and Tenants will usually be responsible for their prorata share (based on each Tenant’s square footage divided by the total square footage) of the fixed costs. In a triple-net lease, gross-up provisions generally operate in the Landlord’s favor by ensuring that it recovers all of the variable costs it incurs on behalf of its tenants. In a lease with a base year expense stop, the gross-up provision may also benefit the Tenant by establishing a “true” base year expense level. The common practice is to gross-up variable expenses to 90% or 95% occupancy and not 100% occupancy; this practice may yield pass-through calculations that differ slightly from the economic reality in some circumstances.

In a triple net lease, the gross-up provision generally protects the Landlord by allowing the Landlord to recover all of the variable expenses from its Tenants. Consider a building where the variable costs would be \$25 at

25% occupancy, \$50 at 50%, \$75 at 75%, and \$100 at full occupancy. If Tenant A leases 25% of the space and the remainder of the space is vacant, the Landlord's variable costs would be \$25. Without a gross-up provision, the Lease would require Tenant A to pay 25% (it pro rata share based on square footage) of the variable costs, or \$6.25. In this scenario, the Landlord does not recover \$18.75 of its variable costs even though all of its variable costs are attributable to Tenant A's lease. An arguably fairer result would be achieved if the variable expenses were grossed-up. If the Landlord grossed-up the variable costs by assuming 100% occupancy, the grossed-up expenses would be \$100. Tenant A would pay 25% of this number, or \$25, which represents the actual increase in variable expenses attributable to Tenant A's lease.<sup>48</sup> In this example, the gross-up provision allows the Landlord to recover 100% of its costs from its Tenant (which was probably the intent of the parties when the Lease was executed because the expenses are directly attributable to the Tenant's lease).

In a lease with a base year expense stop, grossing-up variable costs in the base year benefits the Tenant. After the base year, the Tenant will pay the increase in its share of the expenses.

The following illustration demonstrates the disadvantage to the Tenant if the variable costs in the Lease's base year are not grossed-up. Consider the same office building in the preceding paragraph. Tenant B leases 10% of the space in the office building, bringing the building's occupancy rate to 50%. In the base year, the variable costs for the building are \$50. Without a gross-up provision, Tenant B's share of the variable expenses will be 10% of \$50, or \$5. For every successive year, Tenant B will pay the increase in its share of the variable expenses over \$5. If in year 2 of Tenant B's lease the building is 75% occupied (assuming that the variable costs themselves do not increase between years 1 and 2), Tenant B's share of the variable costs will be \$7.50, and Tenant B will pay \$2.50 in additional rent (the increase over \$5). The increase in Tenant B's share of the variable costs was due to an increase in occupancy only and not due to an increase in the Project's variable costs.

A gross-up provision would have been to Tenant B's advantage in the illustration above. If Tenant B's lease had a 100% gross-up provision, then the variable costs would have been grossed-up to \$100 in the base year. Tenant B's expense stop would have been \$10 in the base year. In year 2 when occupancy was 75%, the grossed-up variable expenses would

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<sup>48</sup> Notice that, if the expenses were grossed-up to 95% occupancy, as is common in many leases in the marketplace, the Landlord would fail to recover some of its costs. The grossed-up expenses would be \$95, and Tenant A would pay 25% of this amount, or \$23.75. Landlord would not recover \$1.25 from Tenant A even though all \$25 of the variable costs are attributable to Tenant A.

have been \$100 again, Tenant B's share would have been zero because there was no increase over the base year.<sup>49</sup> This result more accurately reflects Tenant B's intent—it should only pay increases in variable expenses when the expenses themselves change, not when the occupancy rate of the Project changes.

A sample neutral gross-up provision (which may be substituted for Paragraph (4) in the sample lease provision above) is set forth below:

The “Basic Cost Per Square Foot of NRA” shall be determined by dividing those amounts comprising the Basic Cost by the Net Rentable Area of the Project, whether or not occupied, but subject to adjustment according to the following:

For any calendar year in which less than 95% of the rentable space in the Project is leased during all or a portion of the calendar year, all expenses that are not “Occupancy Independent Costs” (as that term is defined in this paragraph) will be grossed-up to the amount the non-Occupancy Independent Costs would have been if the Project had been 95% leased during all or a portion of the calendar year. The Landlord shall employ sound accounting and property management principles when grossing-up such costs. The adjusted amount of the non-Occupancy Independent Costs will be used in determining the Basic Costs for such calendar year. As used herein, the term “Occupancy Independent Costs” shall refer to those costs, expenses and disbursements which Landlord shall incur, pay or become obligated to pay in connection with the operation, maintenance, repair, replacement, security and ownership of the Building, Project, or Land, which costs, expenses and disbursements do not materially increase or decrease depending on the occupancy rate of the Project. *[Tenant addition: “Notwithstanding the adjustment described in this Section, Landlord shall not collect an amount greater than the actual Basic Costs.”]*

#### 4. Security Deposit

The Tenant Security Deposit required in most leases may be in the form of cash or an irrevocable letter of credit. The Landlord may prefer the irrevocable letter of credit because the Landlord's ability to obtain payment from the letter of credit should not be blocked in a Tenant bankruptcy.<sup>50</sup> Provisions relating to cash security deposits follow; the

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<sup>49</sup> Note that, if the expenses had only been grossed-up to 95%, Tenant B's expense stop would have been \$9.50. The result in year 2 (with 75% occupancy) would have been the same for Tenant B; no variable expenses would have been passed through to it. However, consider year 3 when the building is 100% occupied. If the variable costs have not increased, they would be \$100. The gross-up provision would not apply because occupancy is greater than 95%. Tenant B's share of the variable expenses would be the \$0.50 excess over its expense stop. Here, Tenant B is paying a higher expense rate due only to the increased occupancy of the building, and the Landlord may be collecting a windfall if all of the building's leases have a base year grossed-up to 95%. ***For this reason, many Tenants negotiate to add a sentence to the gross-up provision that prevents the Landlord from recovering more than 100% of the actual variable costs from all of the Tenants in the Project.***

<sup>50</sup> See, e.g., *In the Matter of Compton Corp.*, 831 F.2d 586 (5<sup>th</sup> Cir. 1987) (holding that “a bankruptcy trustee is not entitled to enjoin a post petition payment of funds under a letter of credit from the issuer to the beneficiary, because

provision would require minor modifications if an irrevocable letter of credit is used.

The Security Deposit shall be held by Landlord without liability for interest and as security for the performance by Tenant of Tenant's covenants and obligations under this Lease. It is expressly understood that such deposit shall not be considered an advance payment of Rent or a measure of Landlord's damages in case of default by Tenant. Landlord may, from time to time, without prejudice to any other remedy, use such deposit to the extent necessary to make good any arrearage of Rent or other amounts due hereunder and to reimburse Landlord for any other damage, injury, expense or liability caused to Landlord by any breach of this Lease. Following any such application of the Security Deposit, Tenant shall pay to Landlord on demand the amount so applied in order to restore the Security Deposit to its original amount. If Landlord transfers its interest in the Leased Premises during the Lease Term, Landlord may assign the Security Deposit to the transferee and, thereafter, shall have no further liability for the return of such Security Deposit [*upon delivery of written notice of such assignment to Tenant*].

If Tenant is not then in default hereunder and notwithstanding the provisions of Texas Property Code Section 93.005 to the contrary, the remaining balance of the Security Deposit shall be returned by Landlord to Tenant within sixty (60) days after the expiration of this Lease (less any deductions for damages and other charges for which Tenant is liable hereunder, including without limitation any sums which may be owed to the Landlord as Operating Expenses for the year of the termination). Landlord shall not be required to keep the Security Deposit separate from its general funds.

*[Tenant alternative for second paragraph: The Security Deposit shall be deemed earned upon execution hereof, but will be immediately returned to Tenant, less any deductible costs, upon Tenant's full compliance with and performance under this Lease through its full term. Landlord shall maintain the Security Deposit in an interest-bearing account with all accrued interest to be payable to Tenant annually at the end of each Calendar Year (or used to offset any Tenant underpayment of Operating Expenses). At any time during the Lease Term, the Tenant may substitute an irrevocable letter of credit in an equal amount for the cash Security Deposit.]*

[Authors' Note: The Security Deposit clause above incorporates the 2003 amendment to the Texas Property Code that requires the Landlord to return the unapplied portion of the Security Deposit to the Tenant within 60 days after the Tenant surrenders the Leased Premises and notifies the Landlord of its forwarding address. See H.B. 3190, 78<sup>th</sup> Leg., R.S. The same amendment provides that a Landlord will have acted in bad faith if it does not return the Security Deposit or provide a list of itemized deductions within 60 days after the Tenant surrenders the premises.]

## **5. Permitted Use**

The Permitted Use section of the Lease defines exactly what type of activities the Tenant may carry out in the Leased Premises. The Landlord usually attempts to narrow this Permitted Use as much as possible to ensure that the Tenant does not use the Leased Premises in a manner unintended by the Landlord. The Landlord may also have obligations in leases with other tenants to not allow competing uses in the Project; in this case, the Permitted Use provision becomes even more important for the Landlord. The broadest possible Tenant-oriented use clause would allow "any lawful use." If the Tenant is unable to negotiate for the inclusion

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such a payment is not a transfer of the debtor's property. . . ."). See also In re Elegant Merchandising, Inc., 41 B.R. 398 (Bankr. S.D. N.Y. 1984); In re Illinois-California Exp., Inc., 50 B.R. 232 (Bankr. D. Colo. 1985).

of the broad clause, the Tenant should ensure that any narrower Permitted Use clause allows for the Tenant's intended use and any foreseeable new activities that it might want to pursue during the Lease Term.

## **6. Lease Grant and Covenant of Quiet Enjoyment**

Each Lease should contain a specific grant of lease rights and typically contains a covenant of quiet enjoyment. The covenant of quiet enjoyment is usually made subject to the Tenant's being in compliance with the Lease terms and subject to liens and encumbrances that affect the Land and Project. The Tenant should request that Landlord state that any such liens and encumbrances do not affect the lease rights granted by Landlord. A sample provision follows:

Landlord, in consideration of the Rent to be paid and the other covenants and agreements to be performed by Tenant and upon the terms hereinafter stated, does hereby lease, demise and let unto Tenant the Leased Premises commencing on the Commencement Date and ending on the last day of the Lease Term unless sooner terminated as herein provided.

Tenant shall peaceably and quietly hold and enjoy the Leased Premises for the Lease Term, without hindrance from Landlord or Landlord's successors or assigns, subject to (i) the terms and conditions of this Lease, including the performance by Tenant of all of the terms and conditions of this Lease to be performed by Tenant, including the payment of Rent and other amounts due hereunder, and (ii) actions and claims of any person or entity holding superior title to that of Landlord, including, but not by way of limitation, any person or entity who holds an interest in the Leased Premises to which the leasehold interests created by this Lease is subordinate and all liens and encumbrances recorded in the Real Property Records of Travis County, Texas [*Alternative Tenant clause (ii): (ii) actions and claims of any person or entity holding superior title to that of Landlord by way of one of the liens or encumbrances listed on Exhibit \_\_\_ to this Lease*].

*[Landlord represents and warrants that it owns good and indefeasible title to the Leased Premises and has the legal authority to grant Tenant the lease rights described in this Lease. Landlord also represents and warrants that its grant of the lease rights described in this Lease to Tenant does not violate the rights of any third parties to use any portion of the Leased Premises and that Tenant's permitted use of the Leased Premises does not violate any applicable zoning laws or other laws or regulations.]*

## **7. Holding Over**

Most leases contain a "holdover" clause that describes the effect of the Tenant's remaining in possession of the Leased Premises after the Lease Term expires. This provision usually states that increased "holdover rent" applies to any holdover period; the amount of increased rent may be negotiated between the parties. A sample provision follows:

Should Tenant, or any of its successors in interest, hold over the Leased Premises, or any part thereof, after the expiration of the Lease Term, such holding over shall constitute and be construed as a default under this Lease and a tenancy at will only, at a daily rental equal to the daily Rent payable for the last month of the Lease Term plus one hundred fifty percent (150%) of such amount. The inclusion of the preceding

sentence shall not be construed as Landlord's consent for Tenant to hold over.

## **8. Guaranties**

The Landlord sometimes requires Tenant affiliates or related individuals to guarantee the Tenant's performance of the Lease. This means that the guarantor may be held liable for rent and other amounts due under the Lease in the case of a default by the Tenant. Whether or not the Tenant agrees to a guaranty often depends on market conditions, the financial condition and operating experience of the Tenant, the amount of the Security Deposit, the length of the Lease Term, and the relative bargaining positions of the parties. The Tenant may want to negotiate for a monetary or time limitation on the guaranty. Each Guarantor should execute the Lease or a separate Guaranty Agreement.

Guarantors, jointly and severally, unconditionally and absolutely guarantee to Landlord the prompt and full payment and performance, when due, of all indebtedness and obligations, fixed or contingent, or in any other manner, which Tenant may owe or be required to perform pursuant to the terms of this Lease. Suit may be brought against Guarantors jointly and severally and against less than all of them, without impairing the rights of Landlord against the other Guarantors. Landlord may compromise with any of the Guarantors for less than all of the indebtedness and obligations and release any of the Guarantors from all further liability to Landlord without impairing the right of Landlord to demand and collect the balance from other Guarantors not so released. Landlord shall not be required to pursue any other remedies before invoking the benefits of this Guaranty; specifically, Landlord shall not be required to take any action against Tenant or any other person. The obligations of Guarantors under this Guaranty shall not be released or impaired without the express prior written consent of Landlord. Without limiting the generality of the foregoing, the obligations of Guarantors shall not be released or impaired on account of the following events: (a) the voluntary or involuntary liquidation, sale or other disposition of all or substantially all of the assets of Tenant, or any receivership, insolvency, bankruptcy, reorganization or other similar proceedings affecting Tenant or any of its assets; (b) any impairment, modification, release or limitation of liability of, or stay of lien enforcement proceedings against Tenant, its property, or its estate in bankruptcy or any modification of the Lease resulting from the operation of any present or future provision of the Federal Bankruptcy Code or any other similar federal or state statute, or from the decision of any court, it being the intention hereof that Guarantors shall remain liable notwithstanding any act, omission or thing which might, but for the provisions hereof, otherwise operate as a legal or equitable discharge of Guarantors; (c) Landlord's failure to use diligence in preserving the liability of any person, or in bringing suit to enforce collection of any amounts due under the Lease; (d) the substitution or withdrawal of collateral or release of security, and the exercise or failure to exercise by Landlord of any right conferred upon it herein or in any collateral agreement; (e) if Tenant is not liable because any act is ultra vires or the officers or persons executing the Lease acted in excess of their authority, or for any reason cannot be enforced against Tenant; (f) any payment by Tenant to Landlord if such payment is held to constitute a preference under the bankruptcy laws, or if for any other reason Landlord is required to refund such payment to Tenant or pay the amount thereof to any other party; (g) if this Guaranty is ever deemed invalid or unenforceable as to any of the Guarantors.

*[Notwithstanding the foregoing, or any provision herein to the contrary, Guarantors' liability under this Guaranty shall not exceed \$ \_\_\_\_\_, plus the amount of any attorneys' fees incurred by Landlord in enforcing the Lease or this Guaranty. In addition, provided there has been no default under the Lease, Guarantor's liability hereunder will terminate on \_\_\_\_\_, 20\_\_\_\_. After the termination of this Guaranty, Landlord agrees to take any further action reasonably required by Tenant to evidence the termination of this Guaranty, including without limitation returning the original of this Guaranty to Tenant and executing any document reasonably required by Tenant to memorialize the termination of this Guaranty.]*

## 9. Parking

Parking may be a chief concern for a Tenant with a customer-driven business. The Tenant will want to make sure that the Lease guarantees a certain amount of parking. This is usually done by identifying the parking area on an exhibit. The Tenant may also negotiate for reserved parking spaces that will be marked with signs or curb paintings by the Landlord. The Landlord may want to place limitations on the Tenant's parking in an office lease and allow for an alternative parking area in case the original parking area becomes unusable for any reason. Both parties should be wary of charging additional rent for parking spaces because such amounts, if separately stated, may be subject to Texas sales tax. A neutral parking provision is set forth below:

Provided Tenant is not in default, Tenant shall be permitted to use the parking area (including the parking garage, if any), associated with the Building during the Lease Term for parking of not more than 25 automobiles at such rates and subject to such terms, conditions and regulations as are from time to time charged or applicable to patrons of said parking area for spaces similarly situated within said parking area; provided, however, in the event Tenant, upon commencement of or at any time during the Lease Term, fails to utilize all or any of said parking spaces, Landlord shall have no obligation to make available to Tenant the spaces not utilized; provided further, the inability of Tenant to utilize said parking spaces shall under no circumstances be deemed a default by Landlord as to permit Tenant to terminate this Lease, in whole or in part, or to have any claim or cause of action against Landlord as a result thereof, the same being hereby expressly waived by Tenant. In the event the parking spaces become unavailable to Tenant during a portion of the Lease Term for any reason, other than Tenant's inability to utilize said parking spaces, Landlord shall use reasonable efforts to make available to Tenant on the Land the above-required number of parking spaces, which spaces shall be situated within 1,500 feet from the Building, until the parking spaces are again available to Tenant. *[The Tenant may want to negotiate for a Rent abatement if substitute parking must be provided. The Tenant may also want to require certain types of lighting or security for the parking areas.]*

The Tenant will also want to make sure that the maintenance and repair provisions in the Lease require the Landlord to maintain the parking area.

## B. IMPROVING AND MAINTAINING THE LEASED PREMISES

Both the Landlord and the Tenant will have certain rights and obligations related to improving, maintaining, and repairing the Leased Premises. The Lease should set forth these obligations in detail.

## 1. Landlord's Obligations

The Landlord will typically be responsible for maintaining and repairing the roof, foundation, exterior walls, and other structural elements of the Building. If there are any other specific obligations the Landlord has undertaken, the Tenant will want to make sure these obligations are described in the Lease. The Landlord may also be responsible for certain finish-out in the Leased Premises prior to Lease commencement. Another area that is often negotiated by the parties is the responsibility for HVAC system repairs and maintenance; the outcome of these negotiations will usually depend on the type of space being leased (i.e., in a single-tenant building, the Tenant will usually have most HVAC repair and maintenance obligations; whereas, in an office lease, the Landlord generally has this responsibility).

Landlord, at its sole cost and expense, shall keep the foundation, the exterior walls (except store fronts, plate glass windows, doors, door closure devices, window and door frames, molding, locks and hardware and painting or other treatment of interior and exterior walls), roof and structural components of the Leased Premises and parking areas of the Leased Premises in good repair, except that Landlord shall not be required to make any repairs occasioned by the act or *[gross]* negligence of Tenant, its agents, employees, subtenants, licensees and concessionaires *[Tenant will want to delete "licensees and concessionaires"]*, which repairs shall be made by Tenant. As a part of the common maintenance, Landlord shall also keep all driveways, sidewalks, service-ways and loading areas in commercially reasonable repair. In the event that the Leased Premises should become in need of repairs required to be made by Landlord hereunder, Tenant shall give immediate written notice thereof to Landlord; Landlord shall not be responsible in any way for failure to make any such repairs until a reasonable time shall have elapsed after delivery of such written notice *[Tenant will want to Landlord to commit to complete such repairs within a certain number of days after receiving notice form the Tenant]*. Landlord's obligation hereunder is limited to repairs specified in this Lease Section only, and Landlord shall have no liability for any damages or injury arising out of any condition or occurrence causing a need for such repairs *[unless Landlord's negligently fails to make such repair within the required time after receiving Tenant's notice or fails to make such repair in a reasonable manner]*.

*[Landlord agrees to furnish Tenant while Tenant is occupying the Leased Premises and while not in default under this Lease, facilities to provide (i) water (hot, cold and refrigerated) at those points of supply provided for general use of tenants in the Building; (ii) heated and refrigerated air conditioning in season, during Customary Business Hours (as hereinafter defined), and at such temperatures and in such amounts as are reasonably considered by Landlord to be standard, such service at hours other than Customary Business Hours to be furnished only after Landlord's receipt of a request from Tenant, who shall bear the entire cost thereof; (iii) janitorial service to the Premises as is reasonably considered by Landlord to be standard on weekdays other than Holidays (as hereinafter defined) and such window-washing as may from time to time in Landlord's judgment reasonably be required; (iv) operatorless passenger elevators for ingress and egress to the floor on which the Leased Premises are located, in common with other tenants, provided that Landlord may reasonably limit the number of elevators to be in operation at times other than during Customary Business Hours for the Project; (v) replacement of Project standard light bulbs and fluorescent tubes; and (vi) security, deemed appropriate by Landlord, to the Project during the weekends and after Customary Business Hours during the week; provided that Landlord shall not be liable to Tenant for any reason for losses due to theft or burglary, or for damages done by unauthorized persons on the Leased Premises. In addition, Landlord agrees to maintain the public and common areas of the Project, such as lobbies, stairs, corridors and restrooms, in reasonably good order and condition, except for damage occasioned by the act or gross negligence of Tenant, its agents, employees, or subtenants.]*

## 2. Landlord's Inspection Rights

The Landlord should have the right to inspect the Leased Premises from time to time to evaluate whether or not the Tenant is properly maintaining the Leased Premises. The Tenant may want to require notice from the Landlord before any inspection so as to minimize any interruption of Tenant's business.

### Landlord Provision

Landlord and its officers, agents and representatives shall have the right to enter into and upon any and all parts of the Leased Premises at all reasonable hours (or, if any emergency, at any hour) for all reasonable purposes, including, without limitation, inspecting the condition of the Leased Premises and showing the Leased Premises to prospective tenants, purchasers or lenders. Tenant shall not be entitled to any abatement or reduction of Rent by reason of such inspection, nor shall such be deemed to be an actual or constructive eviction.

### Tenant Provision

*Landlord and its officers, agents and representatives shall have the right to enter into and upon any and all parts of the Leased Premises at a reasonable, agreed hour with at least 24 hours written notice to inspect the condition of the Leased Premises and to show the Leased Premises to prospective tenants (but only during the final three months of the Lease Term and only if Tenant has not exercised its right to renew the Lease) or prospective purchasers or lenders.*

## 3. Tenant's Obligations

Depending on the type of property, the Tenant may have extensive repair and maintenance obligations for the Leased Premises. The Tenant may also want rights to alter the Leased Premises so that it better suits the Tenant's business needs. The Landlord will want to place some limitations on the Tenant's rights.

Tenant shall keep the Leased Premises in good, clean and habitable condition and shall, at its sole cost and expense, make all needed repairs and replacements, including replacement of cracked or broken glass, except for repairs and replacements required to be made by Landlord under the provisions of this Lease. Tenant shall keep all plumbing units, pipes and connections free from obstruction and protected against ice and freezing. Tenant agrees, at its own cost and expense, to repair or replace any damage or injury done to the Leased Premises or Building, or any part thereof, caused by the [gross] negligence or intentional act or omission of Tenant or Tenant's agents, employees, invitees or visitors [*Tenant may want to delete "invitees or visitors"; Tenant may agree to include "subtenants" as a limited class of invitees*]; provided, however, if Tenant fails to make such repairs or replacement within fifteen (15) days after the occurrence of such damage or injury (or, if the damage involves a water spill or leakage, within five (5) days after the occurrence), Landlord may, at its option, make such repairs or replacement, and Tenant shall pay the cost thereof (plus an additional charge of fifteen percent (15%) [*Tenant may want to negotiate a lower percentage mark-up*] of such cost to cover overhead) to Landlord within fifteen (15) days after Tenant's receipt of a request from Landlord to do so. Tenant further agrees not to commit or allow any waste or damage to be committed on any portion of the Project [*Tenant may want to limit this obligation to the Leased Premises only*], and at the termination of this Lease, by lapse of time or otherwise, Tenant shall deliver up said Leased Premises to Landlord in as good condition as at the Commencement Date, ordinary wear and tear excepted. Unless otherwise expressly stipulated herein, Landlord shall not be required to make any improvements or repairs of any kind or character on or to the Leased Premises, or any portion thereof, during the Lease Term.

Tenant, without the prior written consent of Landlord, shall not paint, install lighting or decorations, or install any signs, window or door lettering or advertising media of any type on or about the Project, or any part thereof, or make any other alterations or physical additions in or to the Project, or any part thereof. All alterations, additions

or improvements (whether temporary or permanent in character) [*but except for the installation of Tenant's Personal Property (as defined below),*] made in or upon the Leased Premises, either by Landlord or Tenant, shall be Landlord's property on termination of this Lease and shall remain on the Leased Premises without compensation to Tenant or, at Landlord's option, Tenant shall restore those portions of the Leased Premises which Tenant altered, added to or improved to their original condition.

All furniture, movable trade fixtures and equipment installed in the Premises by Tenant ("Tenant's Personal Property") may be removed by Tenant at the termination of this Lease if Tenant so elects, and shall be so removed if required by Landlord, or if not so removed shall, at the option of Landlord, become the property of Landlord. In the event of any such removal, Tenant shall, at its expense, repair and restore to its original condition any portion of the Leased Premises which is damaged by such removal. All such installations, removals and restorations shall be accomplished in a good workmanlike manner.

*[All warranties, including warranties on materials and workmanship, received by Landlord during its construction of the Leased Premises that cover items that the Tenant is required to repair and maintain shall be assigned to Tenant on the Commencement Date.]*

Tenant shall have no right to penetrate the roof of the Leased Premises without Landlord's prior written consent, and Landlord shall have the right to require that any such penetration be performed by Landlord's personnel or by a contractor retained by Landlord at Tenant's expense. *[Notwithstanding anything contained in this Section, Landlord agrees that Tenant may install one or more satellite dishes or other telecommunications equipment on the roof to provide satellite cable or other similar service to the Leased Premises so long as (i) Tenant shall submit plans for the installation of such dishes to Landlord for Landlord's approval, which approval must not be unreasonably withheld, and (ii) such work or equipment does not adversely affect any warranty related to the roof or building. Landlord will use reasonable efforts to review and approve or deny such work and equipment within fifteen business days of the receipt by Landlord of Tenant's plans and specifications.]*

### **C. ASSIGNMENT AND SUBLETTING**

Landlords and Tenants should both be very cautious when negotiating assignment and subletting clauses. On one hand, the Landlord has a strong interest in making sure that any assignee or subtenant is financially capable of performing the lease obligations and is a desirable tenant; even so, the Landlord may not want to release the original Tenant from its obligations under the Lease. The Landlord will also want to prevent the Tenant from profiting from a sublease in the case of a rising market. The Tenant, on the other hand, wants as much freedom as possible to negotiate with other parties and would like to be able to walk away from its lease obligations if it presents the Landlord with a suitable new Tenant. This Lease section should also address the Landlord's assignment of the Lease.

Tenant shall not, either voluntarily or by operation of law, assign all or any portion of this Lease, nor sublet the Leased Premises or any part thereof, nor permit the Leased Premises or any part thereof to be occupied by any person other than Tenant or Tenant's employees (in each case, a "Transfer" of the Leased Premises), without the prior written consent of Landlord; provided, Landlord agrees to not unreasonably withhold its consent to any proposed assignment if the following conditions are met (if the following conditions are not met, Landlord may withhold its consent to the Transfer in its sole and absolute discretion) (a) the credit worthiness, liquidity and financial condition of the proposed subtenant or assignee ("Transferee") shall be reasonably acceptable to Landlord; (b) the anticipated use of the Leased Premises by the proposed Transferee is acceptable to Landlord in Landlord's discretion reasonably applied; (c) Tenant shall have executed, have acknowledged and deliver to Landlord, and caused the Transferee to execute, have acknowledged and deliver to Landlord, an instrument in form and substance acceptable to Landlord in which (i) the Transferee adopts this Lease and assumes and agrees to perform, jointly and severally with Tenant, all of the obligations of Tenant hereunder, as to the space

transferred to it, (ii) Tenant subordinates to Landlord's statutory lien, contract lien and security interest any liens, security interests or other rights which Tenant may claim with respect to any property of the Transferee, (iii) Tenant agrees with Landlord that, if the rent (or a combination of the rental payable under such sublease plus any bonus or other consideration therefor or incident thereto) due from the Transferee, less Tenant's actual expenses incurred in effecting the Transfer (including brokers' commissions, attorneys' fees, and build-out costs), exceeds the Rent for the transferred space under the Lease, then Tenant shall pay Landlord as additional rent hereunder all such excess rent and other consideration immediately upon Tenant's receipt thereof, (iv) the Transferee agrees to use and occupy the transferred space solely for the purpose approved by Landlord and otherwise in strict accordance with this Lease, and (v) Tenant acknowledges and agrees that, notwithstanding the Transfer, Tenant remains directly and primarily liable for the performance of all the obligations of Tenant under the Lease for the duration of the Lease Term (including, without limitation, the obligation to pay all Rent), and Landlord shall be permitted to enforce this Lease against Tenant or the Transferee, or both, without prior demand upon or proceeding in any way against any other persons; (d) Tenant shall deliver to Landlord a counterpart of all instruments relative to the Transfer executed by all parties to such transaction (except Landlord); (e) Tenant shall pay all reasonable costs and expenses of Landlord, including legal and financial advisor fees and expenses incurred in the review of any proposed Transferee (such sums to be payable whether or not such transfer is approved or effected); and (f) no more than one approved Transfer shall be requested in any twelve month period.

*[The Tenant may want to negotiate for the deletion of all of the above conditions and instead include a clause that simply says "Landlord's consent to a Transfer by Tenant will not be unreasonably withheld."]*

In the event Tenant should desire to Transfer all or any portion of this Lease, Tenant shall give Landlord notice of such desire at least sixty (60) days in advance of the date on which Tenant desires to make such Transfer, which notice shall contain the name of the proposed Transferee, the nature and character of the business of the proposed Transferee, and the term, use, rental rate (which must not be less than the Adjusted Rental per square foot of NRA which was otherwise due from Tenant hereunder) and other particulars of the proposed Transfer, including, without limitation, evidence satisfactory to Landlord that the proposed Transferee is financially responsible and will immediately occupy and thereafter use the Leased Premises (or any sublet portion thereof) for the remainder of the Lease Term (or for the entire term of the sublease, if shorter). Landlord shall then have a period of thirty (30) days following receipt of such notice within which to notify Tenant in writing that Landlord elects, in Landlord's sole and absolute discretion (or in Landlord's commercially reasonable discretion if conditions (a) through (f) set forth above are met), (1) to terminate this Lease as to the space so affected as of the date so specified by Tenant for such assignment or subletting, or (2) to approve or disapprove Tenant's proposed assignment or sublease *[Tenant will want to delete (1)]*. If Landlord shall fail to notify Tenant in writing of such election within said thirty (30) day period, Landlord shall be deemed to have denied consent to such Transfer. If Landlord consents to a sublease, Tenant agrees to provide, at its expense, direct access from the sublet space to a public corridor of the Building if such direct access does not already exist. All plans and specifications for any alterations which may be necessary to provide such access shall be submitted by Tenant to Landlord for its prior written approval, which approval shall not be unreasonably withheld. No Transfer by Tenant shall relieve Tenant of any obligations under this Lease. Consent of Landlord to a particular Transfer shall not be deemed a consent to any other or subsequent transaction.

If Landlord consents to any Transfer by Tenant and subsequently any category of rent received by Tenant under any such sublease is in excess of the same category of Rent payable to Landlord under this Lease, or any additional consideration is paid to Tenant by the Transferee, then Landlord may, at its option, either (1) declare such excess rents under any sublease or such additional consideration for any Transfer to be due and payable by Tenant to Landlord as additional rent hereunder, or (2) elect to cancel this Lease as provided in subparagraph (a) above and at Landlord's option, enter into a lease directly with such Transferee, without liability to Tenant.

Landlord shall have the right to transfer and assign, in whole or in part, all its rights and obligations hereunder and in the Leased Premises, and in such event and upon assumption by the transferee of Landlord's obligations (any such transferee to have the benefit of, and be subject to, the provisions of this Lease), no further liability or obligation shall thereafter accrue against Landlord hereunder.

*[Notwithstanding anything to the contrary contained in this Lease, Tenant shall be entitled to Transfer this Lease without obtaining Landlord's consent (but with the obligation to provide written notice to Landlord) upon the*

*following terms and conditions: Tenant may, without obtaining Landlord's consent:*

*(i) Transfer the leasehold estate created by this Lease to any "affiliate" of Tenant which, for purposes of this Lease, shall be any entity under common control with Tenant, or to the parent, any franchisee or any subsidiary or successor corporation of Tenant, provided that the net worth of the affiliate shall be Five Million Dollars (\$5,000,000.00) or more;*

*(ii) merge into or consolidate with any corporation; provided, following such merger or consolidation, the net worth of the surviving entity shall be Five Million Dollars (\$5,000,000.00) or more; and*

*(iii) Transfer the leasehold estate created by this Lease (A) to a purchaser of all or substantially all of the assets of Tenant, as a going business, or (B) to the purchaser of the assets comprising a substantial number of Tenant's stores; provided that in any such instance, the acquiring entity, immediately following such acquisition, assumes directly to Landlord the obligation to perform and be bound by this Lease for all payments and performance accruing from and after the date of such acquisition and has a net worth of Five Million Dollars (\$5,000,000.00) or more.*

*In the case of a transfer meeting the criteria in sentences (i) through (iii) of the immediately preceding paragraph (each an "Automatic Assignment Event"), Tenant's obligations to Landlord under this Lease shall immediately cease, and Tenant shall be released from all future obligations under this Lease.]*

Prior to Tenant becoming a party to any merger or conversion or share (or interest) exchange transaction which is intended to be participated in by Tenant (or any party owning an ownership interest in Tenant), as the terms "merger," "conversion," "share exchange" and "interest exchange" are defined in any Texas (or other jurisdiction's) business organization statutes, Tenant shall give Landlord written notice of and a reasonable written explanation regarding the proposed transaction (and such other written information and written data relating to each such transaction as Landlord may reasonably request), and, concurrently with such notice, Tenant shall deliver to Landlord true copies of all documents pertaining to each such transaction; and Tenant (and any party owning an ownership interest in Tenant) shall not become a party to any such transaction or execute any document relating to any such transaction without Landlord's prior written approval. Any non-compliance by Tenant (or any party owning an ownership interest in Tenant) with the provisions of the preceding sentence shall, at the option of Landlord, constitute an event of default under this Lease (without the necessity that Landlord give Tenant any prior notice or curative opportunity) and Tenant's signature on (or other manifestation of assent to) any documents relating to any such transaction may, at the option of Landlord, be treated as void and of no effect. *[Tenant may want to delete this paragraph.]*

Additionally, with the exception of any change of ownership of the leasehold estate under this Lease resulting from the demise of a natural party tenant, any change of ownership of such leasehold estate (or any change of ownership of any portion of or interest in such leasehold estate), whether by operation of law (voluntary or involuntary) or otherwise, may, at the option of Landlord, if not approved in writing by Landlord prior to the occurrence thereof, be treated as an event of default (without the necessity that Landlord give Tenant any prior notice or curative opportunity) and Tenant's signature on (or other manifestation of assent to) any documents relating to any such transaction may, at the option of Landlord, be treated as void and of no effect. *[Tenant may want to delete this paragraph.]*

Notwithstanding that Tenant (or any party owning an ownership interest in Tenant) may have failed or refused to comply with any of the immediately preceding two (2) provisions, Landlord's acceptance of Rent and other monetary payments from Tenant (or from any other party) shall not constitute a waiver of or otherwise prejudice Landlord's rights under this Lease, including without limitation, the right of Landlord, at Landlord's option, to declare an event of default under the circumstances stated in such preceding provisions (without the necessity that Landlord give Tenant any prior notice or curative opportunity) and the right of Landlord, at Landlord's option, to treat Tenant's signature on (or other manifestation of assent to) any documents relating to such transaction as void and of no effect. *[Tenant may want to delete this paragraph.]*

The immediately preceding three (3) provisions shall be applicable and in full force and effect notwithstanding that any applicable statutory law or case decision provides that any such merger or conversion or share (or interest) exchange transaction does not constitute or involve the occurrence of a "transfer" or "assignment" of real estate interests or other assets of a constituent party to any such transaction. *[Tenant may want to delete this paragraph.]*

Tenant agrees that it shall not place (or permit any employee or agent to place) any signs on or about the Leased Premises, nor conduct (or permit any employee or agent to conduct) any public advertising which includes any pictures, renderings, sketches or other representations of any kind of the Project or Building (or a portion thereof) with respect to any proposed Transfer of the Leased Premises or any part thereof, without Landlord's prior written consent.

Tenant shall not mortgage, pledge, hypothecate or otherwise encumber (or grant a security interest in) this Lease or any of Tenant's rights hereunder *[except that Tenant may grant a security interest in Tenant's Personal Property located in the Leased Premises]*.

In the event Tenant Transfers this Lease with Landlord's consent as provided herein, any option then held by Tenant (such as an option to renew this Lease or to expand the size of the Leased Premises) shall terminate automatically concurrently with the assignment or sublease.

#### **D. SUBORDINATION, LIENS, AND NONDISTURBANCE**

##### **1. Landlord's Lien and Security Interest and Subordination to Tenant's Lender**

Many Leases contain standard language that grants the Landlord a lien against the Tenant's personal property placed inside the Leased Premises. The provision usually requires the Tenant to allow the Landlord to file a UCC-1 Financing Statement to perfect the lien. If the Tenant cannot negotiate for the Landlord's lien to be removed, then the Tenant should require a provision like the one below that automatically subordinates the Landlord's lien to a third party lender's lien against Tenant's personal property in the Leased Premises.

Notwithstanding the foregoing Landlord's lien, Landlord agrees that the liens contained in this Section shall be automatically and expressly subordinate to the lien of any third party lender who takes or has already taken a lien on Tenant's assets, equipment, or inventory, and Landlord further agrees to reasonably cooperate with Tenant and execute any documents reasonably required by any such lender to further evidence such subordination to Tenant's third party lenders.

##### **2. Tenant's Subordination to Landlord's Lender and Nondisturbance Agreement**

Subordination, Nondisturbance, and Attornment Agreements ("SNDAs") benefit the Landlord, the Tenant, and the Landlord's lender. Reasonable clauses regarding SNDAs should not be resisted by either party. The Landlord will likely require that the Lease be subordinate to its lender's lien on the Land, and the Tenant should be willing to agree to such subordination so long as the lender agrees not to disturb the Tenant's Lease if it forecloses on the Landlord (assuming the Tenant is not then in default under the Lease). The clause set out below requires the SNDA, but the Tenant must follow up to ensure actual receipt of the SNDA.

This Lease and the leasehold estate created by this Lease are and shall be subject, subordinate and inferior to any deeds of trust, mortgages or other instruments of security that now or hereafter cover all or any part of the Leased Premises, the Building, or any interest of Landlord therein (a "Superior Lien"); to further assure the foregoing subordination, Tenant shall, upon Landlord's request, execute any instrument intended to subordinate this Lease or to evidence the subordination of this Lease to any Superior Lien. In the event of the enforcement by the trustee or the beneficiary or mortgage note holder under any Superior Lien of the remedies provided for by law or by such Superior Lien, Tenant will, upon request of any person or party succeeding to the interest of Landlord as a result of such enforcement, attorn to and automatically become the tenant of such successor in interest without change in the terms or other provisions of this Lease; upon request by such successor in interest, Tenant shall execute and deliver a recordable instrument confirming the attornment herein provided for. As a condition to the effectiveness of the subordination and attornment in this paragraph, Landlord will obtain a reasonably acceptable nondisturbance agreement from holders of all Superior Liens; among other things, the nondisturbance agreement will provide that Tenant will not be disturbed by a holder of a Superior Lien so long as Tenant is in compliance with the terms of this Lease.

### **3. Mechanics' and Materialmens' Liens**

The Landlord will require a covenant that the Tenant (1) not allow any mechanics' or materialmens' liens to be filed against the Project and (2) remove the lien or bond around it as quickly as possible after it has been filed. The Tenant will want to carve out a right to protest the lien through proper legal processes.

Tenant will not permit any mechanic's lien or liens to be placed upon the Land, Building, or Leased Premises, or any portion thereof, caused by or resulting from any work performed, materials furnished or obligation incurred by or at the request of Tenant, and in the case of the filing of any such lien, Tenant will immediately *[Tenant will want to delete "immediately]* pay or otherwise obtain the release of same *[or bond around same within sixty (60) days of receipt of notice of the lien from Landlord]*. If default in compliance with this Paragraph shall continue for fifteen (15) *[sixty (60)]* days after delivery to Tenant of a notice thereof from Landlord, Landlord shall have the right and privilege at Landlord's option of paying the lien or any portion thereof without inquiry as to the validity of the lien. Any amounts so paid by Landlord, including expenses and interest, shall be deemed additional rent due from Tenant to Landlord and shall be repaid to Landlord (together with interest at the Past Due Rate from the date paid by Landlord) within fifteen (15) days after delivery to Tenant of a request from Landlord.

## **E. INDEMNITIES AND INSURANCE**

### **1. Indemnity Provisions**

Indemnification provisions protect the Landlord, and sometimes the Tenant, from lawsuits by third parties. Indemnification provisions usually involve three parties: the indemnitor, indemnitee, and the claimant. The claimant is the third party that brings a claim against the landlord or the

tenant. The indemnitee is the party that the claimant is pursuing. The indemnitor is the party that has agreed to defend the claim on the indemnitee's behalf and substitute its liability for the liability of the indemnitee. In single-tenant buildings or buildings with relatively few common areas, the Tenant usually indemnifies the Landlord, and the Landlord has no indemnification responsibilities. In a multiple-tenant building or a building where the Landlord is responsible for larger common areas, indemnification provisions may be mutual.

The indemnification provision may base indemnification obligations on the relative fault of the parties. If any act of the Tenant causes a claimant to sue the Landlord, then the Tenant will defend the claim and bear the ultimate liability. This is appropriate where the Tenant is the only occupant of the Building, or the Building has a relatively small number of tenants with little or no common areas. The rationale supporting this position is that the Tenant is in the best position to prevent injuries on the Leased Premises and should insure against such injuries. Such a provision arguably puts the Tenant in the same position it would be in if it owned the Building—it would be responsible for insuring all of the risks associated with the ownership. In a fault-based indemnification provision, Landlords and Tenants usually negotiate the standard of fault (negligence versus gross negligence)—which standard is chosen usually matters less than trying to negotiate mutual standards (although a higher standard of gross negligence probably helps the Tenant since, in general, its actions at the Leased Premises are more likely to cause an injury). The Tenant will also want to limit the persons for whose actions it is responsible.

In a single-tenant building or building with few common areas, it is unlikely that a Landlord's action will cause an injury. Nevertheless, it is not unreasonable for the Tenant to insist that the Landlord indemnify the Tenant for injuries caused by the Landlord's actions. In a multiple-tenant building or a building with large common areas, the possibility of the Landlord's actions causing an injury increase. Thus, the Tenant should require a mutual indemnification from the Landlord. In this case, the Landlord will also want to make sure that its insurance adequately protects it from such claims.

Notice that fault-based indemnification provisions may lead to the Landlord and Tenant fighting over whose action caused the claimant's injury. Ultimately, a judge or jury may have to decide. Some leases have adopted location-based indemnification provisions that avoid this problem. Location-based indemnification provisions require the Tenant to indemnify the Landlord for all claims arising on its Leased Premises and the Landlord to indemnify the Tenant for all claims arising in the common areas of the Building. Location-based indemnification provisions allow the parties to more easily determine their responsibility for a claim. They

may also more accurately represent the nature of the respective real property interests—the Tenant will insure for risks associated with the space it leased, and the Landlord will insure for risks associated with the common areas it controls.

Despite the simpler approach of location-based clauses, fault-based clauses still seem to be the industry standard. Sample indemnification clauses follow:

Landlord shall not be liable to Tenant, or to Tenant’s agents, servants, employees, customers or invitees and Tenant shall indemnify, defend and hold Landlord harmless from and against any and all fines, suits, claims, demands, losses, liabilities, actions and costs (including court costs and attorney’s fees) arising from (a) any injury to person or damage to the Project or any portion thereof caused by any act, omission or *[gross]* negligence of Tenant, Tenant’s agents, servants, employees, customers or invitees, (b) Tenant’s use of the Leased Premises or the conduct of Tenant’s business or profession, (c) any activity, work, or thing done, permitted or suffered by Tenant in or about the Leased Premises *[Tenant may want to delete (c) because of its breadth]*, or (d) any breach or default in the performance of any obligation on Tenant’s part to be performed under the terms of this Lease. **THIS INDEMNITY SHALL APPLY REGARDLESS OF WHETHER THE LOSS IN QUESTION ARISES OR IS ALLEGED TO ARISE IN PART FROM ANY NEGLIGENT ACT OR OMISSION OF LANDLORD OR LANDLORD’S AGENTS OR EMPLOYEES, FROM STRICT LIABILITY OF ANY SUCH PERSONS OR OTHERWISE, BUT IN SUCH EVENT TENANT SHALL NOT BE RESPONSIBLE FOR THAT PORTION OF ANY LOSS WHICH IS HELD TO BE CAUSED BY THE NEGLIGENCE OR STRICT LIABILITY OF LANDLORD OR LANDLORD’S AGENTS OR EMPLOYEES.**

*[Tenant shall not be liable to Landlord, or to Landlord’s agents, servants, employees, customers or invitees and Landlord shall indemnify, defend and hold Tenant harmless from and against any and all fines, suits, claims, demands, losses, liabilities, actions and costs (including court costs and attorney’s fees) arising from (a) any injury to person or damage to the Project or any portion thereof caused by any act, omission or gross negligence of Landlord, Landlord’s agents or employees or (b) any breach or default in the performance of any obligation on Landlord’s part to be performed under the terms of this Lease.*

*Neither party shall be liable to the other hereunder for incidental, special, consequential, or punitive damages.]*

## 2. Environmental Matters

The Landlord will want to ensure that the Tenant does not do anything on the Leased Premises that may cause environmental contamination. The Tenant will want to make sure that the Landlord bears the financial burden of any required environmental remediation not caused by the Tenant’s actions.

Tenant shall not bring or permit to remain on the Leased Premises any asbestos, petroleum or petroleum products, explosives, toxic materials, or substances defined as hazardous wastes, hazardous materials, or hazardous substances under any federal, state, or local law or regulation *[, except for commercially reasonable amounts of materials used in the ordinary course of Tenant’s business]* (“Hazardous Materials”). Tenant’s violation of the foregoing prohibition shall constitute a material breach and default hereunder and Tenant shall indemnify, hold harmless and defend Landlord from and against any claims, damages, penalties, liabilities, and costs (including reasonable attorneys’ fees and court costs) caused by or arising out of (i) a violation of the foregoing prohibition or (ii) the presence or any release of any Hazardous Materials on, under, or about the Leased Premises during Tenant’s occupancy or control of the Leased Premises *[Tenant will want to delete (ii) because it may make Tenant responsible for contamination that results from actions of others]*. Tenant shall clean up, remove,

remediate and repair any soil or ground water contamination and damage caused by the presence or release of any Hazardous Materials in, on, under, or about the Leased Premises during Tenant's occupancy of the Leased Premises in conformance with the requirements of applicable law. *[Tenant substitute for previous sentence: "Tenant shall clean up, remove, remediate and repair any soil or ground water contamination and damage caused by a violation of the covenant contained above in this Section."]* Tenant shall immediately give Landlord written notice of any suspected breach of this Paragraph, upon learning of the presence or any release of any Hazardous Materials, and upon receiving any notices from governmental agencies pertaining to Hazardous Materials which may affect the Leased Premises. The obligations of Tenant hereunder shall survive the expiration or earlier termination, for any reason, of this Lease.

*[Landlord represents and warrants that as of the Date of this Lease it is not aware of any environmental issues or the presence of Hazardous Substances, other than those Hazardous Substances on the Land, Project, Building, or Leased Premises. Landlord agrees to indemnify and hold Tenant harmless from all claims, demands actions, liabilities, costs, expenses, damages, penalties and obligations of any nature arising from or as a result of contamination of the Leased Premises, Building, Project, or Land with Hazardous Substances that arose or arises from the use of the Leased Premises, Building, Project, or Land by Landlord. The foregoing indemnification and the responsibilities of Landlord shall survive the termination or expiration of this Lease.]*

### **3. Insurance Provisions**

#### **a. Required Insurance**

The Lease will usually require both the Landlord and the Tenant to maintain some form of property and liability insurance. Generally, the Landlord is charged with maintaining property insurance on the Project, and the Tenant is charged with maintaining property insurance on the Tenant's improvements and personal property inside the Leased Premises. Both parties will maintain liability insurance protecting them from third-party injuries caused by their actions on the Project.<sup>51</sup> The Tenant will probably pay for its proportionate share of the Landlord's insurance as a pass-through expense. Both parties will want the other's insurance policy to name all parties as an additional insured under the policy, but the Landlord may not agree to name the Tenant as an additional insured on its policy.

Tenant shall, at its expense, maintain a policy or policies of commercial general liability insurance pertaining to its use and occupancy of the Leased Premises hereunder, with the premiums thereof fully paid in advance, issued by and binding upon a solvent commercially insurance company approved by Landlord *[Tenant may want to delete Landlord's approval right]*, such insurance to name Landlord as an additional insured, and to contain a provision to the effect that Landlord, although named as an additional insured, shall nevertheless be entitled to recovery under said policies for any loss occasioned to Landlord, its servants, agents and employees by reason of the acts, omissions, and/or negligence of Tenant *[Tenant may want to delete everything after the requirement to name Landlord as an additional insured]*. Such policy or policies shall afford minimum protection of not less than \_\_\_ Million and No/100 Dollars (\$\_\_\_,000,000.00) combined single limit for bodily injury, death to any one person, or property damage in any one occurrence. Tenant shall obtain a written obligation on the part of each insurance company to notify Landlord at least 10 days prior to cancellation of such insurance. Such policies

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<sup>51</sup> If the Landlord is not conducting any activity at the Project (i.e., there are no common areas to maintain and the landlord does not have an office at the Project), then the Landlord may argue that it does not need to maintain liability insurance covering its actions.

or duly executed certificates of insurance shall be promptly delivered to Landlord and renewals thereof, as required, shall be delivered to Landlord at least 30 days prior to the expiration of the respective policy terms.

Additionally, Tenant shall obtain and maintain during the Lease Term a contractual liability coverage endorsement with “incidental contract” coverage including all oral or written contracts relating to the named insured’s business. The adequacy of the coverage afforded by said liability insurance shall be subject to review by Landlord from time to time, and if Landlord is advised by Landlord’s insurance agent that a prudent businessman in Austin, Texas, using the Leased Premises for the Permitted Use, would increase the limits of said insurance, Tenant shall to that extent increase the insurance coverage required by this Paragraph. *[Tenant may want to delete this paragraph.]*

In addition to the remedies provided in this Lease for an Event of Default, if Tenant fails to maintain the insurance required by this Section, Landlord may, but is not obligated to, obtain such insurance and Tenant shall pay to Landlord upon demand as additional rental the premium cost thereof plus interest at the Past Due Rate from the date of payment by Landlord until repaid by Tenant.

*[Landlord shall maintain fire and extended coverage insurance covering the full replacement cost of the Leased Premises separate from the insurance maintained on other improvements at the Project (but not including the contents of the Leased Premises). The insurance maintained by Landlord will list Tenant as an additional insured.]*

## **b. Waivers and Subrogation**

The Lease should also include a standard subrogation provision. The provision protects both the Landlord and the Tenant by allowing them to place the financial burden of insured risks on the insurance companies. Without a waiver of subrogation, if the Tenant negligently caused the building to burn down, the Landlord’s insurance company could pay the Landlord (its insured) and then seek to stand in the Landlord’s shoes (or “subrogate”) and pursue the Landlord’s negligence claim against the Tenant.<sup>52</sup> In the end, the Tenant could end up reimbursing the insurance company for its cost. When the Landlord waives its claim against the Tenant and requires a subrogation waiver in its insurance policy, however, the insurance company is precluded from pursuing the claim against the Tenant. Therefore, the real effect of the waiver of subrogation is to force the insurance companies to bear the financial burden of all insurable risks, even when the law might place the fault of the loss on either the Landlord or the Tenant.

Landlord and Tenant agree and covenant that neither shall be liable to the other for losses arising out of damage to or destruction of the Leased Premises or contents thereof when such loss is caused by any perils included within standard fire and extended coverage insurance policy of the state in which the Leased Premises is situated; this agreement shall be binding whether or not such damage or destruction is caused by the

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<sup>52</sup> Or, vice-versa, of course. Generally, waivers of subrogation will not protect parties from their intentional misconduct because loss from a party’s intentional misconduct may not be insured under the insurance policy.

actual or alleged negligent act or omission to act of either party or their agents, employees or visitors. All insurance policies of property insurance carried by Landlord and Tenant in covering the Leased Premises, its contents, and the property of either of them in the Leased Premises will waive any right of the insurer to subrogation against the other to the extent permitted by law. Landlord and Tenant agree that their policies will include such a waiver or an endorsement to them; if a cost is imposed for such waiver or endorsement in Tenant's policy, the Tenant will bear all such costs. The failure of any insurance policy to include such a waiver or endorsement will not affect this Lease.

## **F. CASUALTIES AND CONDEMNATION**

### **1. Fires and Other Casualties**

Landlords and Tenants will both want some rights to terminate or modify the Lease in the case of a catastrophic event at the Leased Premises. In some cases, the Landlord will be required to rebuild the Leased Premises, and the Rent will be abated during such rebuilding period. In more extreme cases, the Lease may terminate. The parties will negotiate for greater control over the response to a casualty event.

In the event that the Leased Premises should be damaged or destroyed by fire or other casualty and Landlord does not elect [*neither Landlord nor Tenant elects*] to terminate this Lease as hereinafter provided, Landlord shall proceed with reasonable diligence and at its sole cost and expense to rebuild and repair the Leased Premises, and this Lease shall continue in full force and effect. If the Leased Premises or the Building shall (i) be destroyed or damaged materially by a casualty not covered by Landlord's insurance; or (ii) be destroyed or rendered untenable to such an extent that in Landlord's opinion [*either Landlord's or Tenant's opinion*] the Leased Premises or the Building cannot economically be rendered tenantable by a casualty covered by Landlord's insurance, or (iii) be damaged to such an extent that the remainder of the Lease Term is not sufficient to amortize the cost of reconstruction, then Landlord may elect [*either Landlord or Tenant may elect*] either to terminate this Lease as hereinafter provided or to proceed to repair or rebuild the Leased Premises. Should Landlord [*either party*] elect to terminate this Lease it shall give written notice of such election to Tenant [*the other party*] within ninety (90) days after the occurrence of the casualty, and this Lease shall terminate effective as of the date of the casualty. If Landlord does not elect [*neither party elects*] to terminate this Lease, Landlord shall proceed with reasonable diligence and at its sole cost and expense to rebuild or repair the Leased Premises; provided, however, that if any mortgagee under a deed of trust, security agreement or mortgage on the Project should require that the insurance proceeds be used to retire the mortgage debt, or in the event any lessor under a ground or master lease affecting the Project should terminate said lease as a result of any such casualty, then Landlord, at Landlord's option, may elect not to rebuild and this Lease shall terminate upon Tenant's receipt of a notice from Landlord to that effect. Landlord's obligation to rebuild and repair under this Section shall in all events be limited to restoring the Leased Premises to substantially the condition same were in at the Commencement Date, excluding all signs, fixtures, equipment or furniture of Tenant and any alterations, additions or improvements to the Leased Premises made by Tenant, whether prior to or after the Commencement Date. Tenant agrees that in a commercially reasonable time after completion of such work by Landlord, Tenant shall proceed with reasonable diligence and at its sole cost and expense to rebuild, repair and restore all signs, furniture, equipment, fixtures and other improvements which may have been placed by Tenant within the Leased Premises. Provided that the casualty did not occur by reason of any act or omission of Tenant or Tenant's agents, employees or contractors [*Tenant may want to delete the first clause of this sentence*], Landlord shall allow Tenant a diminution of Base Rent during the time the Leased Premises are unfit for occupancy, which diminution shall be based upon the proportion of square feet which are unfit for occupancy to the total square feet in the Leased Premises [*; provided, however, if the*

*amount of the Leased Premises that are fit for occupancy is unsuitable to allow Tenant to carry out its business in a commercially reasonable manner, then no Rent shall be owed by Tenant until enough of the Leased Premises is fit for occupancy to allow Tenant to carry out its business]. Except as hereinafter provided, any insurance which may be carried by Landlord or Tenant against loss or damage to the Building or to the Leased Premises shall be for the sole benefit of the party carrying such insurance and under its sole control.*

## **2. Condemnation**

Similar to casualty events, both Landlord and Tenant will want some control over responding to an event of condemnation by local authorities.

If more than twenty percent (20%) of the net rentable floor area of the Leased Premises should be taken for any public or quasi-public use under any governmental law, ordinance or regulation or by right of eminent domain or by private purchase in lieu thereof, this Lease shall terminate, Tenant's obligations under this Lease shall immediately cease and the rental and other sums payable hereunder shall be abated during the unexpired portion of this Lease, effective on the date physical possession is taken by the condemning authority.

If twenty percent (20%) or less of the floor area of the Leased Premises should be taken as aforesaid, Landlord *[either party]* may terminate this Lease by providing written notice to Tenant *[the other party]*, and the Lease shall terminate effective on the date physical possession is taken by the condemning authority. If Landlord does not elect to terminate this Lease, the Lease shall continue in full force and effect; however, the Rent payable hereunder during the unexpired portion of this Lease shall be reduced in proportion to the area taken, effective on the date physical possession is taken by the condemning authority. Following such partial taking, Landlord shall make all necessary repairs or alterations to the remaining premises necessary to make the remaining portion of the Building an architectural whole. *[Notwithstanding the previous three sentences, if such partial taking makes it impractical for Tenant to carry out its intended business, Tenant may terminate this Lease by notifying Landlord of the termination within 90 days after the partial taking is effective. Tenant's obligations under this Lease shall immediately cease upon its election to terminate pursuant to this paragraph.]*

*[If any of the parking areas for Tenant outside of the Building shall be taken as aforesaid, this Lease shall not terminate, nor shall the rental payable hereunder be reduced, except that either Landlord or Tenant may terminate this Lease if the parking spaces remaining following such taking plus any substitute parking area provided by Landlord pursuant to the terms of this Lease shall be less than the parking spaces required in this Lease. Any election to terminate this Lease in accordance with this provision shall be evidenced by written notice of termination delivered to the other party within 90 days after the date physical possession is taken by the condemning authority. Tenant's obligations under this Lease shall immediately cease upon its election to terminate pursuant to this paragraph.]*

All compensation awarded for any taking (or the proceeds of private sale in lieu thereof) of the Leased Premises shall be the property of Landlord, and Tenant hereby assigns its interest in any such award to Landlord; provided, however, Landlord shall have no interest in any award made to Tenant for the taking of Tenant's Personal Property *[, Tenant's leasehold estate, or the loss of Tenant's business]* if a separate award for such items is made to Tenant.

Landlord may, without any obligation or liability to Tenant, agree with any condemning authority to a judgment of condemnation without the necessity of a formal suit or judgment of condemnation. Such agreement shall be treated as a taking under this Section and the date of taking under this clause shall then be deemed the date agreed to under the terms of said agreement.

## G. DEFAULT AND REMEDIES

### 1. Events of Default by Tenant

Much of the Lease's provisions regarding the Tenant's default will be standard pro-Landlord language. The Landlord will want to make sure that it has the legal right to allege a default and implement its remedies upon any misstep by the Tenant, even though the Landlord may not choose to do so. The Tenant will mainly be interested in negotiating for two main points: (1) a limitation on some of the events of default in the Lease (from the Tenant's perspective, as long as it is paying the Rent and not damaging the Leased Premises, it should not be held in default) and (2) notice and cure rights for monetary and nonmonetary defaults.

The following events shall be deemed to be events of default by Tenant under this Lease:

(i) Tenant shall fail to pay when due any Rent or other sums payable by Tenant hereunder *[within 10 days of receipt of written notice of default from Landlord]* (or under any other lease now or hereafter executed by Tenant in connection with space in the Building *[Tenant will want to delete this parenthetical clause]*) *[notwithstanding this provision, Tenant must have received a notice of default for nonpayment of Rent before twelve months after the Rent was due, otherwise such nonpayment of Rent will not be an event of default under this Lease; Landlord shall have no right to collect unpaid Rent unless it has delivered a notice of default before twelve months after the date such Rent payment was due]; [compromise provision: notwithstanding the provisions of this paragraph, Landlord shall not be required to give Tenant more than two notices of monetary defaults during any calendar year of the Lease Term].*

(ii) Tenant shall fail to comply with or observe any other provision of this Lease (or any other lease now or hereafter executed by Tenant in connection with space in the Building *[Tenant will want to delete this parenthetical clause]*), and shall not cure such failure within ten (10) *[thirty (30)]* days after written notice thereof to Tenant (or, if such failure involves the repair or clean up of a water spill or leakage, within one (1) day *[three (3) days]* after written notice thereof to Tenant); *[provided, however, that if the failure to cure is of such a nature that it cannot reasonably be cured within said cure period, Tenant shall not be deemed in default so long as Tenant commences curing such failure within the required period, and diligently prosecutes same to completion;]*

(iii) Tenant or any guarantor of Tenant's obligations hereunder shall make a transfer in fraud of creditors or an assignment for the benefit of creditors; *[Tenant may want to delete the reference to guarantors.]*

(iv) Any petition shall be filed by or against Tenant or any guarantor of Tenant's obligations hereunder under any appropriate federal or state bankruptcy or insolvency law; or Tenant or any guarantor of Tenant's obligations hereunder shall be adjudged bankrupt or insolvent in proceedings filed thereunder; or Tenant or any such guarantor shall admit that it cannot meet its financial obligations as they become due; *[Tenant may want to delete the reference to guarantors.]*

(v) A receiver or trustee shall be appointed for all or substantially all of the assets of Tenant or any guarantor of Tenant's obligations hereunder; *[Tenant may want to delete the reference to guarantors.]*

(vi) Tenant shall abandon any portion of the Leased Premises. For purposes of this Lease, Tenant shall be deemed to have abandoned the Leased Premises if Tenant fails to utilize all of the Leased Premises for the purpose permitted herein for ten (10) or more consecutive days *[Tenant may want to delete this paragraph];* and

(vii) Tenant shall do or permit to be done anything which creates a lien upon the Leased Premises *[and shall fail to discharge or bond around such lien within sixty (60) days of receipt of written notice from Landlord].*

## 2. Landlord's Remedies on Tenant's Default

For the most part, the Landlord will insist on retaining the standard Landlord's remedies reflected in the provision set forth below. The Tenant may be able to negotiate some portions of this customarily pro-Landlord lease provision, but many Landlords will refuse to alter this language.

Upon the occurrence of any *[monetary]* event of default by Tenant *[or any material nonmonetary default by Tenant]* specified in this Lease and after the expiration of any notice and cure period, Landlord shall have the option to pursue any and all remedies which it may then have hereunder or at law or in equity, including, without limitation, any one or more of the following, in each case, without any notice or demand. *[In all cases, Landlord shall be required to mitigate its damages.]*

(a) Terminate this Lease by notice in writing to Tenant in which event Tenant shall immediately surrender the Leased Premises to Landlord, and if Tenant fails to do so, Landlord may, without prejudice to any other remedy which it may have for possession or arrearage in rent, enter upon and take possession of the Leased Premises. To the extent permitted by Texas law, Tenant agrees to pay to Landlord on demand the amount of all loss and damage which Landlord may suffer by reason of such termination, whether through inability to relet the Leased Premises on satisfactory terms or otherwise, including the amounts described in (c)(i) to (c)(vi) below.

(b) Draw upon any letter of credit provided by Tenant pursuant to the requirements of this Lease.

(c) Enter upon and take possession of the Leased Premises, and if objectively reasonable to do so, Landlord may relet all or any part of the Leased Premises on such terms as Landlord shall deem reasonable (including, without limitation, such concessions and free rent as Landlord deems necessary or desirable) *[The Tenant may want to require reletting terms to be "comparable to similar space in similar Projects in the Austin, Texas area"]* and receive the rent therefor, and Tenant agrees (i) to pay to Landlord on demand any deficiency that may arise by reason of such reletting for the remainder of the Lease Term, and (ii) that Tenant shall not be entitled to any rents or other payments received by Landlord in connection with such reletting even if such rents and other payments are in excess of the amounts that otherwise would be payable to Landlord under this Lease. Tenant shall be liable immediately to Landlord for all costs Landlord incurs in repossessing and reletting the Leased Premises, including, without limitation, brokers' commissions, reasonable attorney's fees incurred in connection with the reletting and in connection with Tenant's default hereunder, expenses of repairing, altering and remodeling the Leased Premises required by the reletting, and like costs. Alternatively, Landlord may repossess the Leased Premises and sue to recover the following amounts:

(i) the worth at the time of award of any unpaid rent which had been earned at the time of termination (of possession or of this Lease, as applicable); plus

(ii) the worth at the time of award of the amount by which the unpaid rent which would have been earned after such termination until the time of award exceeds the amount of such rental loss which Tenant proves could have been reasonably avoided; plus

(iii) the worth at the time of award of the amount by which the unpaid rent for the balance of the Lease Term after the time of award exceeds the amount of such rental loss that Tenant proves could have been reasonably avoided; plus

(iv) any other amount, including court costs, expenses of repossessing the Leased Premises and expenses of restoring the Leased Premises to a good condition of repair, necessary to compensate Landlord for all the detriment proximately caused by Tenant's failure to perform Tenant's obligations under this Lease or which in the ordinary course of things would be likely to result therefrom; *[Tenant may want to delete this subparagraph.]*

(v) at Landlord's election, such other amounts in addition to or in lieu of the foregoing as may be permitted from time to time by applicable law; and *[Tenant may want to delete this subparagraph.]*

(vi) all reasonable attorneys' fees incurred by Landlord relating to the default and termination of this Lease plus interest on all sums due Landlord by Tenant at the Past Due Rate.

As used in subparagraphs (i) and (ii) above, the "worth at the time of award" is to be computed by allowing interest at the Past Due Rate.

As used in subparagraph (iii) above, the "worth at the time of award" is to be computed by discounting such amount at the prime rate listed on the Money Rates page of the Wall Street Journal *[plus one percent]*.

The term "rent" as used herein shall be deemed to be and to mean the Base Rent, Operating Expenses and all other sums required to be paid by Tenant pursuant to the terms of this Lease.

(d) Make such payments or enter upon the Leased Premises and perform whatever Tenant is obligated to do under the terms of this Lease; and Tenant agrees to reimburse Landlord on demand for any expenses which Landlord may incur in thus effecting compliance with Tenant's obligations under this Lease (including reasonable attorney's fees), *[Tenant will want to delete the remainder of this paragraph]* and Tenant further agrees that Landlord shall not be liable for, and expressly releases Landlord from, any damages resulting from such actions, **expressly including damages arising from Landlord's negligent acts or omissions.**

(e) Landlord may alter and/or change all locks or other security devices at the Leased Premises in connection with any entry upon the Leased Premises by Landlord or otherwise. Landlord may lock out, expel or remove Tenant and any other person who may be occupying the Leased Premises or any part thereof without being liable for prosecution or any claim for damages therefor, **expressly including [excluding] damages arising from Landlord's negligent acts or omissions upon the Leased Premises.** If Landlord alters or changes any lock or other security device, Landlord shall place a written notice on the main entrance of the Leased Premises stating the name and location or telephone number of the person from whom the new key, combination or means of access may be obtained. The new key, combination or means of access shall be provided only during Landlord's regular business hours and Landlord shall not be required to provide to Tenant such new key, combination or means of access unless and until Tenant has cured all defaults hereunder. The provisions of this Section supersede all provisions of §93.002 of the Texas Property Code (or any successor thereto). No re-entry or taking possession of the Leased Premises by Landlord shall be construed as an election on Landlord's part to terminate this Lease unless a written notice of such intention be given to Tenant. Notwithstanding any such reletting or re-entry or taking possession, Landlord may at any time thereafter terminate this Lease for a previous default.

(f) Landlord may collect, from time to time, by suit or otherwise, each installment of Rent (or portion thereof as represents any deficiency after a reletting) as it becomes due hereunder. Pursuit of any of the foregoing remedies shall not preclude pursuit of any of the other remedies herein provided or any other remedies provided by law, nor shall pursuit of any remedy herein provided constitute a forfeiture or waiver of any rent due to Landlord hereunder or of any damages accruing to Landlord by reason of the violation of any of the terms, provisions and covenants herein contained. Landlord's acceptance of Rent following an event of default hereunder shall not be construed as Landlord's waiver of such event of default. No waiver by Landlord of any violation or breach of any of the terms, provisions and covenants herein contained shall be deemed or construed to constitute a waiver of any other violation or default. No payment by Tenant or receipt by Landlord of any amount less than the amounts due by Tenant hereunder shall be deemed to be other than on account of the amounts due by Tenant hereunder, nor shall any endorsement or statement on any check or document accompanying any payment be deemed an accord and satisfaction.

(g) Tenant expressly acknowledges and understands that (1) Landlord, as owner of an office building, considers many factors in the selection of tenants, including without limitation, exclusivity provisions in existing leases and restrictive covenants, the balance of uses within the Project, the reputation and local, regional, or national name recognition of prospective tenants, the credit of prospective tenants, and the location within the Project of the various uses; and (2) Landlord, at any given point in time, expects to have space in the Project

available for lease to tenants which will compete with the Leased Premises. **TENANT EXPRESSLY AGREES THAT SO LONG AS LANDLORD MARKETS THE LEASED PREMISES AFTER TENANT'S DEFAULT IN A MANNER CONSISTENT WITH LANDLORD'S MARKETING PLAN FOR THE PROJECT, AS SUCH PLAN MAY BE REVISED FROM TIME TO TIME, LANDLORD SHALL BE CONCLUSIVELY DEEMED TO HAVE MADE OBJECTIVELY REASONABLE EFFORTS TO RELET THE LEASED PREMISES AND TO HAVE FULFILLED ANY OBLIGATION TO MITIGATE DAMAGES BY REASON OF TENANT'S DEFAULT, REGARDLESS OF WHEN AND IF THE LEASED PREMISES IN FACT ARE RELET; REGARDLESS OF WHETHER THERE ARE TENANTS WHO REQUEST TO LEASE THE LEASED PREMISES (BUT WHO DO NOT MEET LANDLORD'S SPECIFIC CRITERIA FOR THE LEASED PREMISES); AND REGARDLESS OF WHETHER LANDLORD LEASES OTHER SPACE IN THE PROJECT PRIOR TO LEASING THE LEASED PREMISES. TENANT FURTHER AGREES THAT LANDLORD MAY LEASE ALL OR ANY PART OF THE LEASED PREMISES TO SUCH TENANT OR TENANTS AS LANDLORD MAY DEEM APPROPRIATE AND THAT TO THE EXTENT LANDLORD LOCATES TENANTS WHICH MEET LANDLORD'S MARKETING CRITERIA, LANDLORD MAY LEASE VACANT SPACE IN THE PROJECT OTHER THAN THE LEASED PREMISES BEFORE LANDLORD LEASES THE LEASED PREMISES. TENANT FURTHER AGREES THAT TENANT'S ABANDONMENT OF THE LEASED PREMISES OR ATTEMPTED SURRENDER OF THE LEASED PREMISES WITHOUT LANDLORD'S ACCEPTANCE OF SAME SHALL NOT CONSTITUTE AN EVENT WHICH TRIGGERS ANY OBLIGATION ON THE PART OF LANDLORD TO MITIGATE ITS DAMAGES UNLESS AND UNTIL THERE OCCURS A CONCURRENT OR SUBSEQUENT MONETARY DEFAULT.** *[Tenant may want to delete this paragraph.]*

(h) If Landlord takes possession of the Leased Premises pursuant to the authority herein granted, then Landlord shall have the right to keep in place and use all of the furniture, fixtures and equipment at the Leased Premises, including that which is owned by or leased to Tenant at all times prior to any foreclosure thereon by Landlord or repossession thereof by a lessor thereof or third party having a lien thereon *[Tenant may want to delete Landlord's right to use the Tenant's Personal Property]*. Landlord shall also have the right to remove from the Leased Premises (without the necessity of obtaining a distress warrant, writ of sequestration or other legal process) all or any portion of such furniture, fixtures, equipment and other property located thereon and place same in storage at any premises within the County in which the Leased Premises are located; and in such event, Tenant shall be liable to Landlord for costs incurred by Landlord in connection with such removal and storage and shall indemnify and hold Landlord harmless from all loss, damage, cost, expense and liability in connection with such removal and storage. Landlord shall also have the right to relinquish possession of all or any portion of such furniture, fixtures, equipment and other property to any person ("Claimant") claiming to be entitled to possession thereof who presents to Landlord a copy of any instrument represented to Landlord by Claimant to have been executed by Tenant (or any predecessor of Tenant) granting Claimant the right under various circumstances to take possession of such furniture, fixtures, equipment or other property, without the necessity on the part of Landlord to inquire into the authenticity of said instrument's copy of Tenant's or Tenant's predecessor's signature thereon and without the necessity of Landlord's making any nature of investigation or inquiry as to the validity of the factual or legal basis upon which Claimant purports to act. *[Tenant may want to require Landlord to give the Tenant 10 days notice before relinquishing the property to a Claimant.] [Tenant may want to delete the remainder of this paragraph.]* Tenant agrees to indemnify and hold Landlord harmless from all cost, expense, loss, damage and liability incident to Landlord's relinquishment of possession of all or any portion of such furniture, fixtures, equipment or other property to Claimant, **expressly including costs, expenses, loss, damage or liability arising out of Landlord's negligent acts or omissions.** The rights of Landlord herein stated shall be in addition to any and all other rights which Landlord has or may hereafter have at law or in equity; and Tenant stipulates and agrees that the rights herein granted Landlord are commercially reasonable.

(i) If Landlord is obligated to notify Tenant of any failure (monetary or nonmonetary) to comply with the provisions of this Lease, such obligation shall terminate following the second such notice delivered to Tenant within any twelve (12) month period during the Lease Term.

### **3. Landlord's Default and Tenant's Remedies**

Many leases are silent on the issue of the Landlord's default. The Tenant will want to make sure that the Lease addresses Landlord's defaults. The Landlord should not object to a reasonable provision regarding Landlord defaults.

Landlord shall not be deemed to be in default in the performance of any obligation required to be performed by it hereunder unless and until it has failed to perform such obligation within thirty (30) days after written notice by Tenant to Landlord specifying wherein Landlord has failed to perform such obligation; provided, however, that if Landlord's failure to perform an obligation involves any obligation of Landlord set forth in Section \_\_\_ of this Lease (regarding Landlord's repair and maintenance obligations), the provisions of such Section shall control with respect to Tenant's remedies. However, if Landlord's obligation reasonably requires more than thirty (30) days to perform, Landlord shall not be in default if it commences performance within such thirty-day period and uses reasonable efforts to complete same. Unless and until Landlord fails to so cure any default after such notice, Tenant shall not have any remedy or cause of action by reason thereof. *[If Landlord is in default under the Lease and applicable notice and cure periods have expired, Tenant shall be allowed to pursue all remedies available to it at law or in equity, including an award for damages.]* All obligations of Landlord hereunder will be binding upon Landlord only during the period of its ownership of the Project and not thereafter. The term "Landlord" shall mean only the owner, for the time being, of the Project, and in the event of the transfer by such owner of its interest in the Project *[and the assumption of all of the Landlord's obligations under this Lease by the transferee]*, such owner shall thereupon be released and discharged from all covenants and obligations of Landlord thereafter accruing, but such covenants and obligations shall be binding during the Lease Term upon each new owner for the duration of such owner's ownership. Any liability of Landlord to Tenant relating to this Lease shall be limited to the interest of Landlord in the Project, and Landlord shall not be personally liable for any deficiency *[The Tenant may want to delete this sentence]*.

## **H. MISCELLANEOUS LEASE PROVISIONS**

### **1. Miscellaneous Landlord Provisions**

#### **a. Forced Tenant Relocation**

For small tenants, a Landlord may want to reserve the right to relocate the Tenant in the Project if it needs to create a larger contiguous space for a new tenant.

Landlord shall have the right at any time from the date hereof through the end of the Lease Term to substitute, instead of the Leased Premises, other space (of at least the area of the Premises), hereinafter referred to as "Substitution Space," in the Project.

If Landlord desires to exercise such right, it shall give Tenant at least sixty (60) days prior notice, or at least thirty (30) days notice prior to the Commencement Date of this Lease, specifying the effective date of such substitution, whereupon, as of such effective date: (a) the description of the Leased Premises set forth in this Lease shall, without further act on the part of Landlord or Tenant, be deemed amended so that the Substitution Space shall, for all intents and purposes, be deemed the Premises hereunder, and all of the terms, covenants, conditions, provisions and agreements of this Lease shall continue in full force and effect and shall apply to the Substitution Space except that (i) if the then expired balance of the Lease Term shall be less than one year, the Lease Term shall be extended so that the then unexpired balance of the Lease Term shall be for one year from such effective date, and (ii) if the Substitution Space contains more square footage than the present Leased Premises, the Rent shall be increased proportionately (provided that, unless Tenant otherwise agrees, such rental increase shall not be

in excess of five percent (5%) of the Adjusted Rental immediately preceding such increase); and (b) Tenant shall move from the present Leased Premises into the Substitution Space and shall vacate and surrender possession to Landlord of the present Leased Premises, and if Tenant continues to occupy the Leased Premises after such effective date, then thereafter, during the period of such occupancy, Tenant shall pay Rent for the Leased Premises at the rate set forth in this Lease, in addition to the rent for the Substitution Space at the above described rate.

Tenant shall have the option either to accept possession of the Substitution Space in its “as is” condition as of such effective date or to require Landlord to alter the Substitution Space in the same manner as the present Leased Premises were altered or were to be altered. Such option shall be exercised by notice from Tenant to Landlord within fifteen (15) days after Tenant’s receipt of the aforesaid notice from Landlord of such relocation. If Tenant fails to deliver to Landlord within such fifteen-day period notice of its election, or if Tenant is in default under any of the terms, covenants, conditions, provisions or agreements of this Lease, Tenant shall be deemed to have elected to accept possession of the Substitution Space in its “as is” condition.

If Tenant receives notice regarding Substitution Space after the Commencement Date of this Lease and Tenant elects to require Landlord to alter the Substitution Space, then (i) notwithstanding the preceding paragraph regarding the Lease Term, if such then unexpired balance of the Lease Term is less than three (3) years, the Lease Term, without further act on the part of Landlord or Tenant, shall (unless Landlord otherwise elects) be deemed extended so that the then unexpired balance of the Lease Term shall be three (3) years from such effective date, (ii) Tenant shall continue to occupy the Leased Premises (upon all of the terms, covenants, conditions, provisions, and agreements of this Lease, including the covenant for the payment of Rent) until the date on which Landlord shall have substantially completed such alteration work in the Substitution Space, and (iii) Tenant shall move from the Leased Premises into the Substitution Space immediately upon the date of such substantial completion by Landlord and shall vacate and surrender possession to Landlord of the Leased Premises, and if Tenant continues to occupy the Leased Premises after such date, then thereafter, during the period of such occupancy, Tenant shall pay Rent for the Leased Premises at the rate set forth in this Lease, in addition to the Rent for the Substitution Space at the above-described rate.

If Tenant receives notice regarding Substitution Space prior to the Commencement Date of this Lease, then the Commencement Date of this Lease shall be the earlier of (i) occupancy of the Substitution Space by Tenant or (ii) the date the Substitution Space is substantially complete.

With respect to such alteration work in the Substitution Space, if Tenant or Tenant’s agents shall make changes in the work and if such changes shall delay the work to be performed by Landlord, or if Tenant shall otherwise delay the substantial completion of Landlord’s work, the happening of such delays shall in no event postpone the date for the commencement of the payment of the Rent for such Substitution Space beyond (and such payments shall begin on) the date on which such work would have been substantially completed by for such delay, and, in addition, if notice regarding Substitution Space occurred after the Commencement Date of this Lease, Tenant shall continue to pay Rent for the Leased Premises at the rate set forth in this Lease until it vacates and surrenders same as aforesaid.

Landlord at its discretion may substitute materials of like quality for the materials originally utilized.

If Landlord exercises this relocation right, Landlord shall reimburse Tenant for the reasonable out-of-pocket expenses actually incurred by Tenant for moving Tenant’s furniture, equipment, supplies and telephones and telephone equipment from the Leased Premises to the Substitution Space and for reprinting Tenant’s affected stationary supply on hand immediately prior to Landlord’s notice to Tenant of the exercise of this relocation right.

## **b. Rules and Regulations**

The Landlord will want to attach the Project’s Rules and Regulations to the Lease and require Tenant to comply with them.

**c. Rights Reserved to the Landlord**

The Landlord may want to reserve certain rights at the Project. The Tenant may agree to some of these provisions and resist others.

Landlord shall have the following rights, exercisable without notice and without liability to Tenant for damage or injury to property, person or business and without effecting an eviction, constructive or actual, or disturbance of Tenant's use or possession or giving rise to any claim for setoff or abatement of Rent:

(b) To decorate and to make repairs, alterations, additions, changes or improvements, whether structural or otherwise, in and about the Project, or any part thereof, and for such purposes to enter upon the Leased Premises and, during the continuance of any such work, to temporarily close doors, entryways, public space and corridors in the Project, to interrupt or temporarily suspend Project services and facilities and to change the arrangement and location of entrances or passageways, doors and doorways, corridors, elevators, stairs, toilets, or other public parts of the Project, all without abatement of Rent or affecting any of Tenant's obligations hereunder, so long as the Leased Premises are reasonably accessible.

(c) To have and retain a paramount title to the Leased Premises free and clear of any act of Tenant purporting to burden or encumber them.

(d) To grant to anyone the exclusive right to conduct any business or render any service in or to the Project, provided such exclusive right shall not operate to exclude Tenant from the use expressly permitted herein.

(e) To prohibit the placing of vending or dispensing machines of any kind in or about the Leased Premises without the prior written permission of Landlord.

(f) To have access for Landlord and other tenants of the Project to any mail chutes located on the Leased Premises according to the rules of the United States Postal Service.

(g) To take all such reasonable measures as Landlord may deem advisable for the security of the Project and its occupants, including, without limitation, the evacuation of the Project for cause, suspected cause, or for drill purposes, the temporary denial of access to the Project, and the closing of the Project after Customary Business Hours and on Saturdays, Sundays and Holidays, subject, however, to Tenant's right to admittance when the Project is closed after Customary Business Hours under such reasonable regulations as Landlord may prescribe from time to time which may include, by way of example but not of limitation, that persons entering or leaving the Project, whether or not during Customary Business Hours, identify themselves to a security officer by registration or otherwise and that such persons establish their right to enter or leave the Project.

**d. Notice to Landlord's Lender**

The Landlord may want to include a provision that requires the Tenant to send copies of any notices of Landlord default to the Landlord's lender and to give Landlord's lender additional time to cure any Landlord defaults. Tenants should resist the inclusion of this provision.

Tenant agrees to deliver by certified mail to the beneficiary under any deed of trust or the holder of any mortgage or other security instrument, a copy of any written notice of default given by Tenant to Landlord, specifying the alleged default in reasonable detail, provided that prior to giving any such notice to Landlord, Tenant has been notified in writing (by way of

Notice of Assignment of Rents and Leases or otherwise) of the address of such beneficiary or holder. Tenant further agrees that if Landlord shall have failed to cure such default within the time provided for in this Lease, then any such beneficiary or holder shall have an additional sixty (60) days within which to cure such default, or if such default cannot be cured within that time, then such additional time as may be necessary to cure such default if, within such sixty-day period, such beneficiary or holder has commenced performance of such obligation and diligently pursues the same to completion, including but not limited to commencement of foreclosure proceedings, if necessary to effect such cure.

**e. AS-IS, WHERE IS Language**

The Landlord should insist on the inclusion of strong AS-IS, WHERE IS language to protect itself against Tenant lawsuits alleging breach of warranty or certain misrepresentations. Sample language follows.

**EXCEPT AS EXPRESSLY OTHERWISE SET FORTH HEREIN, TENANT ACKNOWLEDGES THAT (i) IT HAS HAD AN ADEQUATE OPPORTUNITY TO INSPECT THE LEASED PREMISES AND THE BUILDING, (ii) THAT TENANT HAS INSPECTED THE LEASED PREMISES AND THE BUILDING TO TENANT'S SATISFACTION, AND (iii) THAT TENANT HAS FOUND IT SATISFACTORY FOR TENANT'S INTENDED USE. ACCORDINGLY, TENANT ACCEPTS THE LEASED PREMISES IN ITS "AS-IS" CONDITION, WITH ALL FAULTS, AND LANDLORD SHALL HAVE NO OBLIGATION TO IMPROVE, REPAIR, RESTORE, OR REFURBISH THE LEASED PREMISES IN THE ANY MANNER EXCEPT AS EXPRESSLY OTHERWISE SET FORTH HEREIN.**

EXCEPT AS EXPRESSLY OTHERWISE SET FORTH HEREIN, TENANT ACKNOWLEDGES THAT NEITHER LANDLORD, NOR ANY AGENT OR REPRESENTATIVE OF LANDLORD, HAS MADE ANY REPRESENTATION OR WARRANTY, EXPRESS OR IMPLIED, WITH RESPECT TO THE LEASED PREMISES OR THE PROJECT, INCLUDING, WITHOUT LIMITATION, ANY REPRESENTATION OR WARRANTY WITH RESPECT TO THE HABITABILITY, SUITABILITY OR FITNESS OF THE LEASED PREMISES OR ANY OTHER PORTION OF THE PROJECT FOR THE CONDUCT OF TENANT'S BUSINESS OR ANY OTHER PARTICULAR PURPOSE. EXCEPT AS EXPRESSLY PROVIDED FOR IN THE LEASE (AS AMENDED), TENANT SHALL NOT BE ENTITLED TO MAKE ANY FURTHER ALTERATIONS AND IMPROVEMENTS TO THE LEASED PREMISES WITHOUT THE EXPRESS WRITTEN CONSENT OF LANDLORD, WHICH MAY BE WITHHELD IN LANDLORD'S REASONABLE DISCRETION. EXCEPT AS EXPRESSLY OTHERWISE SET FORTH HEREIN, TENANT DISCLAIMS RELIANCE UPON ALL ORAL REPRESENTATIONS AND WARRANTIES, EXPRESS OR IMPLIED, OF ANY KIND OR NATURE.

Landlord will not be liable to Tenant, or any of its agents, employees, servants, or invitees, for any damage to persons or property due to the condition of, design of, or any defect in, the Leased Premises or the Project that may now exist or subsequently occur, except to the extent the same result from the gross negligence or intentional act of Landlord. Landlord does not assume any risk and shall not have any liability or obligation to Tenant, its agents, employees, servants, or invitees for damage to persons and property, either proximate or remote, by reason of the present or future condition of the Leased Premises and the Project, except to the extent the same result from the gross negligence or intentional act of Landlord.

## **2. Miscellaneous Tenant Provisions**

### **a. Renewal Rights**

The Tenant may want to negotiate the right to renew the Lease. The rent during the renewal term could (1) be the same as the Rent during the initial term, (2) increase in accordance with the percentage increase in the Consumer Price Index over the same period, and (3) based on the “market rent.” See Section I.B for a provision concerning the process for determining the “market rent.” A sample provision for the other rental options follows:

Tenant shall have and is hereby granted, the option to renew and extend the term of this Lease for two (2) period(s) of five (5) year(s) (each), provided Tenant is not in default hereunder at the time each such option is exercised. Each extension term shall begin on the expiration of the Lease Term or the current extension term of this Lease, as appropriate. All terms, covenants, and provisions of this Lease shall apply to each such extension term. If Tenant shall elect to exercise any such option, Tenant shall do so by written notice to Landlord not later than one hundred eighty (180) days prior to the expiration of the Lease Term or the current extension term of this Lease, as appropriate. [OPTIONAL; The monthly Base Rental for each such extension term shall be determined by multiplying the monthly Base Rental figure that is in effect as of the date of exercise of the option by a fraction, the numerator of which is the Consumer Price Index figure (as hereinafter defined), published just prior to the commencement date of such extension term, and the denominator of which is the Consumer Price Index figure published just prior to the later of the Commencement Date or the date the most recent increase in Base Rental became effective. Notwithstanding the foregoing, in no event shall the monthly Base Rental for any year of any extension term of this Lease be less than the monthly Base Rental that was in effect as of the date of exercise of the option. As used herein, the term “Consumer Price Index” shall mean the United States Department of Labor’s Bureau of Labor Statistics, Consumer Price Index, unadjusted, All Urban Consumers, All Items, U.S. City Average (1982-84 equals 100), or the successor of that index.]

### **b. Purchase Option**

Tenants that desire the right to purchase the Land and the Project often negotiate for a right of first refusal agreement from Landlord. The right of first refusal agreement grants the Tenant the option to purchase the Land and Project at the time that the Landlord receives an offer from another potential buyer. The agreement should allow the Tenant to match any other offer received by the Landlord and force the Landlord to sell the Land and Project to the Tenant if it chooses to match or beat all other offers. As a general rule, the agreement should be as specific as possible about when the Tenant’s rights arise, what third-party transactions do not give rise to the Tenant’s rights, and what the nonfinancial terms of any subsequent purchase will be.

The Landlord will want to make sure that the Tenant is required to enter into a purchase contract with standard terms so that it is clear that the Landlord’s acceptance of the Tenant’s “matched” offer is not conditioned on nonstandard purchase terms. One simple way of doing this is to require that the parties use the most recent Texas

Real Estate Commission form for commercial real property transactions. The Landlord will also want to make sure that refinancing transactions and sales to related entities do not trigger the Tenant's right of first refusal. The Lease should also state that the right of first refusal does not apply during any period when the Tenant is in default.

Landlords will want to avoid right of first refusal clauses because they may lead to disputes over details not covered in the clause and because they may limit a Landlord's efforts to sell the Land and Project when prospective buyers realize their efforts and offer may be unilaterally usurped by a Tenant. If a Tenant nevertheless wants some sort of first right with respect to purchasing the Land and Project, the Landlord may be willing to compromise with a right of first offer clause. A well drafted right of first offer clause forces the Tenant to purchase at a time and in a manner chosen by the Landlord; if the Tenant fails to purchase when and how determined by the Landlord, all rights of first offer are lost and the Landlord is free to sell the real estate to anyone. A sample right of first offer clause is set for the below.

SPECIAL PROVISIONS—Purchase and Right of First Offer Provision

1. Notice of Intent to Sell. In the event Landlord desires to sell the Project, Landlord shall first provide Tenant with written notice of Landlord's Intent to sell the Project (the "Notice"), which Notice shall include a contract containing the proposed terms of the sale, including the purchase price therefor (the "Proposed Purchase Price") and the terms, if any, of any seller financing (the "Proposed Earnest Money Contract"). Landlord may not require more than \$\_\_\_\_\_.00 as earnest money in the Proposed Earnest Money Contract (the "Earnest Money").

2. Form of Proposed Contract. The form of such Proposed Earnest Money Contract shall be in such form as the Landlord shall require in its sole and absolute discretion. The Proposed Earnest Money Contract shall provide for a thirty (30)-day feasibility study period and opportunity to review the status of title. Landlord shall bear the cost of the Deed, Title Policy, and other normal Seller expenses as provided in the Proposed Earnest Money Contract. The cost of the survey, feasibility study, financing cost shall be borne by Tenant as well as other normal Buyer expenses as provided in the Proposed Earnest Money Contract.

3. Notice Period. Tenant shall have twenty (20) days from the receipt of such Notice (the "Notice period") within which to accept Landlord's offer to sell the Project upon the terms and conditions set forth in the Proposed Earnest Money Contract (the "Acceptance"). The Acceptance shall be accomplished by Tenant executing the Proposed Earnest Contract and depositing the executed Proposed Earnest Money Contract, accompanied by the Earnest Money, with the title company selected by Landlord in the Proposed Earnest Money Contract on or before the expiration of the Notice Period.

4. Authorized Sale to Third Party. If Tenant fails to exercise such Acceptance within the Notice Period, Landlord shall be free to enter into a contract to sell the Project to any third party for any amount at any time thereafter.

5. Automatic Termination of Rights. If Tenant fails to accept Landlord's offer to sell the Project under Articles 1 through 3 of this Exhibit \_\_, the rights granted herein in favor of Tenant shall terminate and thereafter this Exhibit \_\_, and the rights in favor of Tenant herein contained, shall be of no further force and effect. If Tenant fails to complete the purchase of the Project after having entered into a contract for such purchase for any reason other than due to the default of Landlord, the rights granted herein in favor of Tenant shall terminate and thereafter this Exhibit \_\_, and the rights in favor of Tenant herein contained, shall be of no further force and effect.

6. Termination Notice. In the event of any default upon the part of Tenant, or in the event any of the rights granted Tenant herein expire or terminate under Article 5 of this Exhibit \_\_, Landlord may file a document of record in the real property records of Travis County, Texas, noting the termination of the rights herein granted Tenant (the "Termination Notice"). A

copy of such Termination Notice shall be forwarded to Tenant upon the filing of the same.

7. Reliance by Third Parties Upon Notice of Termination. Any third party or title company may rely upon a Termination Notice filed in the Real Property Records of Travis County, Texas, without liability or duty of further inquiry and any third party who acquires an interest in the Project, whether in fee simple otherwise, in reliance upon such Termination Notice will acquire such interest free and clear of any of the rights granted Tenant by this Exhibit \_\_\_ or otherwise and this Exhibit \_\_\_ and the rights herein granted shall be of no force or effect.

8. Non-Assignment. Other than in connection with assignments of the Lease, which are permitted by the Lease or which have been approved by Landlord, the rights and obligations provided for herein are solely for the benefit of Tenant and may not be assigned by Tenant to any third party nor shall the same inure to the benefit of any successor in interest of Tenant, without the express written consent of Landlord.

9. Execution of Other Documents. Each party shall, on demand, execute or obtain such other documents or instruments and corrective filings or instruments and do or cause such other things as may be reasonable necessary or desirable to effect the provisions and purposes of this Exhibit \_\_\_.

### **3. Other Miscellaneous Provisions**

#### **a. Notice Provisions**

Both parties will want to make sure they are very familiar with the notice provisions under the Lease. Some Leases are drafted allowing facsimile notice or electronic mail notice. Because notices of events of default are major events for both parties under the Lease and may trigger time periods for curing the default, both parties may be better served to require written notice by certified mail.

Each provision of this Lease, or of any applicable governmental laws, ordinances, regulations, and other requirements with reference to the sending, mailing or delivery of any notice, or with reference to the making of any payment by Tenant or Landlord, shall be deemed to be complied with when and if the following steps are taken:

(a) All Rent and other payments required to be made by Tenant to Landlord hereunder shall be payable to, and must be received by, Landlord on the date due and at the address set forth in the Lease or at such other address as Landlord may specify from time to time by written notice delivered in the same manner.

(b) Any notice, request or documents (excluding Rent and other payments) permitted or required to be delivered hereunder must be in writing and shall be deemed delivered upon receipt if actually received and whether or not received when deposited in the United States mail, postage prepaid, certified mail (with or without return receipt requested), addressed to the parties hereto at the respective addresses set forth in the Lease or at such other address as either of said parties have theretofore specified by written notice delivered in the same manner.

**b. Force Majeure**

Force Majeure clauses that benefit the Landlord are common in leases. The Tenant will want to make sure that it also receives the benefit of the Force Majeure clause.

In the event that Landlord *[or Tenant]* shall be delayed in the performance of any obligation of Landlord hereunder as a result of strikes, lockouts, shortages of labor, fuel or materials, acts of God, legal requirements, fire or other casualty, or any other cause beyond the control of Landlord *[such party]*, then performance of such obligation shall be excused for the period of such delay, and the period for the performance of such obligation shall be extended by the number of days equivalent to the number of days of such delay. Landlord shall in no event *[Neither party shall in any event]* be required to settle or compromise any strike, lockout or other labor disputes, the resolution thereof being within the sole discretion of Landlord *[such party]*.

LANDLORD OPTION: If Landlord is willing to agree to a mutual Force Majeure clause, it may want to add the following provision: "Notwithstanding the above, Tenant's obligation to pay Rent under this Lease shall not be excused because of the occurrence of an event described in this Section."